

INTERNET GOLD GOLDEN LINES LTD  
Form 20-F  
May 15, 2018

**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, 2017**

**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                        | Name of each exchange on which registered |
|--|---|
| <b>Ordinary Shares, NIS 0.01 Par Value</b> | <b>NASDAQ Global Select Market</b>        |

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, 2017)

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, a non-accelerated filer, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer      Accelerated filer  
Emerging growth company      Non-accelerated filer

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If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards† provided pursuant to Section 13(a) of the Exchange Act.

† The term “new or revised financial accounting standard” refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

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

|              |   |       |
|--------------|---|-------|
| U.S.<br>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

This report on Form 20-F is being incorporated by reference into our Registration Statement on Form F-1 (333-215744)

## 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 11 person Board of directors (at the time). 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, fixed-line broadband Internet infrastructure access services, Internet service provider, or ISP, services, cellular telephony 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 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 collectively referred to as the Bezeq Group in this annual report. The operations of DBS have been included in Bezeq's consolidated financial statements since March 23, 2015, after Bezeq obtained control of DBS.

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, 2017 (NIS 3.467= \$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.

## 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, 2017 set forth selected consolidated financial data, which is derived from our audited consolidated financial statements. The audited consolidated financial statements as of December 31, 2016 and 2017 and for the years ended December 31, 2015, 2016 and 2017 appear in this annual report.

## Consolidated Statement of Income Data:

(Amounts in millions, except share and per share data)

|                                   | Year Ended December 31, |        |       |        |       |              |
|-----------------------------------|-------------------------|--------|-------|--------|-------|--------------|
|                                   | 2013                    | 2014   | 2015  | 2016   | 2017  | 2017         |
|                                   | (NIS)                   |        |       |        |       | (U.S.<br>\$) |
| Revenues                          | 9,563                   | 9,055  | 9,985 | 10,084 | 9,789 | 2,823        |
| Depreciation and amortization     | 2,014                   | 1,873  | 2,131 | 2,161  | 2,117 | 611          |
| Salaries                          | 1,874                   | 1,771  | 1,960 | 2,017  | 2,008 | 579          |
| General and operating expenses    | 3,586                   | 3,371  | 3,878 | 4,024  | 3,911 | 1,128        |
| Other operating expenses (income) | 57                      | (535 ) | 3     | 21     | 149   | 43           |

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|  |        |         |        |          |         |         |
|--|--------|---------|--------|----------|---------|---------|
|  | 7,531  | 6,480   | 7,972  | 8,223    | 8,185   | 2,361   |
| Operating profit                                       | 2,032  | 2,575   | 2,013  | 1,861    | 1,604   | 462     |
| Finance expense  | 931    | 1,329   | 759    | 1,108    | 652     | 188     |
| Finance income   | (535 ) | (635 )  | (164 ) | (133 )   | (75 )   | (22 )   |
| Finance expense, net                                   | 396    | 694     | 595    | 975      | 577     | 166     |
| Profit after financing expenses, net                   | 1,636  | 1,881   | 1,418  | 886      | 1,027   | 296     |
| Share of losses (profit) in equity- Accounted investee | 252    | 170     | (12 )  | 5        | 5       | 1       |
| Profit before income tax                               | 1,384  | 1711    | 1,430  | 881      | 1,022   | 295     |
| Income tax expenses                                    | 524    | 667     | 347    | 442      | 347     | 100     |
| Net profit for the year                                | 860    | 1,044   | 1,083  | 439      | 675     | 195     |
| Profit (loss) attributable to owners of the company    | 26     | (103 )  | 87     | (202 )   | (15 )   | (4 )    |
| Income attributable to non-controlling interest        | 834    | 1,147   | 996    | 641      | 690     | 199     |
| Net profit for the year                                | 860    | 1,044   | 1,083  | 439      | 675     | 195     |
| Basic earnings (loss) per share.                       | 1.33   | (5.38 ) | 4.54   | (10.52 ) | (0.82 ) | (0.24 ) |
| Diluted earnings (loss) per share                      | 1.26   | (5.50 ) | 4.47   | (10.52 ) | (0.82 ) | (0.24 ) |

Table of Contents**Statements of Financial Position data:**

(Amounts in millions)

|                           | December 31, |        |        |        |        |              |
|---------------------------|--------------|--------|--------|--------|--------|--------------|
|                           | 2013         | 2014   | 2015   | 2016   | 2017   | 2017         |
|                           | (NIS)        |        |        |        |        | (U.S.<br>\$) |
| Cash and cash equivalents | 867          | 732    | 619    | 810    | 2,408  | 695          |
| Restricted cash           | -            | 65     | 155    | -      | -      | -            |
| Total assets              | 21,410       | 21,558 | 22,410 | 20,527 | 20,834 | 6,009        |
| Total current liabilities | 4,104        | 3,974  | 5,352  | 4,407  | 4,224  | 1,218        |
| Non-current liabilities   | 14,153       | 14,818 | 14,457 | 13,383 | 14,154 | 4,083        |

## 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, 2013 | 3.611   |
| Year ended December 31, 2014 | 3.578   |
| Year ended December 31, 2015 | 3.884   |
| Year ended December 31, 2016 | 3.841   |
| Year ended December 31, 2017 | 3.600   |

| Period        | High  | Low   |
|---------------|-------|-------|
| November 2017 | 3.544 | 3.499 |
| December 2017 | 3.550 | 3.467 |
| January 2018  | 3.460 | 3.388 |
| February 2018 | 3.535 | 3.427 |
| March 2018    | 3.514 | 3.431 |
| April 2018    | 3.597 | 3.503 |

May 2018 (through May 14) 3.632 3.569

On May 14, 2018, the representative rate of exchange was NIS 3.574 = \$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.

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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 materializes, 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 Directly Related to Internet Gold – Golden Lines

**We 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 we receive from Bezeq and a default under our outstanding debentures could have a material adverse effect on our business, financial condition, results of operations and cash flows.**

We and B Communications have a substantial amount of indebtedness. As of May 14, 2018, we and B Communications had approximately NIS 3.2 billion (approximately \$936 million) of debt. Our 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.

On March 6, 2018, Bezeq's Board of Directors updated the dividend distribution policy of Bezeq, whereby Bezeq will commence with the upcoming distribution in May 2018, distribute to its shareholders, on a semi-annual basis, a

dividend of 70% of the half-yearly profit (after tax) based on Bezeq's consolidated financial statements. Previously, Bezeq had distributed dividends equal to 100% of its half-yearly profit.

Bezeq paid total cash dividends of NIS 1.8 billion, NIS 1.4 billion and NIS 1.3 billion (approximately \$370 million) in the years ended December 31, 2015, 2016 and 2017, respectively, out of which B Communications received NIS 545 million, NIS 379 million and NIS 338 million (approximately \$97 million), respectively. Based on the new dividend distribution policy and the recent forecast by Bezeq that the net profit attributable to shareholders in 2018 is expected to be approximately NIS 1 billion, B Communications' dividends from Bezeq will decline.

Our credit ratings impact the cost and availability of future borrowings and, accordingly, our cost of capital. Our ratings at any time will reflect each rating organization's then opinion of our financial strength, operating performance and ability to meet our debt obligations.

In January 2015, Midroog confirmed a 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. In February 2017, Midroog affirmed the A3.il local rating of our Series C and D Debentures with a stable outlook. In April 2018, Midroog reduced the A3.il rating to Baa1.il and retained the negative outlook.

Any further reductions in our credit ratings will limit our ability to borrow at interest rates consistent with the interest rates that were available to us in the past. If our credit ratings are downgraded or put on watch for a potential downgrade, we may not be able to sell additional debt securities or borrow money in the amounts, at the times or interest rates or upon the more favorable terms and conditions that might be available if our current credit ratings are maintained. See Item 5B. "Operating and Financial Review and Prospects - Liquidity and Capital Resources."



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It is our and our Israeli legal advisors' belief that the publication of our annual financial statements with the accompanying Auditors' Report with a "qualified opinion" does not constitute an event of default under our outstanding debentures. Nevertheless, it is not possible to predict with certainty that a debenture holder may claim otherwise. We believe that we have qualitative legal and economic arguments against a claim of breach by any holder of debentures. There is also a possibility of changing the nature and location of the listing of our or Internet Gold's securities from the United States to elsewhere in a manner that may resolve such possible claim, if raised. A default under the Debentures could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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 of Communications and Finance, or 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 Bezeq, appoint a director or general manager of Bezeq, or to participate in the profits of Bezeq or a share of the remaining assets of Bezeq after payment of its debts upon liquidation.

Recent events may further bring the Control Permit issue into possible question in the future. According to the Control Permit, the control must be held by an "Israeli Party," as defined in the Communications Order. Currently, B Communications and we are deemed to be "Israeli Parties," so long as B Communications and we are controlled by a citizen and resident of Israel. Persons with certain criminal convictions may also not hold a Control Permit. However, if the controlling entity, Eurocom, will change ownership, Eurocom will continue to be our controlling shareholder (while the identity of the shareholders of Eurocom will change). Accordingly, we would not lose our Control Permit in this scenario. Persons with certain criminal convictions may also not hold a Control Permit and the Ministers have very broad discretion in that regard.

The Control Permit includes several other conditions, including 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. We received explicit approval to hold a 25% stake in Bezeq and still maintain control.

In addition, the Control Permit requires that 19% of the issued share capital 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 B Communications and us. 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.

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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 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.

On April 22, 2018, the Tel Aviv-Jaffa District Court issued a liquidation order for Eurocom Communications effective May 3, 2018. According to the order, the official receiver will be the temporary liquidator of Eurocom Communications until the appointment of a permanent liquidator, and attorneys Pinchas Rubin, Amnon Lorch and Uri Gaon were appointed as special managers. The liquidation order does not currently constitute a "change of control" with respect to the Control Permit, but this may be subject to change. Separately from the question of the Control Permit, Shaul Elovitch's effective control of Eurocom Communications is questionable following the appointment of the special managers and his direct holdings of our shares may also be subject to criminal sanctions.

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 Concentration Law, if either B Communications or we are unable to delist our ordinary shares from the TASE and redeem any publicly held debt or go private prior to December 10, 2019, we 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.

We are deemed to be a first-tier company, B Communications is a second-tier company and Bezeq is deemed to be a third-tier company under the Concentration Law. 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, we will not be permitted to control Bezeq after such date and our 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 not to be in Bezeq's interest.

We are currently examining several alternatives for the implementation of the Concentration Law, including, but not limited to, the possibility of raising private debt that will substitute our debentures issued to the public, while delisting our shares from the TASE; merger between B Communications and our company, etc. There is also a possibility of changing the nature and location of the listing of our or Internet Gold's securities from the United States to elsewhere.

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If we do not maintain control of Bezeq (through B Communications), 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. Recent events may further bring the Control Permit issue into possible question in the future. According to the Control Permit, the control must be held by an “Israeli Party,” as defined in the Communications Order. Currently, B Communications and we are deemed to be “Israeli Parties,” so long as B Communications and we are controlled by a citizen and resident of Israel. Persons with certain criminal convictions may also not hold a Control Permit. However, if there is a change in ownership of our controlling entity, Eurocom Communications, it should not affect Eurocom Communications’ continued status as our controlling shareholder (while the identity of the shareholders of Eurocom will change). Accordingly, we will not lose our Control Permit in this scenario.

If we were to no longer maintain 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 Bezeq applies to the U.S. Securities and Exchange Commission, or the SEC for an order permitting Bezeq 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.



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Due to the material weakness pertaining to the design of Bezeq's internal control over financial reporting, such material weakness is also considered a material weakness in our reports

As a consequence of the investigations of Bezeq and several of its directors and senior officers by both the ISA and Israel's Police as described in this Annual Report, we attempted to assess these investigations through the scope of our own internal control over financial reporting. However, due to provisions of Israeli law concerning obstructing investigation proceedings both Bezeq and we are prevented from examining all matters known to us that were raised in the investigations and accordingly we are unable to fully assess the effects of the investigations on our financial statements and internal controls over financial reporting.

Subject to these limitations, we nevertheless completed the work necessary to identify a material weakness pertaining to the design of Bezeq's internal control over financial reporting relating to certain matters, which are mainly the subjects of the investigations. Our management then assessed the effectiveness of our own internal control over financial reporting as of December 31, 2017. In conducting its assessment of our internal controls over financial reporting, our 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.

Due to the material weakness pertaining to the design of Bezeq's internal control over financial reporting, such material weakness is also considered a material weakness in our reports. This has led to our auditors issuing a "qualified opinion" on our financial statements because of the inability to obtain sufficient supporting evidence as to the effect, if any, of the investigations' proceedings on the consolidated financial statements. Our auditors also issued a "disclaimer of opinion" on our internal controls based on their inability to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the effectiveness of Bezeq's internal controls.

If remediation measures at Bezeq (please see Item 15 "Disclosure Controls and Procedures" for further details) are insufficient to address the identified deficiencies, or if additional deficiencies are discovered or occur in the future, our consolidated financial statements may contain material misstatements and we could be required to restate our financial results. Moreover, because of the inherent limitations of any control system, material misstatements due to error or fraud may not be prevented or detected on a timely basis, or at all. If we are unable to provide reliable and timely financial reports in the future, our business and reputation may be further harmed. Restated financial statements and failures in internal controls may also cause us to fail to meet reporting obligations, negatively affect investor confidence in our management and the accuracy of our financial statements and disclosures, or result in adverse publicity and concerns from investors, any of which could have a negative effect on the price of our Ordinary Shares, cause us to list our securities on other exchanges, subject us to further regulatory investigations and penalties or shareholder litigation, and materially adversely impact our business and financial condition.

**Our success depends on the continued service of certain key executives and personnel of Bezeq and the management of our company.**

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. Similarly, our management has been instrumental in our success and loss of any key members of our management could materially adversely affect our financial condition, results of operations and prospects. Recent events have caused the replacement of certain key executives with our consent.

Our business could be negatively affected as a result of actions of activist shareholders, and such activism could impact the trading value of our securities.

In recent years, certain Israeli issuers listed on United States exchanges have been faced with governance-related demands from activist shareholders, as well as unsolicited tender offers and proxy contests. Although as a foreign private issuer we are not subject to U.S. proxy rules, responding to these types of actions by activist shareholders could be costly and time-consuming, disrupting our operations and diverting the attention of management and our employees. Such activities could interfere with our ability to execute our strategic plan. In addition, a proxy contest for the election of directors at our annual meeting would require us to incur significant legal fees and proxy solicitation expenses and require significant time and attention by management and our board of directors. The perceived uncertainties due to these potential actions of activist shareholders also could affect the market price and volatility of our securities. Recently, activist investor Elliot Advisors (UK) has said it is opposed to the appointment of candidates proposed by us to the Board of Bezeq. Elliot Advisors (UK) holds a 4.8% stake in Bezeq. In January 2018, Elliott called for improved corporate governance at Bezeq and for the immediate resignation of some members of the Bezeq board.

**Risks Related to Our Relationship with B Communications and Eurocom Communications Ltd.**

Because Eurocom Communications controls a majority of our ordinary shares, investors will not be able to affect the outcome of shareholder votes that require a simple majority.

For as long as Eurocom Communications has a controlling interest in our company, it, Mr. Shaul Elovitch, chairman of the board of directors of Eurocom Communications (and until recently, chairman of our Board and of B Communications' Board), and the controlling shareholder of Eurocom Communications, 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. Similarly, as long as Eurocom Communications has a controlling interest in our company, Eurocom Communications (whether under the control of Mr. Shaul Elovitch, the current special managers appointed by court order, or future purchasers) 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). Because our interests and those of Eurocom Communications 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.

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Conflicts of interest may arise between B Communications, Eurocom 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 B Communications, Eurocom Communications and us in a number of areas relating to our past and ongoing relationships. Areas in which conflicts of interest between B Communications, Eurocom 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 B Communications and/or Eurocom Communications. The cross officerships and directorships as well as the ownership interests of our directors and officers in the ordinary shares of Internet Gold or Eurocom Communications 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, B Communications, Eurocom 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.

Eurocom Communications is having financial difficulties and is attempting to sell its assets. An Israeli court issued a liquidation order for Eurocom Communications in April 2018

On December 20, 2017, banks filed a motion in Israeli court to liquidate Eurocom Communications. Bezeq was included as a party to the proceeding to liquidate Eurocom Communications, given that it is a significant creditor of Eurocom Communications, in the amount of NIS 119 million.

On January 15, 2018, Eurocom Communications informed Bezeq that together with other privately held companies in Eurocom Group, it had filed an application in the court for an order to convene creditor meetings to approve an arrangement under Section 350 of the Companies Law, and in accordance with the Companies Regulations (Application for a Settlement or Arrangement), 2002. The purpose of the meetings is to approve a proposed creditors' arrangement based on the entry of an investor into Eurocom Group, as part of the settlement of the debts of the key privately held companies in Eurocom Group.

On April 22, 2018, the Tel Aviv-Jaffa District Court issued a liquidation order for Eurocom Communications effective May 3, 2018. According to the order, the official receiver will be the temporary liquidator of Eurocom Communications until the appointment of a permanent liquidator, and attorneys Pinchas Rubin, Amnon Lorch and Uri Gaon were appointed as special managers.

As mentioned above, the liquidation order does not currently constitute a “change of control” regarding the Control Permit but this may change in the future.

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Either banks, as creditors, or an investor, such as the Saidoff Group, may take control of Eurocom Communications and may become our controlling shareholder. In the event that such sale will take place, there is considerable uncertainty as to what steps the new owner will take as it considers its own strategic alternatives. Such steps may also be undertaken by the special managers. Officers in the entire Eurocom Group may be replaced. Such uncertainty may adversely affect the market price of our ordinary shares and completely destabilize our operations.

Risks Relating to the Entire Bezeq Group

Senior Executives of Bezeq, DBS and Eurocom Communications are currently under Criminal Investigation in Israel

In the summer of 2017, we became aware, beginning through newspaper reports in the Israeli media, and we reported that Bezeq, DBS and Eurocom Communications were under criminal investigation for violating, among else, certain Israeli Securities Law clauses relating to fraud and unlawful manipulation. The Israeli Police and the Israel Securities Authority, or the ISA, have recommended indictments of several Bezeq, DBS and Eurocom Communications executives in this matter. Shaul Elovitch who served as Chairman of our company, of B Communications and of Bezeq has resigned from all these companies.

Our Audit Committee has engaged outside U.S. counsel to conduct an assessment of our internal controls and, as applicable, those of Bezeq in connection with the preparation of our financial statements to determine whether there have been any violations of the U.S. Foreign Corrupt Practices Act or any other laws. We incurred substantial expenses in connection with such assessment and we may also incur substantial fines, civil or criminal sanctions, including fines and sanctions against our directors and officers, or third-party claims if any of our officers are directors are held liable under criminal laws and regulations. The Israeli law system might be insufficient to defend us and preserve our rights. We could also be subjected to risks to our reputation and regulatory action on account of any unethical acts by any of our employees, directors or other related individuals. These criminal developments have also added complexity to our corporate compliance regime. The Investigation may adversely affect the market price of our ordinary shares and could have a material adverse effect on our business, financial condition and results of operations.

The Bezeq Group does not have complete information about the investigations, their content, the material and evidence in the possession of the statutory authorities on this matter. Furthermore, in view of the provisions of Israeli law and concern of obstructing the investigation, at this stage Bezeq must refrain from conducting any checks relating to matters that arose in the course of those investigations. This limits Bezeq's ability to operate, including in connection with performing audit activity and reviews for the purpose of publishing Bezeq's reports, as further described below. The lack of information and uncertainty have also led to our auditors issuing a "qualified opinion" on our financial statements because of the inability to obtain sufficient supporting evidence as to the effect, if any, of the investigations' proceedings on the consolidated financial statements. Our auditors also issued a "disclaimer of opinion" on our internal controls based on their inability to obtain sufficient appropriate audit evidence to provide a basis for an

audit opinion on the effectiveness of Bezeq's internal controls.

**The Bezeq Group Companies and certain of our current and former officers and directors have been named in shareholder class action lawsuits related to the recent criminal investigations in Israel, and may be named in further litigation, government investigations and proceedings, which could require significant additional management time and attention, result in significant additional legal expenses or result in government enforcement actions, any of which could have a material adverse impact on our results of operations, financial condition, liquidity and cash flows.**

The Bezeq Group Companies and certain of our current and former officers and directors have been named in shareholder class action lawsuits relating to the recent criminal investigations in Israel, and may become subject to further litigation, government investigations or proceedings arising out of the restatement. The pending litigation and settlements have been, and any future litigation, investigation or other actions that may be filed or initiated against us or our current or former officers or directors may be, time consuming and expensive. We cannot predict what losses we may incur in these litigation matters, and contingencies related to our obligations under the federal and state securities laws, or in other legal proceedings or governmental investigations or proceedings related to the restatement.

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To date, we have incurred significant costs in connection with pending litigation. Any legal proceedings, if decided adversely to us, could result in significant monetary damages, penalties and reputational harm, and will likely involve significant defense and other costs. We have entered into indemnification agreements with each of our directors and certain of our officers, and our amended and restated certificate of incorporation requires us to indemnify each of our directors and officers, to the fullest extent permitted by law, who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding by reason of the fact that he or she is or was a director or officer of the Bezeq Group Companies. Although we maintain insurance coverage in amounts and with deductibles that we believe are appropriate for our operations, our insurance coverage may not cover all claims that have been or may be brought against us, and insurance coverage may not continue to be available to us at a reasonable cost. As a result, we have been and may continue to be exposed to substantial uninsured liabilities, including pursuant to our indemnification obligations, which could materially adversely affect our business, prospects, results of operations and financial condition.

We cannot guarantee that we will not receive inquiries from the SEC, NASDAQ or other regulatory authorities regarding our financial statements or matters relating thereto, or that we will not be subject to future claims, investigations or proceedings. Any future inquiries from the SEC, NASDAQ or other regulatory authority, or future claims or proceedings as a result of the restatement or any related regulatory investigation will, regardless of the outcome, likely consume a significant amount of our internal resources and result in additional legal and accounting costs.

Apart from the recent major events, the Bezeq Group companies have historically been parties to legal proceedings, including class actions, which could result in their being ordered to pay significant sums, most of which cannot be estimated, and therefore, no provisions have been made in Bezeq's financial statements for most of them. In addition, Bezeq's insurance policies are limited to defined cover limits and to certain causes of action, and might not cover claims for certain types of damages. In recent years, class actions against large commercial companies have become more numerous and severe. By their very nature, class actions may result in significant judgments or settlements. In addition, since Bezeq provides communications infrastructures as well as billing services to other licensees, parties suing those licensees in other class actions are also likely to try to involve Bezeq as a party to such proceedings. For more details on class action pertaining to the Bezeq Group, see "Item 8A. Consolidated Statements and Other Financial Information - Legal Proceedings".

The Bezeq Group companies are subject to governmental control and regulation.

The Bezeq Group companies are subject to government control and regulation relating, among other things, to the licensing of operations, setting permitted areas of operation, setting tariffs, operation, competition, payment of royalties, relations between Bezeq and its subsidiaries and a ban on ceasing or limiting its services (which could oblige Bezeq to provide services under uneconomic circumstances). The continuing governmental control and regulation has at times resulted in government intervention that Bezeq believes impedes its business activities. In this regard, Bezeq is exposed to the imposition of various sanctions by the Ministry of Communications, including fines.

In addition, the Minister of Communications has the authority to change the terms of the licenses of the Bezeq group companies, affect existing tariffs and marketing offerings, and impose directives on them. Significant changes in the regulatory principles applicable to the communications industry as a whole and to the Bezeq Group companies in particular, could require Bezeq to make changes to its strategic plans and harm its ability to plan its business activities for the long term.

Bezeq 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 obligates it to ensure that its relationships with its principal subsidiaries do not result in favoring them over their competitors. Separation is required between the managements of Bezeq and those companies, as is separation between the business, financial and marketing systems, assets and employees, which causes duplication and high administration overheads. In addition, Bezeq is currently limited in its ability to offer joint service bundles with those companies. Due to the entry of companies into direct competition with Bezeq based on the provision of service bundles to customers and the option of providing wholesale services in order to offer customers end-to-end services, the risk that this factor will affect Bezeq's operations and results of operations has increased.

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Bezeq's 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.

Bezeq measures exposure to changes in exchange rates and inflation by the surplus or deficit of assets against liabilities, based on the type of linkage. While Bezeq's exposure to changes in currency exchange rates against the shekel is low, its exposure to inflation rates is high, and therefore Bezeq takes steps to cover part of the inflation exposure. 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 Bezeq's 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. Stability in the financial market and the strength of economies in countries around the world, have recently been subjected to high volatility. While the Israeli economy has displayed economic resilience, reflected in economic expansion, low levels of unemployment and inflation rates within government targets, the continued increase in of housing prices, global economic shocks and uncertainty in the political and defense arenas may cast doubt over a continuation of these trends. In the event the local economy is negatively impacted following external or internal events, Bezeq's business results may be harmed as consequence of lower revenues (including revenues from affiliates) or due to an increase in finance costs.

The Bezeq Group's operations are vulnerable to damage or interruption, which could expose it to material risks.

The Bezeq Group companies provide services using various infrastructure systems that include, among others, exchanges, transmission, data communication and access systems, cables, computerized systems, core network sites, antenna and satellite sites and other systems, and are spread throughout the country. If any part of the Bezeq Group's infrastructure 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 have, or may in the future undertake, and their monitoring of network performance, may be insufficient to prevent losses. In such event, the Bezeq Group might incur liabilities or reputational damages

The Bezeq Group companies could be subject to labor disruptions.

The Bezeq Group companies are subject to collective bargaining agreements which may reduce managerial flexibility and result in additional costs. The implementation of human resources and organization plans, including retirement and restructuring plans, involves coordination with the labor unions and with the employees' committees. The implementation processes of such plans may cause unrest in labor relations and be damaging to the Bezeq Group's ongoing activities.

Bezeq 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.

Bezeq is subject to the Israeli Non-Ionizing Radiation Law, which regulates the emission of electromagnetic radiation from broadcast facilities. While Bezeq is working to obtain permits to set up and operate its various broadcast installations, the difficulties it faces in this area, including difficulties stemming from the change in policy by relevant entities and amendments to statutes and standards, could have an adverse impact on the infrastructure of these installations and on the continuity of services using them, and as a result, on Bezeq's revenues from these services. Bezeq's third-party liability policy does not currently cover liability for electromagnetic radiation.

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Frequent technological changes may negatively impact Bezeq's operations and the value of its assets.

The communications sector is characterized by frequent technological changes and the shortening of the economic life of new technologies. The trend has created a need to invest significant resources in technology upgrades, has caused the lowering of barriers to entry into the sector by new competitors, increased depreciation rates, and in certain cases, resulted in the redundancy of technologies and networks owned by Bezeq (the cost of investment in which is still recorded on its balance sheets).

Specific Risks Relating to Bezeq's Fixed - Line Communications

Competition from other providers could adversely affect the Bezeq's business, results of operations and financial condition.

The competition in the domestic fixed-line communications industry has recently intensified, both from other domestic carriers including HOT, Bezeq's principal competitor in this segment, and secondarily from other cellular operators. Competition strengthened significantly upon implementation of the wholesale market by the principal communications groups in Israel and other communications operators (holders of special or unified licenses) who compete with Bezeq in selling end-to-end service packages based on Bezeq's infrastructures at prices prescribed by the Ministry of Communications and not pursuant to commercial terms determined by negotiation. Bezeq may also face competition in the future from potential infrastructure owners. The increased competition has led to the churn of some of Bezeq's customers and has caused Bezeq to lower its prices for certain services and to an increase in the cost of acquiring new customers and retaining existing ones. The entities competing with Bezeq at present or those that might compete with it in the future, benefit from greater business flexibility than Bezeq, including the ability to cooperate with subsidiaries and affiliates for marketing joint packages of services. The ability of HOT to offer "Triple Play" and other packages with tariff flexibility compared with the restrictions that prevent Bezeq from doing the same, has adversely impacted Bezeq's ability to compete and its cash flow from operations.

Bezeq's tariffs for fixed-line services are subject to governmental control, which could have a material adverse effect on its business.

Bezeq's tariffs for its main services (including interconnect fees) are subject to government control and intervention. The Minister of Communications is authorized to intervene in existing tariffs and marketing offers and impose directives on Bezeq. On average, controlled tariffs erode in real terms. Significant changes in Bezeq's controlled tariffs, if implemented could have a material adverse effect on Bezeq's business and results. Additionally, the restrictions applicable to Bezeq in marketing alternative payment bundles may make it difficult for Bezeq to provide

an appropriate competitive solution to market changes and have placed Bezeq at a disadvantage to those competing with it in the sale of end-to-end service packages using wholesale Bitstream Access services, or BSA services, supplied by Bezeq. In the context of the implementation 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 set by the Ministry of Communications may adversely affect Bezeq's level of revenues and profits.

#### Specific Risks Relating to Pelephone

Competition from other providers has adversely affected Pelephone's business and results of operations.

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. Pelephone 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. These competitive forces may create further downward pressure on prices, which may result in a decrease in the Pelephone's average revenue per user, or ARPU, and increase churn rates. Furthermore, the costs of establishing, maintaining and operating a mobile telephony network per subscriber is expected to be higher for Pelephone if it will not be allowed to operate under some form of network sharing model.

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Pelephone is subject to governmental control and regulation

The cellular industry in Israel is subject to legislation and standardization relating to issues such as the environment, increased competition, tariffs, product warranty and repair. Regulatory intervention in the industry may materially impact Pelephone's structure of competition and operating costs. Changes in the regulatory principles applicable to the cellular industry as a whole and to Pelephone in particular, could require Pelephone to make changes to its strategic plans and harm its ability to plan its business activities for the long term.

Pelephone's results of operations are subject to privacy concerns and hacking.

Pelephone operates information security systems to protect against unauthorized hacker access to the network and critical systems. Hacking events could impair performance or adversely affect Pelephone's business.

In May 2018, provisions concerning privacy protection came into force under the Protection of Privacy Regulations (Information Security) 2017 that are expected to significantly affect the operations of many companies. These regulations apply to various companies, including potentially Pelephone, where some of them apply to all types of databases and others are relate to the level of database security.

Pelephone's operations are subject to market risks such as currency fluctuations.

Pelephone is exposed to exchange rate risks as most of its terminal equipment, accessories, spare parts and infrastructure equipment are purchased in US dollars. While its revenues are in NIS. Any erosion of the NIS against the US dollar may affect Pelephone's profitability if it is unable to adjust selling prices promptly.

Frequent technological changes may negatively impact Pelephone's operations and finances.

The cellular market in Israel and worldwide is characterized by substantial capital investments in the deployment of infrastructure. The frequent technological changes in infrastructure and terminal equipment and the fierce competition in various market segments impose a heavy financial burden on the companies operating in the market, requiring them to update their infrastructure technology from time to time.

Pelephone's results of operations are subject to credit risk associated with consumer credit transactions.

Pelephone's sales of terminal equipment are mostly credit-based. Most of this credit, which is not covered by either insurance or sureties, is exposed to risk. The credit is spread among a large number of customers and Pelephone's collection mechanisms are efficient and competent. Negative developments in, or the general weakness of, Israel's economy, in particular increasing levels of unemployment, may have a direct negative impact on consumer defaults. Therefore, a weak economy and negative economic developments may jeopardize Pelephone's growth targets and may have a material adverse effect on its business, financial condition and results of operations.

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.

Pelephone operates hundreds of broadcast facilities and sells electromagnetic radiation emitting terminal equipment. While Pelephone is taking measures to ensure that the levels of radiation emitted by its broadcast facilities and terminal equipment do not exceed the radiation levels permitted in the Ministry of Environmental Protection guidelines (the levels adopted are based on international standards), no assurance can be given that it will be able to do so in the future. If health risks are found to exist or if the broadcast sites or terminal equipment are found to emit radiation levels exceeding the permitted radiation standards, thereby constituting a health hazard, this may have an adverse effect due to reduced consumption of Pelephone's services, difficulty in renting sites, compensation claims for physical and property damages in substantial amounts and attempts to exercise the deeds of indemnity deposited by Pelephone with the planning authorities with respect to applicable law. Pelephone's third-party liability policies do not currently cover electromagnetic radiation and any exposure to such claims could have a material adverse impact on Pelephone's business, results of operations and financial condition.

Pelephone may face difficulties in obtaining some of the building and environmental permits required for the establishment and operation of its cellular antennas.

Pelephone is subject to the Israeli Radiation Law. Establishing and operating cellular antennas require building permits from various planning and building committees, a process that involves, among other things, obtaining several approvals from State entities and local regulatory bodies. The inability to obtain and retain the necessary permits may impact the quality of Pelephone's existing network and the deployment of its new network.

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Pelephone 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 Pelephone'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 taking and use of engineering equipment and facilities by Israel's Defense Forces. These actions could adversely affect Pelephone's business operations.

Pelephone's frequencies are exposed to interference which could impair the service quality of its services.

The frequencies used by Pelephone, 850 MHz, 1800 MHz and 2100 MHz, are exposed to interference and could impair the service quality of the networks operated by Pelephone. The factors that could cause interference include the fact that the 850 MHz frequency is also used for terrestrial television broadcasts by television stations in the Middle East on the same frequency, causing interference in Pelephone's 850 MHz UMTS/HSPA network. Furthermore, the Jordanian networks also use the same 2100 MHz frequency range that Pelephone uses and in view of the limited cooperation between the operators in Jordan and Pelephone, this could have an effect. In addition, the Ministry of Communications notified Pelephone that it plans to adapt the cellular frequencies in Israel to European standards so that Pelephone and another cellular operator will be required to switch the frequencies allotted to them in the 850 MHz spectrum to others in the first giga spectrum. Switching frequencies is a complex engineering project that could require replacement of equipment at all of Pelephone's radio sites and incur substantial costs that could vary depending on the process and timing to be determined by the Ministry of Communications. Pelephone is currently holding discussions with the Ministry of Communications for the purpose of setting out the conditions required for adapting the frequencies, including the financing required, deciding on the timing and duration of the adaptation period and the required regulatory amendments.

## Specific Risks Relating to DBS

Competition from other providers and content piracy has adversely affected DBS's business and results of operations.

Competition in the broadcast sector with HOT and more recently with Cellcom and Partner TV, and including the ability to subscribe to Netflix and Amazon Prime Video directly, requires DBS to constantly invest in attracting and retaining customers, and dealing with high subscriber churn rates between the companies. Competition also increased due to the increasing use of pirated broadcasts. The broadcasting sector is also exposed to piracy by viewers in viewing broadcasts without paying subscription fees and is exposed to unlicensed public access to content to which

the broadcast providers have rights. These competitive forces may create downward pressure on prices, which may result in a decrease in the DBS's ARPU and increase churn rates.

DBS's operations are subject to market risks such as currency fluctuations, economic weakness and the security situation in Israel.

A material part of DBS's expenses and investments are linked to fluctuations in the exchange rate of the US dollar (particularly content, satellite segments, purchase of decoders and additional logistics equipment). Therefore, sharp fluctuations in the exchange rate will have an effect on DBS's business results. In addition, the loans taken out by DBS are linked to the consumer price index and, therefore, sharp rises in inflation rates could have a material effect on DBS's business results. An economic recession, increase in unemployment rates and a decrease in disposable income might bring about a decrease in the number of DBS' subscribers, a decrease in DBS' revenues and harm to its business results. In addition, an ongoing unstable security situation in large areas of Israel, which disrupts the day-to-day lives of the residents, could have an adverse effect on DBS's business results.

Technological developments and improvements may negatively affect DBS and its operations.

The development of new technologies may render existing technology inferior, forcing DBS to invest large sums to retain its competitive edge. Such technological advances and developments may also facilitate increased accessibility to video content, allowing other providers to offer content viewing services without the need for heavy investment that may make it difficult for DBS to recruit new subscribers, retain existing subscribers and offer its services. In order to compete effectively, DBS may be required to invest large amounts. Alternative multi-channel broadcasting infrastructures, such as 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, and its expansion, may have an adverse impact on the financial results of DBS.

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DBS is subject to restrictions on intercompany relations with Bezeq and its other subsidiaries, which harms its ability to compete and adversely affects its business.

DBS is restricted in entering into joint ventures with Bezeq with respect to offering communications service bundles. Both HOT and Cellcom, DBS's principal competitors, are able to provide service bundles to their customers, which provide them with a significant advantage. DBS's inability to ability to offer joint service bundles to customers has had a material impact on its business and competitive ability.

There are significant risks associated with providing satellite-based broadcasting.

DBS broadcasts its multi-channel pay television via space segments on the Amos 2 and Amos 3 satellites stationed at identical points in space. Malfunction of one of the satellites, damage to one of them or the unavailability of space segments on any of the satellites (including the unavailability of a new satellite scheduled to replace a satellite that ceased to broadcast) could disrupt and materially reduce the volume of DBS broadcasts, unless an alternative is promptly found to replace unavailable space segments. While DBS has attempted to provide for redundancy and has entered into a partial backup mechanism in its agreement with Spacecom, it may not be successful in fully replacing its broadcast capabilities and would likely not be able to provide all the channels it now offers. DBS is not insured against loss of revenues caused by satellite malfunction.

DBS is dependent on Spacecom, as the exclusive holder of the rights and the sole provider of space segments used by DBS.

DBS is dependent on Spacecom Communications Ltd., or Spacecom, a company controlled by our controlling shareholder, as the exclusive holder of the rights and the sole provider of space segments used by DBS in providing satellite broadcast. Spacecom is, and is also responsible for operating the space segments. Any inability by Spacecom to provide DBS with the space segments necessary for its broadcasts would negatively impact DBS's business and competitive position.

DBS is dependent on several third-party vendors and a disruption in those services could adversely affect its business.

DBS is dependent on certain providers of software, equipment, content and services, including broadcast encryption services in providing its satellite TV services. Failure to receive the products and services, or the failure to retain broadcast licenses and obtain access to new content from content providers services would negatively impact DBS's



business and competitive position.

DBS depends on its broadcast centers and central computing center in Israel and is susceptible to any event that could adversely affect their condition.

Damage to a broadcast center's operations may significantly impair DBS's ability to continue its satellite TV broadcasts. DBS operates broadcast centers in Kfar Saba and Re'em Junction in order to reduce the risks involved if one of its centers sustains damage and improve the survivability of some of its broadcast capabilities. In the event of damage to one of the broadcast centers, DBS will be able to continue broadcasting only a portion of its channels from the other broadcasting center. This is more significant in the event of damage to the Kfar Saba center, which is the only center with the capacity to broadcast certain of DBS's key channels. Both of the broadcast centers have identical encryption systems and therefore backup is also available for the encryption system in the event of damage to one of the broadcast centers. A significant malfunction in DBS's central computer systems would also severely impact its operational capability. While DBS has a remote backup site designed to be activated and provide partial computer services within a few hours in the event of malfunction, it will be extremely difficult for DBS to operate efficiently without the operation of the central computer systems. Damage to DBS's logistics center could also lead to a disruption of its operations.

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DBS's technology is inferior to that of its principal competitor.

DBS's technology is inferior to that of HOT, its principal competitor. This technical inferiority prevents DBS from providing telephony and Internet services, and various interactive services, including VOD, via its infrastructure; and therefore, DBS is dependent on third parties in order to provide such services

DBS is dependent on third-party encryption systems.

DBS encrypts the broadcasts it transmits via satellite and utilizes encoded smart cards that are installed in the decoders in subscribers' homes. Defects in the encryption system or its enforcement or a breach thereof could make it possible for unauthorized persons to view broadcasts without payment to DBS, causing a reduction in revenues and a breach of the agreements between DBS and its content suppliers. A malfunction of the encryption system or its enforcement could have a material adverse impact on DBS's operations and financial results.

DBS's frequencies are not exclusive, and are subject to interference, which could impair the service quality of its services.

The spectrum of frequencies used by DBS to transmit its broadcasts from the broadcast satellites to the satellite dishes installed in subscribers' homes is allocated in accordance with the license from the Ministry of Communications and is defined as a frequency spectrum with a secondary allocation. An Israeli entity is allowed to make authorized primary use the frequency spectrum used by DBS. If the owner of the primary allocation uses the frequency spectrum, this may cause an adverse impact on the quality and/or availability of DBS broadcasts to its subscribers, which may adversely affect the financial results of DBS. The primary allocation holder has not made use of such frequencies in a manner that has caused any real or lengthy disruptions to DBS's broadcasts. As DBS's broadcasts are wireless transmissions from broadcast centers to broadcast satellites and from them to the receiver dishes in subscriber homes, the broadcast of wireless signals in the same frequency spectrum, whether or not they originate in Israel, and extreme weather conditions of heavy rain, hail or snow could cause disruptions to the quality and/or availability of the broadcasts provided by DBS to its subscribers. Such disruptions may have an adverse effect on DBS's financial results.

Specific Risks Relating to Bezeq International

Bezeq International's operations are subject to currency fluctuations.

The primary currency in which Bezeq International operates is the NIS. While the majority of Bezeq International's revenues are derived from customers in Israel, Bezeq International uses services from providers worldwide and pays them for these services in foreign currency, primarily in US dollars. Changes in the exchange rates of the currencies in which Bezeq International operates against the NIS exposes it to rate differentials on the gap generated, which could adversely affect its profitability by increasing financing expenses, as well as its cash flows. To protect itself against currency exposure, for specific material transactions, Bezeq International engages in hedging transactions and purchases other financial instruments.

Technological developments and improvements may negatively affect Bezeq International's operations.

Bezeq International's operations are characterized by frequent technological developments. The development of technologies constituting attractive alternatives to some of Bezeq International's products, such as Skype as an alternative to long-distance calling, is likely to have a materially adverse effect on its operations. Furthermore, technological developments require frequent investment in infrastructure which could impact its financial condition.

#### 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;

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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.

## Risks Related to Operations 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.

The Bezeq Group companies and we 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. Conflicts in North Africa and the Middle East, including in Egypt and Syria which border Israel, have resulted in continued political uncertainty and violence in the region. Efforts to improve Israel's relationship with the Palestinian Authority have failed to result in a permanent solution, and there have been numerous periods of hostility in recent years. In addition, relations between Israel and Iran continue to be seriously strained, especially with regard to Iran's nuclear program. Such instability may affect the economy, could negatively affect business conditions and, therefore, could adversely affect our operations. To date, these matters have not had any material effect on our business and results of operations; however, 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 our business, financial condition and results of operations 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.

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.



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We may be classified as a passive foreign investment company, which would subject our U.S. investors to adverse tax rules.

For U.S. federal income tax purposes, we may 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, we believe that we are not currently a PFIC, but there can be no assurance that we will not be classified as such in the future.

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 U.S. 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.

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. We received explicit governmental approval to keep the Control Permit even at a level of a 25% ownership interest. “Means of control” means the right to vote at a general meeting of Bezeq, to appoint a director or general manager of Bezeq, to participate in the profits of Bezeq or a share of the remaining assets of Bezeq after payment of its debts upon liquidation.



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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. 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.

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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.

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.

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.

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.

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. The parties received explicit governmental approval to keep the Control Permit even at a level of a 25% ownership interest.

## B. Business Overview

Since April 14, 2010, we, through B Communications, have been 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-35 Index.

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The principal Bezeq Group segments are as follows:

| Bezeq Group Segments | Service   | As of December<br>31, 2017 | Estimated<br>Market<br>Share* | Market<br>Position |
|----------------------|---|----------------------------|-------------------------------|--------------------|
| Bezeq                | Fixed-Line Telephony (private sector)               | 53                         | %                             | 1 of 4             |
|                      | Fixed-Line Telephony (business sector)              | 72                         | %                             | 1 of 2             |
|                      | Fixed-Line Broadband Internet Infrastructure Access | 70                         | %                             | 1 of 2             |
| Pelephone            | Cellular Telephony                                  | 23.3                       | %                             | 3 of 5             |
| Bezeq International  | ISP   | 42.1                       | %                             | 1 of 4             |
|                      | ILD   | 25.6                       | %                             | —                  |
| DBS                  | Pay Television                                      | 37                         | %                             | 2 of 2             |

\*Estimated market share is as of December 31, 2017 (Pelephone market share is as of September 30, 2017).

The Bezeq Group had approximately 1.9 million active fixed line telephony subscribers, 1.6 million fixed-line broadband Internet infrastructure access services subscribers (retail and wholesale), 2.5 million cellular telephony services subscribers and 587 thousand pay television services subscribers as of December 31, 2017. For the year ended December 31, 2017, the Bezeq Group had revenues of NIS 9.8 billion (approximately \$2.8 billion).

Until March 25, 2015, Bezeq held 49.78% of the shares of DBS and it also owned stock options which entitled it to acquire an additional 8.6% of the shares of DBS. On March 25, 2015, Bezeq exercised the stock options that it owned, for no payment, and on June 24, 2015 Bezeq completed a transaction in which it acquired all the holdings of Eurocom D.B.S. in DBS, which at that time constituted 50.22% of the issued share capital of DBS (41.62% fully diluted) as well as all the shareholders' loans that Eurocom provided to DBS (NIS 1,538 million as at December 31, 2014 in consideration for NIS 680 million. Upon completion of the transaction, DBS became a wholly owned subsidiary of Bezeq.

In addition to the cash payment of NIS 680 million, the consideration also included two contingent payments consisting of: (1) additional payment of up to NIS 200 million in accordance with the tax synergy ("First Contingent Payment"). Most of the First Contingent Payment was paid after Bezeq entered into a tax assessment agreement and tax decision with the Tax Authority concerning financing income, shareholders' loans, the losses and merger of DBS; (2) an additional payment of up to NIS 170 million in accordance with the business results of DBS in 2015-2017 ("Second Contingent Payment"). Bezeq paid advances on account of the Second Contingent Payment (which was not recorded as an expense in the financial statements) in the amount of NIS 119 million.

Based on the financial results of DBS for 2017, given that the final amount of the Second Contingent Payment is less than the advances that Bezeq paid to Eurocom DBS for that consideration, Eurocom DBS must return the difference to Bezeq.

In view of reports about discussions that took place between companies in the Eurocom Group and their creditors, in August 2017 Bezeq wrote to Eurocom D.B.S. (with a copy to the banks, the principal creditors of Eurocom Group) asking for information about the ability of Eurocom D.B.S. to refund the difference to Bezeq and with a request to be party to the discussions with Eurocom Group's creditors, and to any move that involves a change in the collaterals or assets of Eurocom Group. Subsequently, Bezeq joined the proceeding to liquidate Eurocom Communications. Furthermore, on January 4, 2018, Bezeq asked Eurocom D.B.S. to pay it within 21 days the amount of the advance on account of the Second Contingent Payment, plus interest as defined in the Agreement, and this after Eurocom DBS failed to meet the targets entitling it to this payment. Bezeq's request was also sent under Section 258(1) of the Companies Ordinance [New Version], 1983, which prescribes conditions that, when satisfied, Bezeq will be deemed insolvent and can be liquidated by the court. Subsequently, and after Eurocom DBS did not respond to the request, on January 31, 2018 Bezeq filed a motion for order of liquidation of Eurocom DBS in the Tel Aviv District Court, on the grounds that Eurocom D.B.S. is insolvent and that it would be right and just to liquidate Bezeq.

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Investigation by Israel's Securities Authority and Israel Police

On June 20, 2017, the ISA launched a criminal investigation, or the Investigation. Eurocom Communications, Bezeq and DBS' offices were searched and documents were seized. The ISA informed Bezeq that the Investigation addressed suspicions of crimes under the Israeli Securities Law and Penal Code in respect of transactions relating to the controlling shareholder. Bezeq was initially informed that the Investigation related to the purchase of DBS shares by Bezeq from Eurocom D.B.S. Ltd., a company controlled by our controlling shareholder. The Investigation was later expanded to include transactions to provide satellite communications services between DBS and Spacecom, a company also controlled by our controlling shareholder, and with respect to dealings between the Ministry of Communications, our controlling shareholder and Bezeq.

As part of the Investigation, the then Chairman of Bezeq, Mr. Shaul Elovitch, the then CEO of Bezeq, Ms. Stella Handler, the CEO and CFO of DBS and certain other senior officers in the Bezeq Group were arrested and questioned. During the course of the Investigation, some of the suspects were released from arrest with certain restrictions, which include partial restrictions on contact with employees and senior officers of Bezeq Group and Eurocom and house arrest. Some of these restrictions expired and some were later re-imposed. Restrictions were imposed on Mr. Shaul Elovitch, which include dealing with matters relating to the Ministry of Communications and DBS. He was also barred from being in contact with members of the Board of Directors, senior officers and employees of the Bezeq Group companies. Matters relating to Bezeq Group companies (excluding DBS) may only be handled by the CEOs of those companies (excluding the CEOs of Bezeq and DBS) or by Mr. David Granot, who was appointed Acting Chairman of Bezeq's Board of Directors. Additional restrictions were imposed on Stella Handler, the former CEO of Bezeq, and she was also barred from making direct or indirect contact with members of Bezeq's Board of Directors other than Mr. Granot.

On November 6, 2017, the ISA issued a press release regarding the conclusion of the Investigation and the transfer of the investigation file to the Tel Aviv District Attorney's Office (Taxation and Economics). According to the notice, the ISA concluded that there is prima facie evidence establishing the involvement of the main suspects in the case in offenses of: (1) fraudulently receiving funds in connection with the entitlement of Bezeq's controlling shareholder to payment of NIS 170 million as part of the transaction for the purchase of DBS shares from Eurocom by Bezeq, payment that was contingent upon DBS meeting certain targets; (2) leaking material from the independent committee of Bezeq's Board of Directors that was required to examine interested party transactions (the transaction for the acquisition of DBS shares by Bezeq and the transaction between DBS and Spacecom for the purchase of satellite segments for DBS) to Mr. Shaul Elovitch and his associates; and (3) promoting Bezeq's interests in the Ministry of Communications, in violation of the Penal Code and the Israeli Securities Law. The notice also relates to the transfer of the investigation file to the District Attorney's Office and that the District Attorney's Office is authorized to decide on the continued prosecution of the matter.

On November 20, 2017, Bezeq and DBS received a letter informing them of the suspicions against them and that the investigative file relating to the investigation of Bezeq and DBS had been submitted to the District Attorney's Office

for review.

At a meeting of Bezeq's Board of Directors held on November 15, 2017, the Board accepted Mr. Shaul Elovitch's suggestion that until further notice he did not wish to return to his position as a director and Chairman of the Board, and that Mr. David Granot should continue to serve as Interim Chairman. Mr. Shaul Elovitch returned to his position as Chairman of the Board of Directors of the Group's subsidiaries, other than DBS, until the date of his resignation from the Board of Directors of the Bezeq Group companies on March 6, 2018.

Between June to August 2017, after disclosure of the Investigation, several legal proceedings were initiated against Bezeq, its senior officers and companies in the Group that hold the controlling interest in Bezeq, including motions to certify a class action and to disclose documents prior to the filing of a motion for certification of a derivative claim. We and several officers of our company were named in a complaint filed in the in the United States District Court Southern District of New York alleging an engagement in a scheme to artificially inflate payments from Bezeq to Eurocom, the majority shareholder of DBS prior to the Bezeq-DBS transaction. There were no specific allegations that any directors or officers of our company, other than Shaul Elovitch, were involved in this alleged scheme or made knowing misrepresentations to our investors. In February 2018, we filed a motion to dismiss the complaint.



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Additionally, in a joint press release issued on February 18, 2018, the ISA and Israel Police announced that in light of evidence found by the ISA during its investigation, which raised suspicion of additional offenses, a new joint investigation was opened by investigators of the ISA and the Unit for Combating Economic Crime at Lahav 433, in which a number of suspects were arrested, including senior Bezeq Group executives Mr. Shaul Elovitch and Mr. Or Elovitch, Ms. Stella Handler, former CEO of Bezeq, and Mr. Amikam Shorer, the Group's former Chief Strategy and Corporate Development Officer (all of whom have been released from their arrests). The officers are suspected of offenses of fraud, administrative offenses, perverting the course of justice, bribery, offenses under the Israeli Securities Law, deception and breach of trust in a corporation, and some of them are also suspected of offenses under the Prohibition on Money Laundering Law, 2000.

Bezeq does not have complete information about the investigations described in this section, their content, the material and evidence in the possession of the statutory authorities on this matter. Furthermore, in view of the provisions of Israeli law and concern of obstructing the investigation, at this stage Bezeq must refrain from conducting any of its own investigations relating to matters that arose in the course of those criminal investigations. This limits Bezeq's ability to operate, including in connection with performing audit activity and reviews for the purpose of publishing Bezeq's reports. Accordingly, Bezeq is unable to assess the effects of the investigations, their findings and results, and the restrictions on Bezeq conducting such checks, on Bezeq and its officers, on the assessment of the internal control of Bezeq, and on the financial statements and the estimates used in preparing these reports, if any.

### **Liquidation of Eurocom Communications**

On December 20, 2017, Eurocom Communications' lending banks filed a motion to liquidate Eurocom Communications. Bezeq was included as a party to the proceeding to liquidate Eurocom Communications, given that it is a significant creditor of Eurocom Communications, in the amount of NIS 119 million.

Subsequently, on January 15, 2018, Eurocom Communications informed Bezeq that together with other privately held companies in Eurocom Group, it had filed an application in the court for an order to convene creditor meetings to approve an arrangement under Section 350 of the Companies Law, and in accordance with the Companies Regulations (Application for a Settlement or Arrangement), 2002. The purpose of the meetings was to approve a proposed creditors' arrangement based on the entry of an investor into Eurocom Group, as part of the settlement of the debts of the key privately held companies in Eurocom Group. On February 23, 2018, Eurocom Communications, including other privately held companies in Eurocom Group filed a motion to approve a creditors arrangement, or the Arrangement, as part of the settlement of the debt issues of Eurocom Communications.

The proposed Arrangement was based on the expected acquisition by the Saidoff Group of Eurocom. Under the Arrangement, the Saidoff Group would receive an option which will allow it to eventually acquire the full 100% interest in Eurocom, or the Saidoff Option. The proposed Arrangement would require significant capital investments

by the Saidoff Group in Eurocom, as well as their assistance in settling the balance of the debt of Eurocom and other affiliated companies. Based on the terms of the Arrangement, management of our company does not believe that there will be a “change in control” event with respect to either our company or Eurocom, since the exercise of the Saidoff Option is subject to obtaining the required regulatory approvals, as well as to meeting the following conditions: (i) obtaining the Court’s approval of the Arrangement, including possible adjustments that may be demanded by the Court; (ii) obtaining a pre-ruling from the Israeli tax authorities regarding various aspects of the Eurocom Arrangement; (iii) not triggering certain material covenants or adverse effects; and (iv) obtaining the necessary regulatory approvals as required by Israeli law (including a control permit for the “Saidoff Group and its affiliates, that will be required to legally exercise its Option.

Accordingly, until the exercise of the Saidoff Option (which is subject to the approval of the Arrangement and the conditions indicated above), there will be no change in the structure of the holdings in Eurocom. In addition, in accordance with the proposed Arrangement, even if the Arrangement is ultimately approved, all the conditions are met and the Option is exercised, Eurocom will continue to be the controlling shareholder of Bezeq. The provisions of the Arrangement would also permit Mr. Saidoff to purchase the assets of the Eurocom Group directly, subject to obtaining all necessary regulatory approvals and legal requirements.

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On March 11, 2018, Eurocom Communications informed Bezeq that the Saidoff Group had filed a court motion claiming that the proposed Arrangement had expired due to the non-fulfillment of preconditions in the proposed Arrangement. The potential investor also claimed that a precondition a pre-ruling from the Tax Authority was not fulfilled and that due to various events with respect to Bezeq, there has been a material adverse change for purposes of the Arrangement. In addition, the Saidoff Group raised claims relating to the request of the creditors of Spacecom regarding the provisions of the Arrangement, which ostensibly seek to limit the Saidoff Group.

Eurocom Communications informed Bezeq that it disputes the Saidoff Group's position, and that no such material adverse change has occurred. Subsequently, the creditors' meeting of Eurocom Communications also confirmed that the Saidoff Group's position is groundless (Bezeq joined this opinion).

On March 12, 2018, Bezeq submitted its response to the motion for approval of the Arrangement in which it announced its support for the proposed Arrangement, subject to reservations that a neutral trustee should be appointed to carry out the Arrangement. In its response, Bezeq announced that it changed its position after Eurocom Communications had filed its motion, and seeing the estimates for the creditors under the Arrangement. After Bezeq analyzed the information, it was believed that the alternative of the Arrangement was preferable to that of liquidation. In its response, Bezeq stated that it reserves the right to reassess its position and to file a supplementary response, insofar as is necessary, after details of the debts are submitted by Eurocom Communications.

Eurocom Communications filed a motion on March 15, 2018. In a hearing held on March 20, 2018 on this matter, the parties agreed, in view of Saidoff's claims regarding a change in circumstances, to examine the feasibility of a different arrangement with the Saidoff Group. Accordingly, the hearing on the case was postponed until April 11, 2018.

On April 11, the Court advised the parties to continue to strive to reach an agreement by April 22, 2018, which was the date of the hearing regarding Eurocom's liquidation motion.

However, such an agreement on the Arrangement has not been reached as of yet, and on April 22, 2018, the Tel Aviv-Jaffa District Court issued a liquidation order for Eurocom Communications effective May 3, 2018. According to the order, the official receiver will be the temporary liquidator of Eurocom Communications until the appointment of a permanent liquidator, and attorneys Pinchas Rubin, Amnon Lorch and Uri Gaon were appointed as special managers. The liquidation order did not constitute a change of control under the Control Permit, but this may change in the future.

Recomposing Bezeq's Board

In January 2018, the Interim Chairman of Bezeq's Board received two applications from different entities (shareholders or their representatives) proposing, among other things, simplification of Bezeq's ownership structure, the resignation of Bezeq's directors who are implicated in the ISA Investigation or affiliated with Eurocom Communications, and their replacement with professional directors, improving the process of appointing directors (including in the event of a change of control in Bezeq), and that a special shareholders meeting should be convened to discuss the appointment of directors and to review aspects of Bezeq's corporate governance.

The Interim Chairman of the Board welcomed the involvement of Bezeq's shareholders and explained his view of the proper functioning of Bezeq's Board of Directors and its committees; the anticipated date for the election of directors to Bezeq (as part of Bezeq's annual general meeting); that he expects changes in the composition of the Board of Directors and that the subject of Bezeq's control structure is not a matter that is handled by Bezeq's Board of Directors.

Subsequently, the Interim Chairman received additional letters from those entities as well as from other entities expressing their opinion that Bezeq must take action to change the composition of the Board of Directors, the action, in their view, that should be taken, and this as soon as possible. The Interim Chairman responded to the applications that the Board of Directors intends to hold a proper process to choose candidates for Bezeq's Board of Directors, to be elected at the upcoming annual general meeting.

In February 2018, B Communications sent a letter to Bezeq requesting that it convene an urgent board meeting for the purpose of discussing the composition of Bezeq's board of directors.

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B Communications' recommendation was to appoint Mr. Shlomo Rodav (a former chairman of Bezeq), Mr. Doron Turgeman (B Communications' and our CEO) and Mr. Tamir Cohen.

Shaul Elovitch, Or Elovitch and Orna Elovitch were to end their service on the Board of Bezeq in furtherance of their desire to calm the atmosphere and the media reports created over the past few days. Mr. Tamir Cohen is a representative of the Saidoff Group. On February 27, 2018, Bezeq's Board of Directors received a letter from the counsel of Elliott Advisors (UK) Limited, who expressed its opinion that Bezeq's Board of Directors must reject our letter.

On March 6, 2018, Bezeq received another letter (from Entropy, in the name of Bezeq's institutional shareholders who hold 6.5% of Bezeq's share capital) demanding to convene a special shareholders meeting under the provisions of Section 63(B) of the Israeli Companies Law, and that the agenda of which would include the appointment of three additional external directors to Bezeq, from a list of six candidates to be nominated to the general meeting. On March 22, 2018 Bezeq issued a notice convening of a general meeting that includes this matter, among others, on the agenda.

On March 7, 2018, Bezeq appointed Mr. Shlomo Rodav and Mr. Doron Turgeman as directors, since in the opinion of the Board of Directors these appointments were for the benefit of Bezeq. Their term of office was until the next General Meeting of the shareholders.

Bezeq further announced that it had appointed a Board Committee whose members are the Interim Chairman of the Board, Mr. David Granot, and the external director Mr. Zeev Vurembrand (the "Appointments Committee"), whose job is to formulate criteria for searching for candidates to recommend to the Board, and following the search process a list of candidates to be proposed by the Board. The Appointments Committee has contracted with a professional company in this field, Emda Support & Management Building Ltd (the representatives of Korn Ferry in Israel), to provide support for the process of formulating criteria for the profile of directors that will be recommended and selection of candidates that will be proposed to the Board as its candidates.

Bezeq announced that its proposal includes the appointment of eight directors, in addition to the three external directors presently serving on its Board, so that the Bezeq Board will have 11 directors in all. These eight candidates would include:

One director from among Bezeq's employees;

One external director and two independent directors, who will be selected by Bezeq's Board after receiving the recommendations of the Appointments Committee;

Four "regular" directors (namely, who are not external directors and not necessarily independent) who will be proposed by the controlling shareholder and will be included in the list of proposed candidates, subject to review by the Appointments Committee that they comply with the said criteria.

On March 22, 2018 Bezeq published notice of its Annual General Meeting, the agenda of which included a proposed resolution concerning composition of the Board of Directors.

Bezeq proposed that the shareholders at the general meeting appoint ten directors, in addition to the three incumbent external directors serving on Bezeq's Board of Directors, so that the Board of Directors will consist of a total of 13 directors.

These ten candidates will include:

one director from among Bezeq's employees;

two independent directors to be elected and recommended by Bezeq's Board of Directors after receiving the recommendation of the Appointments Committee;

two external directors who will be elected from a list of 8 candidates;

five other directors (who are not external directors and are not necessarily independent directors).

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In addition, the notice of convening of the general meeting included a second alternative which was to appoint 12 directors in addition to the three incumbent external directors serving on Bezeq's Board of Directors, so that the Board of Directors will consist of a total of 15 directors. The twelve candidates, according to this alternative, would include in addition to the ten foregoing directors, an additional external director (to also be elected from the same list of 8 candidates) and one additional director (who is not an external director and not necessarily an independent director) who would be recommended by our company, the controlling shareholder of Bezeq.

On April 26, 2018, Bezeq held its annual meeting of shareholders. In the meeting, the following directors were elected to Bezeq's Board: Shlomo Rodav, Doron Turgeman, Ami Barlev, Orly Guy, Ilan Biran, Dov Kotler, David Granot, Rami Nomkin, Idit Lusky (an external director) and Amnon Dik (an external director), so as proposed, ten directors in total were elected, in addition to the three incumbent external directors, so that the Board of Directors of Bezeq currently consists of a total of 13 directors. All the elected directors were either recommended by B Communications or that B Communications supported their election.

On April 30, 2018, Bezeq announced that Shlomo Rodav was appointed as Bezeq's new chairman of the Board.

## Our Strategy

We view our controlling interest 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. We intend to continue to reduce our leverage through the repayment of debt.

## 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. 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. 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 \$38,428 in 2017.

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 growth, 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.



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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.

Pelephone currently operates communications networks using two main technologies:

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

The UMTS/HSPA technology is based on GSM 3G standard. This technology is globally widespread, and enables subscriber identification and services to be provided through a SIM card, which can be moved from one handset to another. This technology supports download speeds of up to 42 Mbps and upload speeds of up to 5.7 Mbps.

In June 2017, Pelephone discontinued operation of the CDMA network, in accordance with an amendment to its license. Under a 2014 agreement L.M. Ericsson Israel Ltd., or Ericsson, serves as Pelephone's supplier for deployment of its 4G LTE radio network. The infrastructures for Pelephone's networks are mainly based at two switch farms which are connected to more than 2,300 sites.

In recent years, Pelephone has invested in the deployment of its fourth generation network and in upgrades with new Beam Forming, Carrier Aggregation Quam 256 and MIMO4x4 technologies. Pelephone estimates that the expected scope of its investments in the network in 2018 will not differ significantly from its investments in 2017 and does not expect a significant increase in the scope of its investments in infrastructure, other than certain possible exchanges of frequencies in accordance with the requirements of the State and other than additional investment in frequencies if such frequencies relevant to Pelephone are offered to tender.

In addition, over the coming decade Pelephone will be required to continue establishing new broadcasting sites to comply with the terms of its mobile telephony license.

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.

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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 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, which allows 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).

Other providers enable VOD viewing through the Internet, such as AppleTV and Netflix (which currently offer content without Hebrew translations). Several 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.

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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, 2015, 2016 and 2017. The operations of DBS have been included for the last nine months of 2015.

|  | Year ended December 31,              |        |        |
|--|--------------------------------------|--------|--------|
|  | 2015                                 | 2016   | 2017   |
|  | (NIS in millions except percentages) |        |        |
| Operating cash flow                        | 3,740                                | 3,526  | 3,525  |
| Capital expenditure, net                   | 1,484                                | 1,278  | 1,432  |
| Capital expenditure, net as a % of revenue | 14.9 %                               | 12.7 % | 14.6 % |

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 has also approved a special dividend on two occasions.

We are the sole controlling shareholder of Bezeq and have a management team with significant experience in developing and operating telecommunications companies.

We have sole control of Bezeq and, together with our controlling shareholders and members of the Eurocom Group, are the only entities or persons that currently hold a permit to control and direct the activities of Bezeq. Since our acquisition of the controlling interest in Bezeq, we have 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, pursuant to Bezeq's collective bargaining agreement.

## 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. These 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 Bezeq 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 communications 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 restrictions are more significantly manifested with the 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.

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Breakdown of figures regarding the results of each of the Bezeq Group's main segments of operation in 2016 and 2017

|  | 2017  | 2016  | Q4<br>2017 | Q3<br>2017 | Q2<br>2017 | Q1<br>2017 | Q4<br>2016 | Q3<br>2016 | Q2<br>2016 | Q1<br>2016 |
|--|-------|-------|------------|------------|------------|------------|------------|------------|------------|------------|
| Revenues (NIS million)   | 4,244 | 4,383 | 1,047      | 1,061      | 1,058      | 1,078      | 1,082      | 1,089      | 1,100      | 1,112      |
| Operating profit (NIS million)   | 1,971 | 2,076 | 470        | 492        | 496        | 513        | 481        | 519        | 540        | 536        |
| Depreciation and amortization (NIS million)  | 728   | 717   | 185        | 186        | 177        | 180        | 161        | 188        | 185        | 183        |
| EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million) (1)                         | 2,699 | 2,793 | 655        | 678        | 673        | 693        | 642        | 707        | 725        | 719        |
| Net profit (NIS million)   | 1,172 | 1,232 | 260        | 276        | 317        | 319        | 235        | 343        | 326        | 328        |
| Cash flow from operating activities (NIS million)  | 2,225 | 2,064 | 587        | 573        | 465        | 600        | 482        | 526        | 517        | 539        |
| Payments for investments in property, plant & equipment, intangible assets and other investments (NIS million) | 825   | 834   | 226        | 170        | 219        | 210        | 205        | 207        | 227        | 195        |
| Proceeds from the sale of property, plant & equipment and intangible assets (NIS million)                      | 94    | 132   | 22         | 46         | 16         | 10         | 15         | 22         | 54         | 41         |
| Free cash flow (NIS million) (2)   | 1,494 | 1,362 | 383        | 449        | 262        | 400        | 292        | 341        | 344        | 385        |
| Number of active subscriber lines at the end of the period (in thousands) (3) (8)                              | 1,916 | 2,010 | 1,916      | 1,942      | 1,961      | 1,968      | 2,010      | 2,031      | 2,050      | 2,068      |
| Average monthly revenue per line (NIS) (ARPL) (4) (8)  | 54    | 57    | 53         | 54         | 54         | 56         | 55         | 57         | 57         | 58         |

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|  |       |        |       |       |       |       |       |       |       |       |
|--|-------|--------|-------|-------|-------|-------|-------|-------|-------|-------|
| No. of outgoing use minutes (millions)   | 4,475 | 5,006  | 1,068 | 1,132 | 1,098 | 1,177 | 1,136 | 1,297 | 1,257 | 1,316 |
| No. of incoming use minutes (millions)   | 4,972 | 5,297  | 1,205 | 1,266 | 1,220 | 1,281 | 1,252 | 1,383 | 1,314 | 1,348 |
| Number of active subscriber lines at the end of the period (in thousands) (7)                  | 1,635 | 1,558  | 1,635 | 1,608 | 1,593 | 1,580 | 1,558 | 1,539 | 1,521 | 1,503 |
| The number of which are internet lines at the end of the period - wholesale (in thousands) (7) | 532   | 377    | 532   | 484   | 444   | 414   | 377   | 347   | 323   | 290   |
| Average monthly revenue per Internet subscriber (NIS) – retail (8)                             | 90    | 89     | 92    | 90    | 90    | 90    | 90    | 88    | 90    | 90    |
| Average bundle speed per Internet subscriber - retail (Mbps)(5)                                | 51.5  | 43.4   | 51.5  | 49.5  | 47.2  | 45.1  | 43.4  | 41.8  | 40.2  | 38.9  |
| Telephony churn rate (6)   | 9.8 % | 10.2 % | 2.4 % | 2.3 % | 2.4 % | 2.7 % | 2.4 % | 2.6 % | 2.4 % | 2.8 % |

EBITDA (Earnings before income taxes, depreciation and amortization) is a financial index that is not based on generally accepted accounting principles. Bezeq presents this index as an additional index for assessing its business results since this index is generally accepted in Bezeq's area of operations which counteracts aspects arising from the (1) modified capital structure, various taxation aspects and methods, and the depreciation period for fixed and intangible assets. This index is not a substitute for indices which are based on GAAP and it is not used as a sole index for estimating the results of Bezeq's activities or cash flows. Additionally, the index presented in this report is unlikely to be calculated in the same way as corresponding indices in other companies.



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- Free cash flow is a financial index which is not based on GAAP. Free cash flow is defined as cash from operating activities less cash for the purchase/sale of property, plant and equipment, and intangible assets, net. Bezeq presents (2) free cash flow as an additional index for assessing its business results and cash flows because Bezeq believes that free cash flow is an important liquidity index that reflects cash resulting from ongoing operations after cash investments in infrastructure and other fixed and intangible assets.
- (3) Inactive subscribers are subscribers whose Bezeq lines have been physically disconnected (except for a subscriber during (roughly) the first three months of the collection process).
- (4) Excluding revenues from transmission services and data communication, internet services, services to communications operators and contractor and other works. Calculated according to average lines for the period.
- (5) For bundles with a range of speeds, the maximum speed per bundle is taken into account.
- (6) The number of telephony subscribers (gross) who left Bezeq Fixed Line during the period divided by the average number of registered telephony subscribers in the period.
- (7) Number of active Internet lines including retail and wholesale lines. Retail - Internet lines provided directly by Bezeq. Wholesale - Internet lines provided through a wholesale service to other communications providers.
- (8) Bezeq revenues have been reclassified so that certain revenues are now classified under the Cloud and Digital category. Accordingly, retroactive amendments were made to these items (number of active subscriber lines and average monthly revenue per line and internet subscribers).

## Telephone

|   | 2017  | 2016  | Q4<br>2017 | Q3<br>2017 | Q2<br>2017 | Q1<br>2017 | Q4<br>2016 | Q3<br>2016 | Q2<br>2016 | Q1<br>2016 |
|---|-------|-------|------------|------------|------------|------------|------------|------------|------------|------------|
| Revenue from services (NIS million)   | 1,782 | 1,818 | 437        | 461        | 449        | 435        | 439        | 468        | 456        | 455        |
| Revenue from sale of terminal equipment (NIS million)   | 764   | 812   | 214        | 174        | 183        | 193        | 213        | 181        | 202        | 216        |
| Total revenue (NIS million)   | 2,546 | 2,630 | 651        | 635        | 632        | 628        | 652        | 649        | 658        | 671        |
| Operating profit (NIS million)  | 72    | 32    | 15         | 22         | 30         | 5          | (4 )       | 27         | 8          | 1          |
| Depreciation and amortization (NIS million)   | 383   | 380   | 90         | 100        | 99         | 94         | 89         | 92         | 95         | 104        |
| EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million) <sup>(1)</sup> | 455   | 412   | 105        | 122        | 129        | 99         | 85         | 119        | 103        | 105        |
| Net profit (NIS million)  | 95    | 61    | 21         | 24         | 34         | 16         | 3          | 32         | 13         | 13         |
|   | 605   | 582   | 86         | 209        | 193        | 117        | 65         | 152        | 180        | 185        |

|   |        |        |       |       |       |       |       |       |       |       |  |
|---|--------|--------|-------|-------|-------|-------|-------|-------|-------|-------|--|
| Cash flow from current activities (NIS million)   |        |        |       |       |       |       |       |       |       |       |  |
| Payments for investments in property, plant & equipment, intangible assets and other investments, net (NIS million) | 309    | 241    | 76    | 78    | 82    | 73    | 63    | 64    | 63    | 51    |  |
| Free cash flow (in NIS million) <sup>(1)</sup>  | 296    | 341    | 10    | 131   | 111   | 44    | 2     | 88    | 117   | 134   |  |
| Number of subscribers at the end of the period (thousands) <sup>(2)(5)</sup>  | 2,525  | 2,402  | 2,525 | 2,475 | 2,410 | 2,430 | 2,402 | 2,348 | 2,260 | 2,692 |  |
| Average monthly revenue per subscriber (NIS) (ARPU) <sup>(3)(6)</sup>   | 61     | 63     | 58    | 63    | 61    | 60    | 62    | 68    | 68    | 57    |  |
| Churn rate <sup>(4)</sup>   | 28.2 % | 23.7 % | 6.9 % | 7.1 % | 6.3 % | 7.9 % | 6.3 % | 6.1 % | 6.2 % | 5.2 % |  |

(1) See comments (1) and (2) in the Bezeq Fixed Line table.

Subscriber data includes Pelephone subscribers (without subscribers from other operators hosted on the Pelephone network) and does not include subscribers connected to Pelephone services for six months or more but who are (2) inactive. An inactive subscriber is one who in the past six months has not received at least one call, has not made one call / sent one SMS, performed no surfing activity on his phone or has not paid for Pelephone services. A customer may have more than one subscriber number (line).

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Average monthly revenue per subscriber. The index is calculated by dividing the average total monthly revenues from cellular services, from Pelephone subscribers and other telecom operators, including revenues from cellular operators who use Pelephone's network, repair services and extended warranty in the period, by the average number of active subscribers in the same period.

The churn rate is calculated at the ratio of subscribers who disconnected from the company's services and subscribers who became inactive during the period, to the average number of active subscribers during the period.

(4) The churn rate beginning in Q2 2017 does not include the effect of the writing off of 83,000 CDMA subscribers when the network was closed down, and in Q2 2016 it does not include the writing off of CDMA subscribers as noted in note 6.

(5) On June 28, 2017, Pelephone discontinued operation of the CDMA network, as a result of which 83,000 subscribers ceased to receive service and were written off the subscriber listings.

(6) In Q2 2016, Pelephone wrote off 499,000 CDMA subscribers. The effect of writing off the CDMA subscribers led to an increase of NIS 11 in Pelephone's average ARPU in every quarter beginning in Q2 2016.

## Bezeq International

|   | 2017   | 2016   | Q4<br>2017 | Q3<br>2017 | Q2<br>2017 | Q1<br>2017 | Q4<br>2016 | Q3<br>2016 | Q2<br>2016 | Q1<br>2016 |
|---|--------|--------|------------|------------|------------|------------|------------|------------|------------|------------|
| Revenues (NIS million)  | 1,537  | 1,548  | 379        | 367        | 407        | 384        | 392        | 384        | 377        | 395        |
| Operating profit (NIS million)  | 174    | 176    | 41         | 39         | 45         | 49         | 47         | 45         | 47         | 37         |
| Depreciation and amortization (NIS million)   | 135    | 137    | 35         | 34         | 33         | 33         | 34         | 35         | 35         | 33         |
| Operating profit before depreciation (EBITDA) (NIS millions)  | 309    | 313    | 76         | 73         | 78         | 82         | 81         | 80         | 82         | 70         |
| Net profit (NIS million)  | 127    | 125    | 31         | 27         | 33         | 36         | 33         | 33         | 33         | 26         |
| Cash flow from current activities (NIS million)   | 277    | 269    | 82         | 74         | 69         | 52         | 86         | 65         | 69         | 49         |
| Payments for investments in property, plant & equipment, intangible assets and other investments, net (NIS million) (2) | 139    | 119    | 35         | 29         | 46         | 29         | 25         | 24         | 33         | 37         |
| Free cash flow (NIS million) (1)  | 138    | 150    | 47         | 45         | 23         | 23         | 61         | 41         | 36         | 12         |
| Churn rate (3)  | 23.4 % | 20.4 % | 6.8 %      | 6.3 %      | 5.0 %      | 5.3 %      | 5.2 %      | 5.5 %      | 4.5 %      | 5.2 %      |

(1) See comments (1) and (2) in the Bezeq Fixed Line table.

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

(3) The number of Internet subscribers who left Bezeq International during the period, divided by the average number of registered Internet subscribers in the period.



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## DBS

|   | 2017   | 2016   | Q4<br>2017 | Q3<br>2017 | Q2<br>2017 | Q1<br>2017 | Q4<br>2016 | Q3<br>2016 | Q2<br>2016 | Q1<br>2016 |
|---|--------|--------|------------|------------|------------|------------|------------|------------|------------|------------|
| Revenues (NIS million)  | 1,650  | 1,745  | 404        | 406        | 416        | 424        | 438        | 434        | 434        | 439        |
| Operating profit (NIS million)  | 163    | 264    | 27         | 35         | 49         | 52         | 68         | 62         | 77         | 57         |
| Depreciation and amortization (NIS million)   | 285    | 296    | 72         | 72         | 71         | 70         | 71         | 75         | 74         | 76         |
| EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million) (1)                              | 448    | 560    | 99         | 107        | 120        | 122        | 139        | 137        | 151        | 133        |
| Net profit (loss) (NIS million)   | (244 ) | 68     | 11         | (123 )     | (151 )     | 19         | 395        | (142 )     | (114 )     | (71 )      |
| Cash flow from current activities (NIS million)   | 430    | 629    | 95         | 115        | 169        | 51         | 207        | 154        | 110        | 158        |
| Payments for investments in property, plant & equipment, intangible assets and other investments, net (NIS million) | 234    | 208    | 53         | 69         | 52         | 60         | 41         | 50         | 58         | 59         |
| Free cash flow (NIS million) (1)  | 196    | 421    | 42         | 46         | 117        | (9 )       | 166        | 104        | 52         | 99         |
| Number of subscribers (at the end of the period, in thousands) (2)  | 587    | 614    | 587        | 597        | 603        | 608        | 614        | 618        | 623        | 629        |
| Average monthly revenue per subscriber (ARPU) (NIS)(3)  | 228    | 233    | 226        | 226        | 229        | 232        | 237        | 233        | 231        | 231        |
| Churn rate (4)  | 18.8 % | 15.9 % | 5.9 %      | 4.8 %      | 3.8 %      | 4.3 %      | 3.6 %      | 4.5 %      | 3.6 %      | 4.2 %      |

(1) See comments (1) and (2) in the Bezeq Fixed Line table.

Subscriber - a single household or small business customer. In the case of a business customer with multiple reception points or a large number of decoders (such as a hotel, kibbutz, or gym), the number of subscribers is

(2) calculated by dividing the total payment received from the business customer by the average revenue from a small business customer. The number of subscribers was corrected retrospectively due to an insignificant change in the counting of subscribers among large customers.

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

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

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.

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### Fixed-Line Telephony Services

Bezeq had approximately 1.9 million active fixed telephone lines as of December 31, 2017. Bezeq's fixed-line telephony services include basic telephone 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.

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

Bezeq provides broadband Internet access infrastructure services in xDSL technology. Internet service has become one of Bezeq's main activities and is a central focus for its investments in technology, marketing, advertising, customer acquisition and upgrades. The average surfing speed of Bezeq's Internet subscribers at the end of 2017 was 51.5 Mbps compared with an average of 43.4 Mbps at the end of 2016. xDSL service is also provided free of charge on subscriber lines with no telephony and at no additional cost. According to a decision of the Ministry of Communications (in respect of the cancellation of NDSL services), Bezeq may not apply differential xDSL pricing between subscribers who use the service together with telephony service and subscribers who only use the xDSL service. Bezeq also provides a free WiFi service that enables its customers to share part of their wireless bandwidth in return for browsing outside of their homes as well and benefiting from nationwide and worldwide hotspots.

Bezeq is obligated to provide broadband Internet access services in a BSA wholesale format to service providers that provide end-to-end Internet services in this way to their customers, including infrastructure.

Graph – Changes in the surfing speeds of Bezeq's Internet subscribers in 2012-2017

(in Mbps at the end of each year)

(\*) For bundles with a range of speeds, the maximum speed per bundle is taken into account.

*Transmission and Data Communication Services*

Data communication services are network services for point-to-point data transmission, data transmission between computers and between various communications networks, services to connect communications networks to the Internet, and remote access services.

Bezeq offers transmission services, including high speed, to communications operators and their business customers over a variety of interfaces.

There has been a decline in use of Bezeq's transmission and data communication services by communications providers, in part as a result of the competition from other communications groups.



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### Cloud and digital services

Beginning in 2017, Bezeq centralizes its revenues under this category separately. These services are defined as computing services provided to users by remote computer, whereas the user connects through the internet or a special communication line. In cloud computing, the data and business logic of the computer systems in servers and computing centers and operated from remote terminal units. Accordingly, users are not required to purchase and manage computing resources and systems, and instead, they hire them as a service from providers that offer computing power that is accessed remotely via the Internet.

This category includes virtual server, Bcloud and Bcyber services; smart home, smart business and smart city services; private virtual PBX (IP Centrex) services; and B144 services, which Bezeq's advertising platform for digital advertising and marketing to small businesses, WiFi, SMS, BCAM and remote backup.

### Other Services

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

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

### Broadcast services

Bezeq operates and maintains radio transmitters, which are operated by the Israel Broadcasting Corporation, Israel Army Radio (Galei Zahal), among others, and also maintains and operates the transmitters of several regional radio stations and the DTT transmitters for the Second Authority. Bezeq is not responsible for the content of the broadcasts.

### Contract work

Bezeq installs, maintains, and operates networks or subnetworks for various customers (e.g., the Ministry of Defense, HOT Telecom, radio and television broadcasting companies, cellular operators, international call operators, local authorities, municipalities, and government bodies). Bezeq has agreements with HOT Telecom to provide installation, maintenance and network hosting services using Bezeq's infrastructures.

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

Bezeq's revenues are divided into two main customer types: private (53%), and business, which includes revenue from the service providers in the wholesale service (47%). The distribution is by revenues, as shown in the following table (in NIS million):

|                                 | 2017  | 2016  | 2015  |
|---------------------------------|-------|-------|-------|
| Revenue from private customers  | 2,232 | 2,329 | 2,507 |
| Revenue from business customers | 2,012 | 2,054 | 1,900 |
| Total revenue                   | 4,244 | 4,383 | 4,407 |

The following table shows the distribution of Bezeq's Domestic Fixed-Line Communications revenues from its main products and services in its segment of operation, 2015-2017 (in NIS millions):

|  | 2017   | 2016   | 2015   |
|--|--------|--------|--------|
| Revenues from Bezeq's fixed-line telephony                     | 1,281  | 1,392  | 1,499  |
| Percentage of total Bezeq's Fixed-Line revenues in the segment | 30.18% | 31.76% | 34.01% |
| Revenues from Internet infrastructure services                 | 1,544  | 1,500  | 1,450  |
| Percentage of total Bezeq's Fixed-Line revenues in the segment | 36.38% | 34.22% | 32.90% |
| Revenues from transmission and data communication services     | 975    | 1,069  | 1,053  |
| Percentage of total Bezeq's Fixed-Line revenues in the segment | 22.97% | 24.39% | 23.89% |
| Revenues from cloud & digital services                         | 230    | 203    | 184    |
| Percentage of total Bezeq's Fixed-Line revenues in the segment | 5.41%  | 4.63%  | 4.17%  |
| Revenues from other services                                   | 214    | 219    | 221    |

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## 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.

|   | As at and for<br>the year ended<br>December 31,<br>2017<br>(in millions,<br>except<br>percentages) |   |
|---|--|---|
| Pelephone   |  |   |
| Revenues (in NIS)                                 | 2,546  |   |
| Estimated market share (as of September 30, 2017) | 23.3   | % |
| Active lines                                      | 2.6  |   |
| Churn rate  | 28.2   | % |

## Services provided by Pelephone:

## Package services. Package services provided by Pelephone include:

Basic telephone services (voice) including basic voice services, call completion and auxiliary services such as call waiting, follow-me, voice mailbox, voice conference call and caller ID, MMS multimedia messages.

Browsing and data communications services – Internet browsing using 3G and 4G mobile devices.

Messaging service – a service for sending and receiving SMS text messages and multimedia MMS messages.

*Content services.* Pelephone offers its customers content services such as video services, Pelephone cloud backup and storage, anti-virus, a variety of television channels (Super TV) and a music library (Musix) that enables listening to a variety of music via mobile phone and PC.

*Roaming services.* Pelephone offers roaming services to customers traveling to countries throughout the world by using their own personal handset, with roaming coverage in more than 220 countries. Pelephone also provides incoming roaming services for the customers of foreign operators staying in Israel.

*Service and repair services.* Pelephone offers expanded repair and warranty services; for a monthly fee entitling the customer to mobile handset repair and warranty services, or for a one-time payment at the time of repair. Pelephone provides these services to its subscribers as well as under hosting agreements.

The mobile radio telephony segment is extremely competitive. Competition in this sector has led to high subscriber churn between the cellular operators and erosion of their revenues, and to an increase in the internet browsing volume included in the base package that has caused significant erosion of the average revenue per user (ARPU). The growth in the number of subscribers in the past two years has compensated for price erosion, halting the erosion of Pelephone's revenues, which it has experienced in recent years. In the Reporting Period, revenues from mobile radio services amounted to NIS 1,782 million compared with NIS 1,818 million in 2016 and NIS 1,999 million in 2015.

Opening of the market to parallel imports and opening of multiple stores selling terminal equipment has led to a decline in the sales of cellular handsets and terminal equipment by the cellular operators. Abolishing of purchase taxes on imported terminal devices in 2017 further contributed to a decline in turnover. To minimize damage to revenues, Pelephone increased the range of equipment it sells and it also sells non-cellular electronic equipment. The launching of Chinese brands alongside the launch of lower price models of devices of other manufacturers has led to a decline in the average revenue per device. In February 2016, Pelephone launched a private brand of terminal equipment (GINI) that includes several models of devices. Pelephone's revenue from terminal electronic equipment in 2017 amounted to NIS 764 million, constituting 30% of its total revenues compared with revenues of NIS 812 million in 2016, constituting 31%. Most terminal and electronic equipment is sold on installments.

The decrease in terminal equipment sales over the years has led to a decrease in trade receivables as well as a decline in trade payables to terminal equipment suppliers.

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Pelephone also 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.

Pelephone offers its subscribers comprehensive voice, data and text messaging services and advanced multimedia services through its nationwide 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 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.

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.

### Revenue from products and services

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

In 2016, Pelephone launched a private brand of terminal equipment (GINI).

In April 2017, the Finance Minister announced an economic plan that includes the elimination of import duties and purchase taxes. As part of this plan, the Finance Ministry decided to abolish purchase tax on imported mobile devices, which was 15% of the value of the device.

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

|  |       |        |        |
|--|-------|--------|--------|
| Products and services                      | 2017  | 2016   | 2015   |
| Revenue from services                      | 1,782 | 1,818  | 1,999  |
| Percentage of Pelephone's total revenue    | 70 %  | 69.1 % | 69.2 % |
| Revenue from products (terminal equipment) | 764   | 812    | 891    |
| Percentage of Pelephone's total revenue    | 30 %  | 30.9 % | 30.8 % |
| Total revenue                              | 2,546 | 2,630  | 2,890  |

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

|                                  |       |       |       |
|----------------------------------|-------|-------|-------|
| Products and services            | 2017  | 2016  | 2015  |
| Revenue from private customers   | 1,541 | 1,616 | 1,750 |
| Revenue from business customers* | 1,005 | 1,015 | 1,140 |
| Total revenue                    | 2,546 | 2,630 | 2,890 |

\*Revenue from business customers includes revenues from hosting agreements.

At the end of 2017, Pelephone had 2.6 million subscribers. Pelephone also had 770,000 prepaid subscribers (customers who pay for communications services in advance) at the end of 2017. The revenues from these customers are not material in relation to Pelephone's total revenues.

#### 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.

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In the internet service provider (ISP) sector, some 80 companies have so far been granted ISP licenses, among them holders of special licenses for providing these services and special general licenses authorizing them to provide international call services, domestic operator services and MRT services.

|                        | As at and for<br>the year<br>ended<br>December<br>31, 2017<br>(in millions,<br>except<br>percentages) |   |
|------------------------|---|---|
| Bezeq International    |   |   |
| Revenues (in NIS)      | 1,537   |   |
| ISP                    |   |   |
| Estimated market share | 42.1  | % |
| Churn rate             | 23.4  | % |
| ILD                    |   |   |
| Estimated market share | 25.6  | % |

## ISP Services

In the Internet services sector Bezeq International provides Internet service provider (ISP) services for private and business customers, including requisite terminal equipment and support over DSL based transmission, configuration and cable infrastructure. and access services to Bezeq's Internet infrastructure (as part of the wholesale market); hosting services offering site and server storage services at a designated installation, including value added services (such as monitoring and control); information security services; Internet and LAN network connection security using required terminal equipment or software, including monitoring; data services including international IP based data communication solutions for business customers with global deployment; and high speed Wi-Fi services, including public hotspots.

Bezeq International provides these Internet services primarily via its exclusive wholly-owned Jonah submarine cable between Israel and Italy, launched in December 2011. Bezeq International is the only provider among ISPs operating in Israel to own a submarine cable.

## International data services

Bezeq International provides international data communication solutions for business customers including customized global deployment. The services are provided via Bezeq International's submarine cable and the optic cables deployed from Israel to Europe over which Bezeq International has long-term user rights, and through its business partnerships with leading global telecom providers such as British Telecom, which provide its customers access to their sophisticated global network services.

In addition to the foregoing services, Bezeq International offers ITS licensees to provide Bezeq International's services and ISP licensees the use of its international capacities (through leasing or by purchasing indefeasible rights of use), over Bezeq International's submarine cable, and the user rights it acquired in European terrestrial infrastructures and in other international networks.

#### Business Sector-Data Services and ICT

Bezeq International provides ICT (Information and Communication Technology) solutions for business customers. Customer ICT solutions include extensive communications solutions such as server and web hosting services, technical maintenance and support services, system and networking services, outsourcing and out-tasking services, security and risk management solutions, IP based services, cloud computing services, online backup services, market and advertising services for businesses over a digital platform (Bigger) and equipment sales. Bezeq International has adopted a comprehensive solution model with a single contact person, fully responsible for dealing with the customer (one service provider, one responsibility).



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

## Multi-Channel Pay Television (DBS)

DBS broadcasts via satellite include linear channel broadcasts (approximately 150 channels, of which 30 are HD High Definition channels and a 4K channel), as well as radio, music and interactive services.

|                            | As at and for<br>the year<br>ended<br>December<br>31, 2017<br>(in millions,<br>except<br>percentages) |   |
|----------------------------|---|---|
| DBS                        |   |   |
| Revenues (in NIS)          | 1,650   |   |
| Estimated market share     | 37  | % |
| Subscribers (in thousands) | 587   |   |
| Churn rate                 | 18.8  | % |

Furthermore, DBS provides its subscribers online VOD services via the internet (OTT), allowing user selectable content viewing. These services are provided for a service subscription fee (for subscribers who are not yet ultimate subscribers), with additional charge for some of the content. Connecting to VOD services requires, among other things, the use of certain types of decoders. In recent years, the number of DBS subscribers connected to VOD services and the consumption of VOD services has increased significantly due to the increased supply of available content, increase in available band width at subscribers' homes and significant increase in use of advanced decoders.

DBS also operates its online OTT yesGo service, allowing subscribers to view its satellite broadcasts of the channels included in this service that they have purchased for home television viewing, as well as VOD content, via a variety of terminal devices.

To allow reception of DBS services online, several types of decoders are installed in the subscriber's home: decoders enabling reception of SD broadcasts only, and advanced decoders, some of which are PVR converters for recording content, some are HD Zapper decoders for receiving HD broadcasts, and some combine all the foregoing features (HDPVR decoders). DBS also markets state-of-the-art PVR decoders that enable higher resolution viewing, known as 4K or UltraHD.

Most of the PVR decoders also enable MultiRoom service through which, via a home network, content recorded on such decoders can also be viewed through other (HD Zapper or HDPVR) decoders in the subscriber's home.

The majority of DBS subscribers use advanced decoders of various types (HD Zapper, HDPVR, PVR and PVR 4K decoders).

Under the terms of DBS's broadcasting license and the Council's decisions, its satellite broadcasts include a basic package or one of the core packages that every subscriber is required to purchase (the maximum price for the basic package is supervised by the Ministry of Communications), as well as additional user selectable channels, either as packages or as individual channels.

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In January 2018, DBS launched a campaign that reflects a new business model, the highlights of which are: offering a package that includes all the linear channels and VOD service at an inclusive price (other than exclusions) which for most DBS subscribers is a price decrease; the foregoing pricing applies uniformly for all existing and new subscribers. The offer includes the use of regular decoders and one advanced decoder while additional advanced decoders incur an additional cost.

Currently, the acceptance rate of the new offer is high and DBS estimates that most of its subscribers will gradually subscribe, which is expected, together with further measures, to help DBS cope with the increasing competition and subscriber abandonment.

### Sting TV Services

In November 2017 DBS launched its online television service known as Sting TV, which includes linear TV channels and VOD content that are part of the service. The service is based on the Android TV operating system which allows content to be viewed via a streamer, smart TV and other terminal devices. The service is made up of a number of content packages, with each package containing linear channels and VOD content, and subscribers can join one or more of these packages, according to choose. As a rule, this service is low cost compared with the services provided under the broadcasting license.

The service is primarily digital (subscribing and customer service are via online interfaces), based on subscriber self-installation (if installation of a streamer is required).

### *Recent DBS Developments*

In April 2018, Altech Multimedia International, or Altek, manufacturer of ZAPPER HD decoders and KPVR4 decoders purchased by DBS from Draco and OSI, announced its intention to cease its decoder production operations in November 2018. DBS is working with Altek to clarify the significance of its announcement. In addition, DBS has made an increased order of decoders manufactured by Altek in order to provide surplus until an agreement to purchase alternative decoders manufactured by another manufacturer is signed.

In May 2018, Cisco notified DBS of the pending sale of its multi-channel television services to a third party. Cisco says the agreement to sale its services was signed but not completed. DBS is examining the significance of this notice, noting its agreements with Cisco and its relevant operations.

## 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 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 network includes more than 450 points of sale at which it is possible to join Pelephone's services. The point of sale network is diverse and includes stores and stalls operated by Pelephone, retail chains that market Pelephone products and 28 customer service and sales centers deployed around the country that engage in sales, repair of devices and customer retention. In addition, Pelephone operates an internal and external telemarketing network. As a rule, these dealers are paid a commission on sales.

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In the past year Pelephone continued expanding its distribution network. Pelephone's subscriber service network includes online channels, including Pelephone's website and 12 call centers.

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

Bezeq International has sales channels for the private market, including customer recruitment and retention call centers, a country-wide direct sales network (providing "door to door" and point of sale services), a technical support and customer service network and a distribution channel system that includes external marketing and dealership centers. The business market sales channels include customer recruitment centers and business and administration service and solution centers for business customers. Bezeq sells Bezeq International services as part of joint service bundles.

### 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 medias 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, MultiRoom, streamer and mobile applications). DBS also highlights its relationships with other well-known, popular brands.

## Networks

### Domestic Fixed-Line Communications (Bezeq)

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, FTTC), and also based on an access network (a

system that connects NEPs on the subscriber's premises to the network and engineering systems). The connection from the home to the access network is based on copper cables and the connection from the access systems to the backbone is based mainly on optic cables. In addition, some of the peripheral equipment (equipment installed at the subscriber, such as routers) is owned by Bezeq and leased to the customer.

Bezeq is expanding the deployment of infrastructure, including optical fiber deployment as from 2013 so that the fibers will be as close as possible to the customer's premises (FTTH/FTTB), as a basis for future provision of more advanced and broader-band communication services than those currently provided, in part on the basis of new technologies using the copper cables on the customer's premises. In this regard, a detailed design of the project and optical fiber purchasing and deployment are being carried out. The project is modular, and Bezeq reviews the project's scope and outline on a regular basis, as well as the need for adjustments in view of the advancement of relevant technologies and the development of customer needs.

Since by the end of 2016 the distribution of optical fibers was significant whereas advanced technologies that facilitate extensive high-speed provision of the service are still being tested and have not yet reached the necessary technological readiness, and in view of the prices resulting from these technologies, which at this stage are not economical, Bezeq slowed the pace of distribution of the fibers significantly in 2017. As of the end of 2017, Bezeq deployed optic cables to 1.5 million homes and businesses.

Bezeq is focusing its efforts on examining the readiness of the new technologies, which will allow it to provide the service more extensively, and on investments in the existing network with the purpose of increasing the bandwidth, quality and survivability of the network. On March 28, 2018, Bezeq applied to the Ministry of Communications with a request to regulate the ultra-high speeds segment in a manner that would enable wide national deployment of these speeds.

In the NGN used by Bezeq, broadband speeds of up to 100 Mbps download speed and innovative added value services can be provided using VDSL2 technology (Very High Bit Rate Digital Subscriber Line – Digital Subscriber Line (DSL) at very high speed.) Other advantages of the new technology are simplification of the network structure and better management ability. At the beginning of 2016, Bezeq started testing G.fast and optic technologies in the field, which allow ultra-high-speeds of hundreds of megabits and even 1 gigabit, with the aim of reviewing the technological and economic aspects of operating the network.

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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, 2015, 2016 and 2017, Pelephone had net capital expenditures of NIS 426 million, NIS 241 million and 309 million (approximately \$89 million), respectively, for its network infrastructure.

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

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 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.

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.

At present, Pelephone's network infrastructure is based at 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).

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.

Under its mobile telephony license and the Wireless Telegraph Ordinance, Pelephone has rights of use of frequencies 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. During the course of 2017 Pelephone returned two 1 mega bandwidth frequencies in the 850 Mhz spectrum to the national pool of frequencies and towards the end of April 2017 it received a temporary allocation of 5 mega bandwidth on the 1800 Mhz spectrum. This allocation is for limited use and for a limited period and will expire at the end of 2019 or earlier, according to the conditions specified in the allocation.

Infrastructure sharing agreements and providing right of use of networks

The following active radio segment network sharing agreements are in effect:

*HOT – Mobile.* According to the radio segment network sharing agreement between Partner and HOT Mobile, Partner and HOT Mobile established a joint company that obtained a special license for providing radio infrastructure services to a MVNO operator, for 10 years. The purpose of the company, which is owned by Partner and HOT Mobile in equal shares, is to maintain and develop one advanced cellular network for both companies and to operate the radio segment jointly.



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*Golan Telecom - Cellcom - Marathon 018*

Golan Telecom, Cellcom and Marathon 018 have entered into agreements for radio network sharing and/or hosting. While Marathon 018 is not yet operating in the market, according to media announcements it is expected to begin operating in 2018.

Pelephone is not party to a network sharing agreement, therefore it does not benefit from the savings of a shared radio network, but on the other hand it has exclusive control of its cellular network, maintenance of its technological channel and the scope of its investments.

The inventory of frequencies available for its network may be smaller than those of some of its competitors and could allow it less flexibility in managing its networks and require it to find alternative solutions in order to be able to provide competitive services.

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.

ISP, ILD, Domestic Services and ICT (Bezeq International)

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.

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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.

Breakdown of Bezeq International’s revenue (in NIS millions):

|  | 2017   | 2016   | 2015   |
|--|--------|--------|--------|
| Voice services   | 268    | 325    | 379    |
| % of total revenue   | 17.44% | 20.99% | 24.02% |
| Business internet and telecommunication services (ISP, PBX, ICT, data) | 1,269  | 1,223  | 1,199  |
| % of total revenue   | 82.56% | 79.01% | 75.98% |
| Total revenue  | 1,537  | 1,548  | 1,578  |

## Trade receivables

Bezeq International is not dependent on any single customer and it does not have one customer that provides 10% or more of its total revenues.

Breakdown of revenue from private and business customers (in NIS million):

|                                 | 2017  | 2016  | 2015  |
|---------------------------------|-------|-------|-------|
| Revenue from private customers  | 563   | 570   | 555   |
| Revenue from business customers | 974   | 978   | 1,023 |
| Total revenue                   | 1,537 | 1,548 | 1,578 |

## Multi-Channel Pay Television (DBS)

DBS is the sole DTH provider in Israel. 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.

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).

## Competition in the Israeli Telecommunications Market

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

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Competition in the communications industry is fierce, particularly due to the large number of cellular telephony operators, which has brought down prices, increased customer switching and led to a decline in the use of fixed-line telephony minutes and higher churn rates (including many customers without a fixed line at home), which in turn has affected the Group's results. Following widespread penetration of free applications, there has been a decrease in the volume of cellular minutes and transmission of text messages. Competition has increased in the television services segment by over the top (OTT) streaming television content services (VOD services and linear channels) and receiving Idan+ channels, which are not subject to regulatory supervision and the same liabilities as those of the multi-channel broadcast providers. Implementation of the wholesale market has also intensified competition in the Internet service packages and deepening implementation of the wholesale services may lead to even fiercer competition and customer switching. Competition is also escalating by rival communications groups developing independent infrastructures, operating in the passive wholesale market and participating in relevant tenders. To reduce the impact on performance, the Group Companies are introducing streamlining and other measures to improve the services they provide and differentiate themselves from their competitors.

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

Communications groups in the Israeli market

Recently, the market is characterized by competition among the communications groups operating in several segments with the aim of providing a solution for all of the customer's communications requirements: Cellcom Group - Cellcom Group provide cellular telephony services; fixed-line telephony on its own infrastructure, transmission and data communication services for business customers through Cellcom's own transmission network, ISP services, end-to-end ISP service packages, wholesale service-based Internet infrastructure, international telecommunication services, fixed-line telephony services using VoB technology; an Internet-based television (OTT) service which includes VOD services, several linear channels, and integration of Idan+ channels.

Cellcom is also deploying independent infrastructures and using Bezeq's infrastructures in the wholesale market.

Partner Group - Partner Group provides cellular telephony services, transmission and data-communications services, ISP services, end-to-end ISP service packages, wholesale service-based Internet infrastructure, and fixed-line telephony services using VoB technology and Internet-based television (OTT) services. Partner is also deploying independent infrastructures and using Bezeq's infrastructures in the wholesale market.

HOT Group - Hot Group owns a nationwide cable infrastructure and provides multi-channel television services, cellular telephony services, fixed-line telephony services, Internet infrastructure, transmission and data communications services, and IPS services. Certain structural separation restrictions were imposed on Hot Group and specific restriction on marketing joint service bundles that include ISP services.

Additional competitors that do not belong to the above communications groups (such as Golan Telecom, MVNO cellular operators, international operators and ISPs, including service providers in the wholesale market) also operate in the market.

The competition between the communications groups is reflected by increased use of service bundles (including various combinations of several different communication services). Communications groups market or may in future market “joint” service bundles consisting of different communication services of the companies in each group. As a rule, the marketing of the joint bundle enables the communications group to offer its customers more attractive tariffs than purchasing each service separately (in some cases with “cross-subsidization” among the bundle’s components), and a comprehensive solution that does away with the need to be subscribed of several different providers. These trends were reinforced with implementation of a wholesale BSA service, which allows operators that do not own infrastructure and those that are not part of a communications group to offer a full end-to-end service bundle (including infrastructure) to their customers. Unlike the other groups, at the date of this report, Bezeq Group is subject to the stricter restrictions in marketing joint service bundles.

Provision of comprehensive services that meet a range of needs for the customer has become easier due to the technological unity trend, regulatory changes, and the transition to regulation through a consolidated business license that was granted to different communications operators, as part of which different communication services that in the past required separate licenses may be provided under the same license.

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Fixed-Line Telephony Services Market

Wholesale market

The wholesale market enables communications providers to compete with Bezeq while using its physical infrastructure, including infrastructure segments, and its services, at controlled prices that are not set by Bezeq. The wholesale market allows communications providers to offer their subscribers broadband services and end-to-end service packages, including access infrastructure.

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

Telephony

Bezeq estimates that at the end of 2017, its market share in the fixed-line telephony market was approximately 53% of the private sector and 72% of the business sector, a 2% and 1% decrease respectively compared with 2016 as a result of the significant competition in the fixed-line communications segment.

Bezeq and HOT Telecom both own nationally-deployed fixed-line telephony infrastructures and are in fierce competition with each other, which is manifested, among other things, by HOT combining Internet infrastructure, telephony and cable television, and possibly cellular services as well, to households. HOT also markets telephony services to business customers.

Bezeq also faces competition from license-holders for domestic fixed-line communication services, including VoB, which provide the service on Bezeq's broadband access service, including the wholesale BSA service.

Since July 2017, Bezeq provides telephony services on its network in a resale format to unified license holders that are permitted to provide domestic carrier services. At present, the number of subscribers for this service is negligible.

## Competition in telephony from the cellular companies

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

In 2017, the trends that began in 2012 continued, marking a leap in competition in the cellular communications market in Israel. The activity of the new infrastructure operators, Golan and HOT Mobile, and to a lesser extent the activity of virtual cellular operators, continued the trend of erosion of prices and maintained the high level of mobility of customers between the companies. However, the continuation of these trends has a minor effect on the fixed-line operation compared with previous years, and since 2015 there has been a decrease in the average movement per line and in the rate of removal of fixed telephone lines.

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

In the cellular telephony sector, the trend has been for cellular users to use applications that allow making calls and sending messages via the Internet.

## VoC services

According to the Ministry of Communications policy, VoC service is a fixed service, the provision of which will be regulated by a general Domestic Carrier License or special license that currently provide VOB services, since VOB or VoC telephony services are telephony services which use IP technology over another entity's data transmission network (irrespective of whether such network is mobile or fixed) and it is therefore a single fixed service.



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As a result of the Ministry of Communications' decision that provides an exemption to cellular operators from requiring a general license or a permit to set up and operate access points, the cellular operators can use Wi-Fi access points as part of their networks to provide services. This provides them with a transition to providing cellular telephony services over a Wi-Fi network and assists in diverting loads to this network from their cellular network.

Internet infrastructure segment

Bezeq estimates that at the end of 2017 its market share in the internet infrastructure market was approximately 70% (compared with 69% at the end of 2016). The competition in this field is also lively:

Competition from HOT Group – HOT's internet infrastructure is deployed nationwide, in which a range of communication services and interactive applications can be provided. On November 13, 2014, the former Minister of Communications decided that HOT Telecom will be required to implement the first stage in completing deployment of its network by November 13, 2016. Implementation of this decision was delayed twice (by May 13, 2018) while during that time HOT was required provide its services to all subscribers in OTT technology on broadband internet (which in practice belongs to Bezeq) in all communities in which it does not currently serve. Moreover, as from October 1, 2017, HOT may use Bezeq's physical infrastructure. On February 8, 2018, Bezeq contacted the Ministry of Communications raising questions about the legality of delaying the decision and requested its response on the matter. On March 6, 2018, the Ministry responded that the purpose of Bezeq's letter at such time is unclear. A decision has not yet been made regarding continuation of the additional examination. The Ministry clarified that if it decides to change the layout of deployment set out in the 2014 decision and new recommendations are formulated on the matter, this will be brought to the attention of the public.

HOT's network is currently the main alternative to competition with the Bezeq's infrastructures in the private sector. HOT was compelled to provide wholesale services, including BSA services, but to Bezeq's knowledge, the actual volume of wholesale subscribers on its network, if any, is negligible.

Competition from ISPs and telecommunication groups - operating the wholesale market enables ISPs and telecommunication companies (holders of a single license) to offer customers service bundles that also include internet infrastructure based on Bezeq's infrastructures and services (in exchange for controlled tariffs to be paid by the telecommunication providers to Bezeq). Moreover, if and insofar as the mechanism for preventing a 'margin squeeze' is implemented, similar to the one described in the Ministry of Communications hearing, Bezeq's ability to market promotional offers of its wholesale services will also suffer, in terms of both time to market (TTM) and prices at which the services are offered.

Competition from cellular operators – The cellular companies have deepened their Internet activities on the cellular range both in the private sector and in the business sector. Unlike the fixed-line communications segment (where the provision of access infrastructure services – mainly by HOT, is separate from provision of Internet access services – by the ISP), the cellular Internet service is provided as one unit. Surfing services are provided both from the cellular handset and through a cellular modem that connects laptop and desktop computers in combination with Internet access services. The capacity of cellular networks has increased substantially due to the rise in popularity of 4G services. However, migration of the cellular operators to 4G in 2015 did not significantly change the interchangeability between cellular internet and fixed-line internet.

Competition from IBC - IBC, which is obligated to have universal deployment according to long-term milestones fixed in its license (allowing provision of services to license holders), is laying a fiber optic infrastructure to provide internet over the electrical grid and has started operating commercially in several cities. According to media reports, volume of subscribers recruited by IBC is not material. Following an amendment to the Communications Law, IBC may use Bezeq's physical infrastructures.

The fact that Bezeq is restricted in marketing DBS television services (including over the Internet) in view of the structural separation limitations imposed on it puts it at a material competitive disadvantage.

#### Transmission and data communications

In addition to Bezeq, other companies operating in this segment are Cellcom, Partner and internet companies.

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Cellcom has deployed and set up a transmission network which it uses for its own needs and for competition with Bezeq's services in the transmission and data communications market. Partner also provides transmission and data communication services combined with telephony and internet to business customers.

Cellcom and Partner use Bezeq's physical infrastructures as part of the wholesale service to compete with Bezeq in this segment and for its own use.

The infrastructure owners IBC (in a volume that is not material) and HOT (nationwide) also operate in this segment. These infrastructure owners may use the Bezeq's physical infrastructures.

Other competing infrastructures

On November 20, 2017, Cellcom and Partner announced that they are negotiating a potential long-term cooperation agreement for the deployment of fiber optic infrastructure by both companies, whereby each party will be entitled to purchase from time to time, as per its needs and at its sole discretion, fiber optic infrastructure services (including Indefeasible Right of Use - IRU) in the other party's present and/or future fiber optics infrastructure in order to connect residential buildings throughout Israel. Previously, Partner announced the deployment of its optical fibers at an accelerated rate and the launching of commercial marketing of internet infrastructure to customers. Furthermore, Cellcom is still in the experimental stage of connecting households in limited areas where it deployed fibers.

IBC also has a general license to provide fiber-optic based communication infrastructure services to license holders. Under the license, IBC will enter into an agreement with IEC to obtain the right to use its fiber-optic network and will become the network's operator. Pursuant to the provisions of the license, IBC was obligated to make a gradual universal deployment over a period of 20 years. Furthermore, IBC has a special license (which does not impose a universal obligation) to provide domestic fixed data-communication services, according to which it is entitled to provide IPVPN services and broadband data-communication lines.

The joint holdings of IBC (other than IEC's holdings) are for sale. The Ministry of Communications allowed (in June 2016) companies without fixed-line infrastructure (Cellcom and Partner) to compete for investment in IBC. In parallel, Partner informed the Ministry of Communications that it intends to deploy optical fibers. According to the Ministry of Communications, these measures are designed to open the fixed-line market (in which Bezeq has a monopoly) to competition, with the emphasis on infrastructure upgrades.

There are also currently a number of infrastructures in Israel with the potential to serve as communications infrastructures, which are based on optical fibers and mostly owned by government companies and entities, such as Israel Railways, Mekorot Israel National Water Co., Petroleum & Energy Infrastructures Ltd., and the Cross Israel Highway Ltd. Some municipalities are also trying to create an alternative to installation of pipes or fibers by deploying their own infrastructures.

Domestic fixed-line telephony is regulated and overseen by the Ministry of Communications by granting licenses to entities operating in the segment.

In the telecommunications market, three of the general licenses holders that provide domestic fixed-line communication services are obligated to provide service to all those requesting it nationwide (universal service), namely Bezeq, HOT Telecom and IBC, whose license is limited to the principle of providing services to other communications providers, whereas its deployment obligations are gradual extending until approximately 2034. These companies are termed “infrastructure owners”. Other holders of domestic carrier licenses (unified) are not bound by this obligation. The infrastructure owners compete with each other. Nevertheless, the Economic Arrangements Law allowed them to make mutual use of each other’s physical infrastructures (except for the infrastructure owned by IEC, which is required for the provision of critical services) and the infrastructures of another domestic carrier license, so that there can in fact be competition through the physical infrastructures of another license holder, and in practice, mainly on Bezeq’s infrastructures.

Fixed-line telephony is characterized by a lively competitive dynamic. Bezeq’s competitors are HOT Telecom and VoB service providers which have been operating under license for several years with no obligation to provide universal services, and without their own independent access infrastructure. Since July 2017, holders of a single license are permitted to provide domestic fixed-line services, purchase telephony services from Bezeq in a resale format, and provide telephony services without their own infrastructure. Some of them compete with Bezeq as part of telecommunications groups, and Bezeq believes that the cellular companies are also its competitors in the telephony segment.

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The internet segment is characterized by high rates of penetration, which is attributable to the deployment of a national access infrastructure. Bezeq's main competitor in this segment is HOT. Upon implementation of a wholesale market, ISPs compete with Bezeq in providing service packages, including broadband internet access infrastructure using Bezeq's infrastructures, at wholesale prices. Bezeq is also exposed to competition from the cellular companies.

In the wholesale services segment, HOT competes with Bezeq as the owner of infrastructure compelled to provide wholesale services (although even though tariffs have been set out in regulations for some of the wholesale services on HOT's network, these are provided in a negligible volume, if at all).

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

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

Internet Access-Infrastructure and ISP Services

In the Internet segment, growth has been recorded in recent years in terms of number of subscribers. The Internet segment is characterized by a rise in surfing speeds and the adoption of advanced services and value-added applications. In 2017, there was a 4% increase in the number of fixed-line Internet subscribers in Israel. In 2017, against the backdrop of introduction and expansion of the wholesale Internet services, the number of Bezeq's Internet subscribers (retail and wholesale) increased by 5% compared with 2016. Average monthly revenue per Internet subscriber (retail) rose by 2% compared with 2016.

*Graph - Internet subscribers - wholesale market since launching of the service in the first quarter of 2015 (quarterly, in thousands):*



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Graph - Distribution of internet lines on Bezeq infrastructure (quarterly, in thousands):

The transmission and data communications segment

The transmission and data communications segment for business customers and communications providers is characterized by a rapid increase in the customers' broadband consumption, but in general by lower prices per given volume of traffic. This stems both from development of the technology allowing greater bandwidth at lower prices than in the past, and from competition in this area. There is also a decline in use of Bezeq's transmission and data communication services by communications providers, in part as a result of the trend of entry of communications groups. This trend is expected to increase due to the use of physical infrastructure (as part of the wholesale services provided by Bezeq) also for cellular requirements.

*ISP Market.* The market is saturated with competitors, the main ones being Bezeq International, Cellcom, Partner and Hot Net. Bezeq International estimates that its share of the ISP market at December 31, 2017 is 42.1%. Competition in 2017 was reflected by price erosion. Developments in this market in 2017 include:

Strengthening the service bundle sales trend, particularly due to the expansion of the wholesale sales model operations (provider + infrastructure) in 2017.

Continuing the increasing trend in sales of added value services such as anti-phishing, ransom attack and other cyber protection services.

Due to market saturation, emphasis is given to strengthening customer loyalty.

*Cellular Telephony Services Market*

There are currently five operators with mobile telephony license in the cellular telecommunications market in Israel (Pelephone, Cellcom, Partner, Golan Telecom and HOT Mobile) and a few MVNO operators with mobile telephony licenses for hosting on another network (virtual operators). In addition, it should be noted that, according to media announcements, another company, Marathon 018 is expected to begin operating as a sixth operator with mobile telephony license during the course of 2018. The extreme market competition is reflected in the high subscriber churn between operators, substantial erosion of rates and profit margins.

In 2018, a number of factors are expected to affect Pelephone's activities. Pelephone expects that in 2018 subscriber churn will continue and competition will focus on increasing added value and browsing volume in the packages offered to the customers. Pelephone expects that as a result of the increase in browsing volume offered in its packages and the increase in number of subscribers using the 4G network, the upward trend of online data communications consumption will continue.



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*Cellular network and product innovations*

In 2018, Pelephone expects to continue investing in its LTE mobile telephony network and establishing its position as a high speed, top quality and cutting-edge network. Concurrent with investments in the network, Pelephone is expected to continue promoting a number of services and products that will enable an increase in revenues and increase its image advantage over the competitors: cyber services, data and big data SIM solutions, IOT, further focus on large-scale launches and development of the online store.

*Infrastructure sharing*

Infrastructure sharing allows consolidation of the cellular operators' sites and substantially reduces the operating and maintenance costs of the radio sites of each operator. Infrastructure sharing in the market is as follows:

Partner and HOT Mobile operate under radio segment infrastructure sharing through a joint company that received a special license for providing radio cellular infrastructure services to cellular operators.

Cellcom and Marathon 018 engaged in a network sharing agreement, subject to obtaining the approval of the Ministry of Communications.

Golan Telecom hosted on Cellcom's network without a network sharing agreement. At the same time, since Electra's acquisition of Golan Telecom, Golan Telecom, Electra and Cellcom engaged in a network sharing agreement (that was approved by the Ministry of Communications).

*Virtual operators - MVNO*

While several MVNO licenses have been granted to virtual operators, only a few MVNO licenses are active.

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

*Establishment of cellular networks using advanced technologies*

Technology developments and the desire to widen the range and quality of services offered to the customer, require the cellular operators to periodically upgrade their network technologies. The cellular networks in Israel operate primarily using the UMTS/HSPA and LTE technologies, which are planned for upgrade to the LTEA (LTE Advanced) technology.

Since 2014 Pelephone has been extending its LTE network and the network is currently available in most parts of the country and Pelephone is continuing to extend it to the rest of the country. As of 2017, Pelephone utilizes three technologies: MIMO4x4, Beam Forming and Quam 256 to improve performance and increase browsing speeds on fourth generation websites. These technologies have been recognized by the GSA as technologies that affect quality of the speed, and Pelephone is believed to be the only company in Israel and one of only 39 cellular companies worldwide to utilize these technologies. Additionally, in 2017 Pelephone began integrating Carrier Aggregation technology (that enables optimal utilization of the frequency spectrum and increases browsing speed) at some of its sites. On April 20, 2017, Pelephone received permission from the Ministry of Communications to operate the LTE Advanced technology (LTEA).

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

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## Smartphones

The introduction of smartphones continues to increase the consumption of data transmission services, coinciding with the increase in supply of apps and video services. In addition, there has been an increase in the rate of smartphones that support LTE technology, a technology that allows better browsing. This increase has led to a further increase in consumption of 4G Data.

Below is a breakdown of the number of subscribers of Pelephone and of its competitors in 2016 and 2017 (in thousands of subscribers, approximate).

|                         |                                   | Pelephone |   | Partner |   | Cellcom |   | HOT Mobile |   | Golan Telecom |   | MVNOs <sup>(1)</sup> |   | Total subscribers in market |
|-------------------------|-----------------------------------|-----------|---|---------|---|---------|---|------------|---|---------------|---|----------------------|---|-----------------------------|
| As at December 31, 2016 | No. of subscribers <sup>(2)</sup> | 2,400     |   | 2,700   |   | 2,800   |   | 1,450      |   | 850           |   | 210                  |   | 10,400                      |
|                         | Market share                      | 23.1      | % | 25.9    | % | 26.9    | % | 13.9       | % | 8.2           | % | 2                    | % |                             |
| At Sept 30, 2017        | No. of subscribers <sup>(2)</sup> | 2,480     |   | 2,680   |   | 2,800   |   | 1,560      |   | 900           |   | 230                  |   | 10,650                      |
|                         | Market share                      | 23.3      | % | 25.2    | % | 26.3    | % | 14.6       | % | 8.5           | % | 2.1                  | % |                             |

<sup>(1)</sup> Most of the MVNOs are private companies which do not publish figures regarding the number of their subscribers and these figures are based on estimates.

<sup>(2)</sup> The number of subscribers as of September 30, 2017 and December 31, 2016, are based on the public reports issued by Cellcom, Partner, HOT Mobile and Golan Telecom (in Electra's financial reports).

## ILD Market

As of the end of 2017, there are more than ten participants in the market (including Bezeq International, Cellcom, Partner, Golan Telecom and HOT Mobile). Bezeq International estimates that its market share for outgoing international calls at December 31, 2017 is 25.6 %, a substantial improvement compared with its market share of 21 % at December 31, 2016. Competition is focused on specific population sectors.

In 2017 the number of call minutes decreased, among other things, due to an increase in the use of the WhatsApp application for making calls via the internet. As a result of this and other factors, Bezeq International believes that this service has become a commodity.

#### Communication solutions for the business sector

In the ICT sector Bezeq International competes with competitors such as Binat, Teldor, IBM and others. In 2017, Bezeq International continued to establish its position in the ICT market and gained recognition and endorsement from leading global suppliers in the market.

NEP services - the traditional telephone exchange sector includes a large number of competitors and fierce competition that has given rise to erosion of service prices.

Bezeq International promotes its business with emphasis on differentiating it from its competitors as the owner of its own international infrastructure (Jonah cable) for its customers' traffic providing high quality browsing performance, as well as its leading customer service.

The fact that, unlike some of its competitors, Bezeq International is unable to offer its services as part of a non-detachable communications services bundle, adversely affects its operations.

#### Pay Television Services Market

Currently, there are several competing groups on the market.

DBS's main competitors are HOT, which was declared a monopoly in the broadcasting sector and holds the largest share of the market, Cellcom, which holds the largest share of the market among the players that do not have broadcasting licenses, and Partner.

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Over the past year DBS's share of this market has decreased.

Breakdown of DBS's subscriber numbers and market shares as at December 31, 2015, 2016 and 2017:

| 2017                          |                 |  | 2016                          |                 |  | 2015                          |                 |  |
|-------------------------------|-----------------|--|-------------------------------|-----------------|--|-------------------------------|-----------------|--|
| Subscribers<br>(in thousands) | Market<br>share |  | Subscribers<br>(in thousands) | Market<br>share |  | Subscribers<br>(in thousands) | Market<br>share |  |
| 587                           | 37 %            |  | 614                           | 40 %            |  | 635                           | 42 %            |  |

There are several operators in the subscriber television broadcasting sector operating in a number of key categories:

Broadcasting licensees under the Communications Law operating in the multi-channel television sector - DBS and HOT, that provides cable television services, and has a pronounced monopoly under the Antitrust Law in the multi-channel television broadcasting sector. DBS and HOT provide linear channel broadcasts and VOD services.

Online OTT multichannel television providers - Cellcom (has been operating for a few years) and others that started operating in 2017 include, Pelephone, Triple C Cloud Computing Ltd., STINGTV (offered by DBS), Next (offered by HOT, in collaboration, via Rami Levy Marketing. These services combine VOD content and linear channel viewing (including the DTT content that is transmitted via the system or online) and can be viewed via a special decoder or via an apps downloaded on a range of terminal devices.

Online television content streaming providers – The online television content streaming providers are mainly international providers such as Netflix, Apple TV services (that charges per viewing) and Amazon Prime services, which provide VOD content viewing options. Currently, some of this content is not translated into Hebrew.

*DTT network*

There is a digital terrestrial television broadcasting system (DTT), known as Idan+, through which certain channels are broadcast to the public free of charge. At present, the system is operated by the Second Authority for Television and Radio ("Second Authority"). The Minister of Communications and the Minister of Finance may appoint a private operator for its operation, and the Council may also grant a general broadcasting license which will be financed from

subscription fees or commercials. It broadcasts the channels of the Broadcasting Authority (Channel 1 and Channel 33), the commercial channels (Keshet, Reshet and Channel 10), Channel 20, Music Channel (Channel 24), Channel 23 and the Knesset Channel (Channel 99). The DTT operator may broadcast additional channels including radio channels, Educational TV Channel and subject-based and niche channels. The channels are broadcast for a broadcasting fees, however the Ministers of Communications and Finance may decide that the State will subsidize broadcasting fees applicable for subject-based channels and niche channels.

The DTT is an alternative product, in part, to the multi-channel television broadcasts and is a basic broadcasting platform that is offered together with content services offered by OTT operators (such as Cellcom). Under the Digital Television Broadcasting Law, 2012, a broadcasting body whose broadcasts are part of the “open broadcasts” (i.e. television broadcasts via the sports channels) will give each content provider consent to broadcast its broadcasts via the internet free of charge, subject to the terms set out in the Law. With regard to the commercial channels, the applicability of the foregoing arrangement was deferred for five years (until January 2022), during which special arrangements will apply, including granting a license to any registered content provider that applies for one, at the best price and under the best terms granted by the commercial channel to other content providers under another broadcasting license that is valid when the license is granted, and all as set out in the interim provisions of the Law.

HOT, Partner and Cellcom offer their services together with the other media services they provide, including as part of undetachable bundles (such as the Triple bundles providing landline and mobile telephony and TV services).

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Competition in the sector increased significantly in 2017, mainly due to the entry and establishment of local and international online television service providers, which operate at relatively low prices. These providers that operate via the internet, without requiring designated infrastructures, and also without regulatory supervision, have an adverse impact on DBS's competitive position. DBS believes that this intensification of the competition could have a significant adverse effect on its operations and results.

Competition in the television sector is fierce with a relatively large number of players, some of which operate at very low price levels, increasing the competition in the sector. Increasing the number of subscribers in the current state of competition is mainly possible by recruiting new subscribers from the competitors, requiring substantial resources to be invested in retention of existing subscribers and recruitment of new subscribers.

In 2017, the cellular companies, Cellcom and Partner, began to penetrate the television market, in addition to the further establishment of international participants such as Netflix.

The total market share of the broadcasting licensees, DBS and HOT, is being eroded and DBS's share is estimated to be 56% of households in Israel. Cellcom's market penetration rate is estimated to be 6% and Partner's market penetration rate is estimated to be 1% of the total households in Israel. DBS does not have information regarding the number of subscribers to the international companies operating in the market or regarding the number of DTT viewers. DBS believes that some of these households are also subscribers to one of the broadcasting licensees or the cellular companies operating in the sector. DBS estimates that the chances of increasing the total market share of these participants are not high due to the fact that a large part of the remaining households are not potential audiences.

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 B Communications' 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, (the controlling shareholders of our company and B Communications), or the Individuals' Control Permit. According to the Communications Order, B Communications is not allowed to transfer control or any Means of Control which will result in a decrease of B Communications' minimum holding requirement in Bezeq 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 the issuance of shares which will result in a decrease of B Communications' minimum holding requirement in Bezeq (30%) or B Communications ceasing to control Bezeq without the prior consent of the Ministers (certain permitted issuances do not require the Minister's prior consent). 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. The parties received explicit governmental approval to keep the Control Permit even at a level of a 25% ownership interest. 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. In addition to B Communications' ownership of Bezeq shares, an additional 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.



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B Communications' SP2 subsidiary owns most of B Communications' Bezeq shares. In accordance with the Control Permit, SP2 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 and B Communications' Articles of Association require 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 Bezeq, to appoint a director or general manager of Bezeq, or to participate in the profits of Bezeq or a share of the remaining assets of Bezeq 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. We received explicit governmental approval to keep the Control Permit even at a level of a 25% ownership interest.

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.

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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, on such proxy card or 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.

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According to the Communications Order a “principal shareholder” or a person with “significant influence” in Bezeq shall not be; (i) 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 (ii) 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 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 B Communications’ rights with respect to its 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.

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 our company, B Communications 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 (like ourselves), and accordingly, B Communications is deemed a “second-tier” company under the Concentration Law.

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The Concentration Law prohibits a second-tier company, such as B Communications, 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). For the purpose of the law, Bezeq is considered a third tier company, and accordingly, if by December 10, 2019, B Communications remains a tier company, B Communications will not be allowed to control Bezeq from that date.

We are currently examining several alternatives for the implementation of the Concentration Law, including, but not limited to, the possibility of raising private debt that will substitute our debentures issued to the public, while delisting our shares from the TASE; merger between B Communication and our company, etc. There is no certainty that any of the alternatives will be implemented.

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.



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### Regulatory Requirements Relating to 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.

### Structural separation

The Communications Law grants the minister the authority to order accounting separation between different services provided by the same group/company and to demand separate companies for the provision of different services, including separation between rendering of services to a license holder and services rendered to a subscriber, and provisions regarding implementation of the separation.

Bezeq's domestic carrier license stipulates that it must maintain structural separation between itself and its subsidiaries. This requires, among other things that management of the companies be fully separate. The structural separation restrictions place the Bezeq Group at a competitive disadvantage, which is worsening over time compared with other communications groups that are not subject to such far-reaching limitations, and based on the ability for the operators

to provide end-to-end services to subscribers using wholesale services, mainly BSA. These structural separation restrictions also contribute to high management overheads.

*Cancellation of structural separation.* In Bezeq's opinion, many of the conditions for cancellation of structural separation set out in the policy document dated May 2, 2012 concerning expansion of competition in the fixed-line communication whole sale market segment were met several months ago, because many companies operate in the internet-based television service segment following the launch on February 17, 2015 of a broadband wholesale market, in which various service providers offer end-to-end broadband services on Bezeq's infrastructure to over a half a million customers, and in view of the fact that there is fierce competition in the cellular service segment.

The Ministry of Communications appointed a team, that includes Ministry of Finance representatives, that is charged with advancing the cancellation of the structural separation.

On February 6, 2018, Bezeq sent the Ministry of Communications a letter indicating that it cannot accept the continued procrastination in dealing with this issue and requesting his urgent intervention in canceling the structural separation between it and each of its subsidiaries immediately.

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*Marketing of joint service bundles with a subsidiary to ease the effect of the structural separation restriction*

Bezeq was permitted to offer subscribers joint service bundles with its subsidiaries, subject to approvals by the Ministry of Communications and several terms enumerated in the Domestic Carrier license, including:

The bundles must be unbundleable (separated), meaning that a service included in them will be offered separately and on the same terms.

At the time of submitting a request for approval of a bundle, there is a group of services in similar format being marketed to a subscriber as a package by a license-holder who is not a subsidiary of Bezeq, or there is a group that includes license-holders who provide a private subscriber with all the services included in the joint service bundle.

Joint service bundles marketed by the subsidiaries including the services of Bezeq, are also subject, according to their licenses, to similar limitations, including a requirement for unbundling (except for a bundle marketed by a subsidiary that contains only Bezeq's Internet infrastructure service).

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

The Ministry demanded changes to the format and sales agreements of the bundles (selling the Internet infrastructure service together with ISP service) mainly transferring bundle customer information to the relevant service provider and splitting the bundle after a year, otherwise the approval granted to Bezeq to a market joint service bundle as set out in the license will be canceled. Bezeq made the change and continued (with the Ministry's approval) to market the bundle with service providers that entered into an agreement with Bezeq. On March 27, 2017, the Ministry of Communications notified Bezeq that it would not approve Bezeq's request to market a joint service bundle with DBS, given that the Ministry will, in the near future, be completing several regulatory measures that will allow more complete implementation of the wholesale market reform, including regulation of telephony resell, new regulations relating to Bezeq's retail tariffs, regulation of a mechanism to reduce profit margins and regulation of the conditions for marketing reverse bundles. According to the Ministry's notice, it is therefore willing to review requests of this kind for joint service bundles which include a bundle, telephony and television, in at least six months' time, after it has examined the effect of the above measures on the market and is certain that Bezeq satisfies the regulatory requirements. In its notice, the Ministry reiterated its intention to review, subject to a hearing, the cancellation of the structural separation obligation in Bezeq Group and to examine regulations that will replace the existing structural

separation regime, in a manner that could affect the marketing of joint service bundles.

Bezeq was permitted to offer subscribers joint service bundles with its subsidiaries, subject to approvals by the Ministry of Communications and several terms enumerated in the Domestic Carrier license, including the following requirements: (i) the bundles must be unbundlable (a service included in them must also be offered separately and on the same terms); and.(ii) at the time of submitting a request for approval of a bundle, there is a group of services in similar format being marketed to a subscriber as a package by a license-holder who is not a subsidiary of Bezeq, or there is a group that includes license-holders who provide a private subscriber with all the services included in the joint service bundle.

Joint service bundles marketed by the subsidiaries including the services of Bezeq, are also subject, according to their licenses, to similar limitations, including a requirement for unbundling (except for a bundle marketed by a subsidiary that contains only Bezeq's Internet infrastructure service). These limitations, and in particular the unbundling obligation, which severely limits the Bezeq Group's ability to offer discounts on the components of the bundle, places the Bezeq Group at a competitively disadvantage as compared to the competing communication groups which are not subject to similar limitation in marketing joint bundles (other than a limitation on marketing a joint bundle of HOT-Net and other HOT Group companies,). Bezeq's limitation 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 unbundlable bundles that Bezeq can market.

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There are other limitations on cooperative ventures between Bezeq and Bezeq Group companies, both under the antitrust laws and conditions enumerated by the Antitrust Commissioner in approvals of mergers between Bezeq and Bezeq Group companies, which prohibit discrimination in favor of Bezeq Group companies when providing certain services, and pursuant to the provisions of Bezeq's license, which requires it to provide its services equally to all.

Lifting of the restrictions on structural separation and waiving the limitations applicable to cooperative ventures between the Bezeq Group companies, may provide the Bezeq Group with various opportunities to utilize synergies or the facilitate utilization of such synergies.

Recently, a wholesale market model has started being implemented in Israel. The model includes the obligation imposed on Bezeq and HOT, owners of a country-wide fixed-line access infrastructure, to sell wholesale services to other communications operators.

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

1. Implementation of the wholesale market reform.

The investment in infrastructures in the fixed-line communications segment, and structural aspects, including  
2. reference to the Ministry of Communications' actions in connection with the cancellation of the structural corporate separation in Bezeq.

3. The Prime Minister's conflicts of interests in his capacity as Minister of Communications.

***Wholesale services***

The wholesale services were established pursuant to the policy document in which the Minister of Communications adopted the main recommendations of the committee appointed to review and revise the structure of Bezeq's tariffs and to set wholesale service tariffs in the communications segment (Hayek Committee). The policy document states, among other things, that owners of country-wide fixed-line access infrastructures who provide retail services, including Bezeq, will be obligated to sell wholesale services to holders of telecommunication licenses on a non-discriminatory basis and with no discounts for size. The document also stipulates the terms for cancellation of the

structural separation and that within six months of publication of the Shelf Offering for the sale of wholesale services by the infrastructure owners, the Minister of Communications will take action to change to a method of oversight of Bezeq's prices by setting a maximum price and within nine months and that the Ministry of Communications will formulate regulations aimed at increasing the investment in and upgrading fixed-line communications infrastructure in Israel.

Further to the policy document, the Ministry of Communications established service portfolios setting out the format for provisions of the services by the infrastructure owners. The maximum tariffs that Bezeq is permitted to charge for these services were determined by the Minister of Communications with the agreement of the Minister of Finance in the Communications (Telecommunications and Broadcasts) (Use of a Domestic Carrier's Public Network) Regulations, 2014, or the Use Regulations. Tariffs for HOT's wholesale services were only published on June 26, 2017. The volume of whole subscribers on HOT's network is negligible.

### ***BSA services***

Bezeq started to provide BSA services on February 17, 2015. This service allows service providers that do not own infrastructure to offer their customers full end-to-end Internet services, including Internet connectivity services and infrastructure services of Bezeq. Since launching of the service, hundreds of thousands of customers have switched to receiving services through these service providers who rely on Bezeq's infrastructure.

In the initial period of provision of the service, the Ministry conducted an oversight proceeding of Bezeq, which led to the imposition of NIS 8.5 million in fines. Bezeq paid the amount of the fines and petitioned the court against this proceeding, which was dismissed in January 2018. On March 14, 2018, Bezeq filed an appeal against dismissal of the petition. In addition, disputes erupted between Bezeq and the service providers regarding implementation of the service portfolio. These disputes concern the payments owing to Bezeq for the service and division of responsibility for installation and malfunctions.

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The Ministry held hearings on various issues related to implementation of this service. Some of the hearings were initiated by the Ministry for implementation of its policy, some stemmed from the disputes regarding implementation of the service and others derived from Bezeq's petition to the court prior to launching the service. The results of the hearings may affect the service tariffs and Bezeq's competitive position in the market.

The main hearings on the matter dealt with mechanisms for reviewing and revising the forecast for demand for the purpose of updating the wholesale market tariffs (in which a decision was made regarding reduction of the tariffs of the BSA service component), revising the service level (SLA) requirements, and the procedure for movement of customers between operators, etc.

On August 29, 2017, the Ministry of Communications published a secondary hearing (for the hearing published on November 17, 2014), with respect to the determination of the format for reviewing a market squeeze by fixed-line broadband network owners in marketing offerings, whereby it is considering allowing the infrastructure owners to conduct their own review to rule out a margin squeeze, by means of inspection tools to be approved by the Ministry (in addition to the limited advance review track). As considered, the effective tariff for the reviewed service or group of reviewed services will not be lower than the minimum price level set for marketing those services examined by the license holder. In the hearing, "license holder" includes Bezeq, Bezeq International, DBS, HOT Broadcasts, HOT Telecom and HOT Net. On November 14, 2017, Bezeq submitted its comments on the hearing whereby there is no reason to determine a format for examining margin squeeze, although if such format is determined, the independent inspection mechanism proposed in the hearing should be expanded. Bezeq believes that if the margin squeeze review format is applied, it could affect the ability of Bezeq and Group Companies to market bundles with respect to the timing of the offers and the prices they will be able to offer.

### ***Wholesale service use of physical infrastructures***

Pursuant to the service portfolio that entered into force on July 31, 2015, Bezeq allows service providers without infrastructure to use its physical available-for-transfer communication cable infrastructure and available dark fibers out of Bezeq's available optic cables. In order to connect the service provider's infrastructure to Bezeq's infrastructure, the service provider must set up a passive infrastructure near Bezeq's passive infrastructure facility.

In a letter dated July 6, 2016, the Ministry of Communications announced its decision that the infrastructure work will be performed by Bezeq or several companies whose services Bezeq uses in exceptional cases in coordination with it, as opposed to a situation in which the service providers without infrastructure that use Bezeq's infrastructure perform the work. In another letter, it was clarified that these provisions will also apply with respect to the use of Bezeq's infrastructure by infrastructure owners.

On October 19, 2017, the Ministry of Communications informed Bezeq that it must allow certain contractors to enter its infrastructures and carry out work for the service providers, instead of Bezeq employees, and not only in exceptional cases. Bezeq disputes the information and reasons provided by the Ministry of Communications, it views them as an infringement of its property and a security exposure, and on November 9, 2017, it filed a petition in the High Court of Justice to grant an order nisi against the Ministry of Communications and its Acting Director General to repeal his foregoing decision. In the petition, Bezeq argues that the decision was made in breach of the duty to hold a hearing and in serious violation of its right to present arguments, and that the decision is unreasonable and disproportionate given that it will lead to chaos in the communications infrastructures, exposing them to risks without any grounds or justification. The petition was dismissed on January 29, 2018. At the publication date of the report the service providers work on Bezeq infrastructures through contractors and are in the process of regulation regarding use of Bezeq's infrastructure by additional infrastructure owners as well.

Since it is a service in a completely new format, differences of opinion arise from time to time, some of which disputes the Ministry has decided, whereas with respect to others, such as transfer on infrastructures that do not belong to Bezeq, the Ministry is yet to decide.

In the amendment to the Communications Law, as applied in the Economic Arrangements Law, the obligation of a licensed domestic carrier to allow other licensed domestic carriers (which are not necessarily license holders without infrastructure) access to its passive infrastructure (excluding the passive infrastructure of a licensed domestic carrier owned by IEC and which it requires, for the purpose of its operations as the holder of a critical service provider license) for performance of any telecommunications operation and provision of any telecommunications service under its license. This means allowing IBC to use Bezeq's passive infrastructure and as from October 1, 2017 also HOT Telecom, at tariffs to be set by the Minister of Communications with the agreement of the Minister of Finance by April 1, 2018, whereas until these tariffs are set, the tariffs set in the Use Regulations will apply. Once these tariffs have been established, settling of accounts will be made between Bezeq and HOT Telecom only. Bezeq is negotiating with these infrastructure owners regarding formats for implementation of the service. Tariffs and an appropriate service portfolio, which is required to set out the work arrangements and sites at which infrastructures may be used, have yet to be established, whereas in Bezeq's opinion, the duty applies only when the applicant for use (HOT, IBC or Bezeq) has no infrastructure. On February 1, 2018, the Ministry of Communications notified Bezeq and HOT (in response to HOT's inquiry dated January 15, 2018, which is not in Bezeq's possession) that although the service portfolio does not regulate how HOT will use Bezeq's passive infrastructures, this does not derogate from the duty of a domestic operator to allow use of its infrastructures according to the provisions of the law, which do not limit (according to its clarification) the use which HOT is permitted to make only for areas in which it does not currently provide any service, and that Bezeq may not stipulate any such limit for granting use, unless determined otherwise. On February 5, 2018, Bezeq responded that its letter sent on December 10, 2017 setting out the process it intends to carry, has not be answered or mentioned at all. Bezeq requested that the matter be examined and that a hearing be held, and that it is awaiting an answer to be able to coordinate how to move forward with HOT.



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*Wholesale telephony service*

On May 18, 2017, the then Acting Minister of Communications issued a decision that Bezeq is to provide telephony services in a resale format for a year beginning on July 31, 2017. Provision of wholesale telephony services (at wholesale prices) on Bezeq's network was postponed for the 14 months of the arrangement, when the option to extend the arrangement or turn it into a permanent arrangement will be reviewed (a recommendation on this matter will be put for a public hearing). On March 25, 2018 Bezeq wrote to the Ministry requesting that the Ministry extend the arrangement, at the current price and format, and that the arrangement become permanent. The decision is the result of a petition filed by Bezeq in the High Court of Justice against the Minister of Communications' decision of November 14, 2014 regarding provision of a wholesale telephony service. The petition included claims that the service would be impossible to implement in the service portfolio format (BSA + telephony) and is unjustified. Also, with respect to reverting to the wholesale telephony service portfolio (at significantly lower tariffs than Bezeq's telephony tariffs), Bezeq clarified that the service format in the service portfolio is impossible to implement, unjustified and contradicts the global trend. The only way that Bezeq may provide the service in the service portfolio format would require switch replacement and would compel Bezeq to perform a complex, disproportionate unauthorized and unjustified procedure.

The decision of May 18, 2017 also set out maximum payments for the service even before being heard, including a fixed monthly payment of NIS 16 per line and variable payment for outgoing calls of 1.6 agorot per minute of outgoing call. According to the decision, the final maximum payments will be determined after a hearing has been held and if it becomes clear in the hearing that the payments must be adjusted, the amounts will be offset retroactively from the date of the decision between the relevant operators. On June 28, 2017, Bezeq submitted its comments on the late hearing in which context it argued that there were serious defects in the calculations on which the maximum payments recommended for the service are based, and that these tariffs are lower than they should be. Bezeq is ready to provide the service from July 31, 2017.

On October 29, 2017, Bezeq received a letter from the Acting Director General of the Ministry of Communications according to which the obligation defined in the hearing regulations with respect to both wholesale telephony service and resale telephony service refers to the provision of telephony services by a domestic carrier as separate, stand-alone services (namely - an obligation to provide telephony service even if it is not on a BSA service).

Bezeq believes that the service may have an adverse effect on its financial results. Nevertheless, at this stage, Bezeq is unable to estimate the extent of the effect since it depends on different variables. Currently, the number of customers who subscribe to the service is negligible.

On October 19, 2017, the Ministry of Communications sent Bezeq a final supervision report regarding implementation of a wholesale telephony service, or the Supervision Report, (after Bezeq responded to an initial supervision report in

June 2015) according to which Bezeq violated the provisions by failing to provide the wholesale telephony service on May 17, 2015. Concurrently with the Supervision Report, Bezeq was issued a notice after it was found to have violated the provisions of the Use Regulations and Bezeq's license, of the intention to impose a financial sanction on Bezeq in the amount of NIS 11,343,800. The Notice also stated that Bezeq must take affirmative action to comply with the instructions of the Ministry of Communications in the matter, since the MoC is considering initiating another proceeding in the same matter. Bezeq submitted its arguments in writing against the intention to impose a financial sanction and against the amount of the financial sanction, according to which Bezeq did not breach its obligations and the application of the financial sanction is out of place. On February 22, 2018, the Ministry of Communications notified Bezeq that it requires more time to carry out further tests prior to a final decision regarding the financial sanction and that in accordance with its authority, it has decided to postpone the date of the decision until March 27, 2018.

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*State Comptroller's Report dated July 12, 2017*

On July 12, 2017, the State Comptroller published a report regarding the Ministry of Communications' actions to regulate the fixed-line communication segment. By its very nature, the State Comptroller's report deals with criticism of government ministries (primarily with respect to issues pertaining to Bezeq) and its findings are directed at those entities. It includes three reports on the following topics: implementation of the wholesale market reform, the investment in infrastructures in the fixed-line communications segment, structural aspects, including reference to the Ministry of Communications' actions in connection with the cancellation of the structural/corporate separation in Bezeq, and the Prime Minister's conflicts of interests in his capacity as Minister of Communications.

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

*Change in interconnect tariffs.* The Group's telecom companies (Bezeq, Pelephone and Bezeq International) pay interconnect fees to other carriers for calls that are terminated on the networks of those carriers, and some of them (Bezeq and Pelephone), receive interconnect fees for calls that are terminated on their networks and from international communications operators for outgoing calls on their networks. The interconnect fees are determined by the Ministry of Communications as the maximum tariffs in the interconnection regulations. Changes in the interconnect tariffs have an offsetting effect at the Bezeq Group's level, in view of their impact on both the expenses and revenues of Bezeq and its subsidiaries.

*Restriction of the exit penalty a license-holder can collect from a subscriber.* Under the provisions of the Communications Law, holders of domestic carrier licenses, ITS licenses and broadcast licenses, including Bezeq, Bezeq International, DBS and B.I.P, may not collect disconnection fees from subscribers who cancel agreements if their average monthly bill is less than NIS 5,000, or deny them a benefit that they would have received had they not ended the agreement. Cellular operators, including Pelephone, may not collect disconnect fees from customers who hold up to 100 phone lines or condition a contract for cellular services on an agreement to purchase, rent or lease terminal equipment. As a rule, these restrictions make customer retention difficult for the communications operators that are subject to them.

*Non-discrimination in the offering of benefits and special tariffs.* Due to the different positions expressed by the Ministry of Communications in the past, communications companies may be restricted under certain circumstances in their ability to offer benefits and special tariffs to their new customers or to prevent a subscriber from switching to plans marketed to new customers. The Ministry of Communications announced its intention to hold a hearing regarding revision of the provisions of the licenses regarding price discrimination between subscribers in a manner that is also consistent with the changes and developments in the market.

*Amendments of licenses and additional legislation*

*Hearing about call center waiting times*

On August 18, 2014, the Ministry of Communications published hearings for communication license holders on the subject of regulating the response at the support and call centers, including the definition of the obligations of human responses, a series of other provisions, and a memorandum to amend the Communications Law, which prescribes compensation without the need to prove loss if the response time is longer than that prescribed, and compensation for overcharge. Responses to the hearing opposing the proposed arrangements were submitted. If the proposed arrangement is approved in the format prescribed in the hearings, an increase in the operation costs of the call centers of the Bezeq Group's companies is possible. On July 26, 2017, the Consumer Protection Bill, Amendment no. 55 (Professional human response on IVR systems), 2017, passed its first reading. Accordingly, the dealers listed in the Second Schedule to the Consumer Protection Law will be obligated to provide a human response after the option to choose a language on an IVR system, where the waiting time will not be more than the number of minutes that has yet to be defined and consumers will not be directed to a voice mail service. On November 21, 2017, in a meeting held by the Knesset Economic Committee on this bill, it was determined that the Ministry of Communications would formulate an appropriate arrangement in the licenses of the relevant communications operators within a given time. On January 28, 2018, the Ministry sent a hearing letter regarding amendment of the licenses of the communications operators, setting out rules regarding routing of calls at call centers to a professional human response, binding response times and quotas, a reporting system, etc. On February 15, 2018, Bezeq submitted its response to this amendment, which de facto cancels the development of the existing customer service system and is disproportionate. Bezeq set out necessary changes to the proposed amendment and requested holding professional discussions in this regard. If the bill and/or license amendment is approved in the current format, the costs of operating the call centers of the Bezeq Group's companies are likely to increase significantly.

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*Amendment of licenses 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. According to the amendments, the license holders must comply with minimum requirements to ensure operational continuity (a business continuity plan and network disaster recovery plan) in the event of emergencies. On November 1, 2016, the Ministry of Communications published a hearing for further amendments to the licenses, including provisions concerning the installation of supporting infrastructure on core sites. Bezeq submitted its comments to the hearing.

*Consumer legislation.* Changes in consumer legislation affect the operations of the Bezeq Group companies on a regular basis. Various amendments have been made in recent years to the Consumer Protection Law and regulations, concerning the cancellation of transactions even after service has begun, disconnection from on-going services, the need for the customer to give express consent to continue transactions after the end of the specified period and sending of messages, provisions concerning a refund of charges collected from the subscribers which are not in accordance with the communication agreement plus fixed handing charges prescribed in the Law, restrictions on debt collection procedures, maximum waiting time for a human response, and extension of the visiting times of technicians at the subscribers' homes. Various bills have also been tabled in the Knesset introducing further amendments to the Consumer Protection Law which may affect the terms of customer agreements and the conduct of the Bezeq Group companies towards their subscribers.

On August 15, 2017, Bezeq received a request to produce documents from the Consumer Protection and Fair Trade Authority, whereby the Authority is conducting an investigation with respect to suspicion of breaches of the Consumer Protection Law. Among other things, the request is for data and detailed information in relation to consumers of surfing packages and/or Bezeq's internet infrastructures. Bezeq provided the documents as requested.

On December 4, 2017, Bezeq received a demand to produce documents and references from the Consumer Protection and Fair Trade Authority regarding the description of Bezeq's cyber service in various advertisements, further to a previous request to receive advertisements about the service. Bezeq removed the information as required.

*Enforcement and financial sanctions.* Over the last few years, the Communications Law, the Antitrust Law, the Securities Law and the Consumer Protection Law were amended, giving the regulators powers of enforcement, supervision and imposition of graded fines for violation of these laws or regulations and their provisions. A similar bill to amend the Protection of Privacy Law, 1981, which also includes changes in the penal part of the law, is in advanced stages of legislation. Likewise, the Law to Increase the Enforcement of Labor Laws was legislated. This legislation affects the way in which the Bezeq Group's companies manage their affairs, in part with respect to concern for imposition of sanctions, their ability to protect themselves, etc.

The Ministry of Communications has recently made extensive use of the oversight powers and has issued notice of its intention to impose fines on Bezeq for ongoing regulatory matters as well as matters pertaining to implementation of the wholesale market. Bezeq submitted its comments on these oversight reports and notice of the imposition of such penalties to the Ministry. In some cases, the Ministry rejected Bezeq's position and imposed fines on Bezeq. In addition, provisions enabling administrative enforcement by means of imposing fines or an administrative warning are included in a proposed amendment to the Telegraph Ordinance under the Economic Arrangements Bill.

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*Restrictions on providing credit to business groups.* Powers were granted to the Minister of Finance and the Governor of the Bank of Israel to promulgate regulations and provisions limiting the cumulative credit that financial institutions in Israel may give to a corporation or business group (a group of companies under joint control and their controlling shareholder).

*Restrictions on the allocation of rights in critical infrastructures to a highly concentrated entity.* The Market Concentration Law prescribes a special, restrictive procedure that must be applied prior to the allocation of rights (such as a license, franchise, contractual agreement with the State to operate a critical infrastructure and in certain circumstances also to extend existing licenses) in those areas that are defined as a “critical infrastructure” to entities that are defined as a “highly concentrated entity.” In this regard, a list of areas was defined that will be deemed “areas of critical infrastructure”, including operations for which certain communications licenses are required (domestic carriers, excluding a specialist domestic carrier (such as VoB operators and cellular operators), broadcast licenses, and other areas. Bezeq, the companies that it controls and that are controlled by its controlling shareholder are included in the list published by the Antitrust Authority and are considered highly concentrated entities. The procedure prescribed in the law in relation to the allocation of a right to a highly concentrated entity will also apply to approval given for transferring the means of control in state-owned companies or companies that were previously government companies (Bezeq included) at the rates defined in the law, to a highly concentrated entity.

The provisions of this law became effective in December 2014, although the provisions relating to extending the validity of existing licenses, will go into effect in December 2017. This law may adversely affect the Bezeq Group’s ability to enter new areas of activity as well as its current operations.

*Restrictions on creating charges on the assets of Bezeq Group companies.* The Communication Law, the Communication Order (which applies to Bezeq), and some of the communications licenses of Bezeq Group companies, contain restrictions on granting rights to a third party on assets used to provide the critical service or on the assets of the license, as the case may be, including the need to obtain regulatory approval to create charges on these assets. In some cases, such as Pelephone’s cellular operator’s license, and Bezeq International’s unified license, there are exceptions permitting the creation of charges in favor of banks without the need for advanced approval, provided that the charge agreement includes instructions to ensure that the services rendered under the license will not be affected if the bank exercises the charge. In addition, under the provisions of the law and the communications licenses, the license and the resulting rights are not transferable and they cannot be pledged or confiscated (with certain exceptions).

Bezeq has provided undertakings to certain financing entities not to pledge its assets without simultaneously creating a charge of the same class, rank and amount (negative charge) in favor of those financing entities, subject to specific exceptions. DBS created a floating charge on all its assets and a fixed charge on certain assets, whose conditions include, restrictions on the creation of additional charges without obtaining the consent of the holder of the charge.

*Bezeq*

*Control of Bezeq's tariffs*

The control of Bezeq's tariffs as described below has a number of implications. Bezeq's tariffs are subject to regulatory intervention and from time to time, Bezeq is exposed to significant changes in its tariff structure and tariff levels. The review mechanism for the controlled tariffs, as defined in the authorizing legislation and the regulations, results in a real average erosion of the tariffs over the years. Control of the tariffs could make it difficult for Bezeq to provide an appropriate and competitive response to market changes and to offer competitive prices on short notice. Furthermore, the restrictions on granting discounts on tariffs limit Bezeq in participation in certain tenders.

The following are the main control arrangements over Bezeq's prices:

Under the Communications Law, the Minister of Communications is entitled, with the approval of the Minister of Finance, to determine payments (including maximum payments or minimum payments) for services from a license holder. The payment can be determined on the basis of (1) the cost, according to the calculation method instructed by the Minister plus a reasonable profit; or (2) reference points deriving from: payment for services provided by the license holder; payment for comparative services; payments in other countries for such services.



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The tariffs for Bezeq's controlled services (telephony and others) which are fixed in the regulations, were updated in accordance with a linkage formula less an efficiency factor provided in the regulations, so that on average, Bezeq's controlled tariffs have eroded in real terms. In the last three years, the prices in the regulation have not been updated and the date of the update has been postponed. Under the provisions of the regulations and the relevant temporary orders, the postponement will be taken into consideration in the next update.

The Ministers of Communications and Finance are authorized to prescribe interconnect payments or for the use by a license holder of the telecommunication facilities of another license holder, and to provide instructions.

If tariffs that are neither at the maximum nor minimum levels are determined for supervised services, Bezeq may offer an alternative payments package for a bundle of telecommunication services at such fixed payments, provided that the Ministers of Communications and Finance do not oppose the package. The Gronau report states that an alternative payment package will be approved only if it is worthwhile for 30% or more of subscribers who use the services offered in the package, and that the smaller the market share of the Bezeq Group in fixed-line telephony is, the higher the maximum discount rate permitted in an alternative payment package will be.

If maximum or minimum payments are determined according to Sections 5 or 15 the Communications Law, for telecommunication services provided to another license holder, Bezeq may indiscriminately offer any other license holder an alternative payments package for the bundle of services at maximum or minimum payments, and such services together with services for which payment has not been determined according to Sections 5 or 15 to the Law, provided the Ministers are not opposed or approved the package.

Bezeq may request a reasonable payment for a service for which a payment is not determined according to Sections 5 or 15, or for which a maximum or minimum payment has been determined. The Minister of Communications may require Bezeq to notify him of any payment Bezeq intends to request as set out above and of any change in the payment prior to the provision of the service or the change. If the Minister of Communications determines that Bezeq intends to request an unreasonable payment, or a payment that raises suspicion of harming competition, the Minister may set (for a period not exceeding one year) the maximum payment it may request for the service or separation of the payment for the service from the payment for the bundle of services.

On June 27, 2017, Bezeq received a hearing letter from the Ministry of Communications that two alternative supervisory mechanisms for the current tariffs of telephony (and other services for which the tariffs are fixed in regulations):

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

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

Similarly, it is proposed that only existing subscribers of the alternative payments package for the “Kav Kal” (Light Line) service will be able to continue to receive it. The Ministry of Communications is also considering determining that price control will be lifted on PRI channels and the price control on their call components will be canceled. On August 13, 2017, Bezeq submitted its comments on the hearing, opposing the proposed tariffs, and on December 6, 2017 was also heard verbally. Bezeq believes that the change in the control mechanism being considered in the hearing, insofar as this change is implemented, will negatively affect its financial results. Bezeq believes that its retail tariffs will be affected in parallel also as a result of the setting of wholesale prices for telephony services.

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*Bezeq's Domestic Carrier license*

Bezeq operates under a Domestic Carrier license which enumerates the services Bezeq must provide and its duty of universal service. Bezeq is required to provide its services to all on equal terms for each type of service, irrespective of location or unique cost. While the license is unlimited in time; the Minister may modify or cancel the license or make it contingent. The license and any part of it cannot be transferred, no charge can be imposed on it, nor can it be subject to attachment.

Bezeq is required to maintain and operate the network and provide its services at all times, including in emergencies, in an orderly and proper manner according to the technical and service quality requirements, and to work towards improving its services. The license includes a Service Standards for the Subscriber appendix, which is to be amended after Bezeq provides the Ministry with data. Bezeq submitted its proposals for amendment of the appendix to the Ministry, adapting it to the current state of affairs and the licenses of other operators, but the amendment report has not yet been published.

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

Provisions have been made for the operation of Bezeq's network in times of emergency, including the obligation to operate it in a manner that prevents its collapse in emergencies. Bezeq is required to provide telecommunication services and set up and maintain the terminal equipment infrastructure for the security forces in Israel and abroad, as provided in its agreements with the security forces. Bezeq is required to appoint a security officer and to comply fully with the security instructions contained in the appendix to the license. Bezeq provides special services to the security forces. Bezeq is required to ensure that each purchase and installation of hardware in its telecommunications installations, except for terminal equipment, will be made in full compliance with instructions given to Bezeq according to Section 13 of the Communications Law.

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

The Domestic Carrier license includes restrictions on the acquisition, maintenance and transfer of means of control pursuant to the Communications Order and on cross-ownership, which are mainly a ban on cross-holding by entities in which those with an interest in another material Domestic Carrier as noted in the license, and restrictions on a

cross-holding by entities with Domestic Carrier licenses or general licenses in the same segment of operation.

Bezeq submitted a bank guarantee of US\$ 10 million to the Director General of the Ministry of Communications to secure fulfillment of the terms of the license and for indemnifying the State for any loss it incurs due to their violation by Bezeq. The Director General at the Ministry of Communications is authorized to impose a fine 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 intended for providing its services (the incomes of Bezeq's subsidiaries are not considered income for this purpose).

### ***The Communications Order***

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

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The main provisions of the Communications Order are these:

Restrictions on the transfer and acquisition of means of control in a company, which includes a ban on holding 5% or more of means of control of a certain kind without the prior written approval of the Prime Minister and the Minister of Communications, or the Ministers.

Transfer or acquisition of control in a company requires the approval of the Ministers. The Control Permit establishes the minimum holding percentage in each of the means of control in Bezeq by the holder of the Control Permit. A transfer of shares or an issuance of shares that causes the ownership percentage of the Control Permit holder to fall below the minimum percentage is prohibited without the prior approval of the Ministers, subject to permitted exceptions (among them are an issuance to the public under a prospectus or sale or private placement to institutional investors).

Holdings not approved will be considered “exceptional holdings” and the Order states that exercise of a right by power of exceptional holdings will not be valid. The Order also contains provisions authorizing the Ministers and Bezeq to submit an application for the enforced sale of exceptional holdings to the courts.

At least 75% of the members of the Board of Directors of Bezeq must be Israeli citizens and residents who have security clearance and security compatibility as determined by the General Security Service. The Chairman of the Board, the external directors, the CEO, the Deputy CEO and other office-holders in Bezeq as listed in the Order, must be Israeli citizens and residents and have security clearance appropriate to their functions.

“Israeli” requirements are enumerated for the controlling shareholder in Bezeq: for an individual – he is an Israeli Entity (as defined in the Order); for a company – it is incorporated in Israel, the center of its business is in Israel, and an Israeli Entity holds at least 19% of the means of control in it.

The approval of the Ministers is required for granting rights in certain assets of Bezeq (switches, cable network, transmission network and data bases and banks). In addition, grant of rights in means of control in subsidiaries of Bezeq, including allotment of more than 25% of the shares in the subsidiary, requires the approval of the Ministers.

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

*Authority with respect to real estate*

Pursuant to the provisions of Section 4(F) of the Communications Law, the Minister of Communications granted Bezeq certain powers in connection with real estate, as set out in Chapter Six of the Law. The law distinguishes between land owned by the State, the Development Authority, the Jewish National Fund, a local authority or a company lawfully established and owned by one of them, and a road, or Public Land”), and other land, or Private Land. With regard to Public Land, Bezeq and any person it authorizes, can enter it to perform network deployment and maintenance works and to provide telecommunication services, provided that the deployment is executed according to the provisions of the Planning and Construction Law. The amendment to the Communications Law and the Planning and Construction Law in the Economic Arrangements Law cancel the duty to obtain the approval of the local Planning and Construction Committee, so certain actions do not require a building permit if performed by a license holder that was granted powers under section F of the Communications Law, if carried out according to an approved plan.

A network on Private Land will be deployed according to the provisions of the Planning and Construction Law and requires the consent of the landowner, the lessee in perpetuity or the protected tenant, as the case may be. 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 on the applicant’s premises (or shared premises), Bezeq may 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 as well.

Under the provisions of the Planning and Construction (Application for a Permit, its Terms and Tees) Regulations, 1970, an applicant for a permit to construct a residential building is required 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 (part of the access network installed in residences and in apartments intended to be used by those residences only) for provision of its services, it is obliged to provide maintenance services for that wiring installed by the permit applicant, without this granting it any proprietary rights in the internal wiring. Pursuant to the hearing published on May 7, 2015 on the subject of wiring in residential buildings, the Ministry of Communications is holding a round table with Bezeq, DBS, HOT and IBC to reach an arrangement regarding installation of infrastructure in new buildings.

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***Immunity and exceptions to liability***

The Minister of Communications granted Bezeq immunity from certain liabilities for damages listed in Chapter Nine of the Communications Law, in accordance with his authority to grant immunity to a general license-holder. In addition, Section 13 of the Communications Law contains exceptions to criminal and civil liability for an act done in fulfillment of a directive to provide services to the security forces in that section.

***Regulations and rules under the Communications Law***

Regulations in three additional and important areas currently apply to Bezeq: (1) cessation, delay or restriction of telecommunications actions and services; (2) installation, operation and maintenance; and (3) ways of supervising the actions of the license-holder.

***Antitrust laws***

The Antitrust Commissioner declared Bezeq a monopoly in the following areas:

Basic telephone services, provision of communications infrastructure services, and transfer and transmission of broadcasting services to the public.

Provision of high-speed access services through the access network to the subscriber.

Provision of high-speed access services for ISPs through a central public telecommunications network.

The Commissioner's declaration that Bezeq is a monopoly constitutes prima facie evidence of its content in any legal proceeding, including criminal proceedings.

Bezeq has adopted an internal compliance procedure containing internal rules, guidelines and an internal reporting and control system, the purpose of which is to ensure that the activities of Bezeq and its employees are carried out in accordance with the provisions of the Antitrust Law.

In connection with the approval of the merger of Bezeq and Pelephone, restrictive terms were imposed, mainly prohibiting discrimination in favor of Pelephone in the supply of a product in which Bezeq is a monopoly, prohibiting the bundling of the supply of certain products by any of the companies when purchasing products or services from the other, and restrictions on certain joint activities.

In connection with the approval of the merger of Walla and Bezeq, terms were imposed restricting discrimination in favor of Walla against its competitors.

On October 11, 2011, the Antitrust Authority informed Bezeq that the Commissioner was considering the issuance of a ruling in accordance with his powers under Section 43(A)(5) of the Antitrust Law, that Bezeq had abused its position in contravention of the provisions of Section 29A of the Antitrust Law. The notice stated that the Commissioner was considering stipulating that Bezeq refused to provide transmission services for the provision of telephony and Internet services to Cellcom and Partner. In accordance with the decision of the Ministry of Communications, Bezeq provides infrastructure and transmission services to both Cellcom and Partner.

On November 16, 2014, Bezeq received the decision of the Deputy Commissioner of the Antitrust Authority pursuant to Section 43(A)(5) of the Antitrust Law, to the effect that 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 provisions of Section 29A to the Antitrust Law 1988 in setting a negative margin by determining lower prices for Internet and telephony services than for Internet infrastructure only, in a campaign. The decision states that these prices places competitors who wish to offer this service at a disadvantage.



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On March 20, 2018 a ruling was issued by the Antitrust Tribunal in the appeal filed by Bezeq against the decision, according to which the decision was dismissed, following a joint motion filed by the parties. In accordance with the ruling, the earlier decision was deemed null and void, i.e. as though it was never issued.

On March 7, 2018, Bezeq received notification from the Antitrust Authority that the Antitrust Commissioner is considering determining in accordance with her authority under section 43(A)(5) of the Antitrust Law, 1988, that Bezeq abused its position in contravention of section 29A(a) and section 29A(b)(3) of the Law, and to impose financial sanctions on Bezeq and the CEO for an alleged breach of the provisions of section 29 of the Law and of the provisions of the foregoing sections. According to the notice, the evidence in its possession indicates that Bezeq allegedly made use of its market strength as a result of its control of the passive infrastructure and has placed obstacles in the way of new players who wish to use Bezeq's passive infrastructure to install communications networks that will be used to compete with Bezeq in providing communications services to consumers, such that this was likely to deter them and prevent them from setting up an independent fixed-line communications network or at least to delay them and limit the scope of the network. According to the notice, Bezeq's actions raise concerns of harm to the end consumer. The alleged acts of violation by Bezeq are blocking access to private areas and demanding the cutting of fibers. In the light of the foregoing, the Antitrust Commissioner is considering whether in respect of the two violations Bezeq abused its monopoly position, contrary to the provisions of the Law, and is considering imposing an overall fine of NIS 30,953,000 on Bezeq and NIS 736,800 on Bezeq's CEO. Prior to exercising her powers, Bezeq and the CEO have been granted the right to a hearing before the Commission until May 6, 2018. Bezeq and CEO intend to study the Authority's notice, exercise the right to a hearing and make their arguments before the Commissioner.

## The Telegraph Ordinance

The Telegraph Ordinance regulates the use of the electromagnetic spectrum, and applies to Bezeq's use of radio frequencies as part of its infrastructure. The set-up and operation of a system that uses radio frequencies is subject, under the Telegraph Ordinance, to grant of a license, and the use of radio frequencies is subject to the designation and allocation of a suitable frequency. The Telegraph Ordinance imposes license fees and fees for the designation and allocation of frequencies. The Government deals with the shortage of radio frequencies for public use in Israel (among other reasons, due to the allocation of a large number of frequencies for security purposes), by limiting the number of licenses granted for the use of frequencies, and providing incentives for efficient use of frequencies.

On March 22, 2018, the Economic Arrangements Bill (Amendments for Implementation of the Economic Policy for the 2019 Fiscal Year) 2018, was published, which includes an amendment to the Wireless Telegraph Ordinance. The amendment regulates a series of powers (some of which already exist in legislation or secondary legislation) with regard to wireless devices or base stations that are subject to the Ordinance and licensing, the power to grant licenses, power to determine that import and production of devices that comply with the conditions prescribed will not be subject to a license, but rather confirmation of conformity in a short track, powers to exempt from application of the Order, and power to apply the provisions of the Ordinance to devices for transmission of communication signals by electric wire. The powers of the frequencies committee and the supreme frequencies committee, and administrative

enforcement are also regulated in the amendment (monetary sanctions).

#### Setting up communications facilities

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

The classification of the facilities according to their technical variables and physical dimensions, which affect the determination of safety ranges for protection against the effects of radiation and the extent to which they protrude on the landscape, determine which facilities will be included in Part A of the NOP 36 and which in Part B of the Plan.

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

*NOP 36A.* Part A of NOP 36 deals with guidelines for erecting small and miniature broadcasting installations. Bezeq has obtained building permits for most of the small broadcast installations in accordance with NOP 36A. From time to time, a need arises to add broadcast 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 Communications Law, Bezeq believes that it is not obliged to obtain building permits for miniature broadcasting installations, which are “wireless access facilities” under those laws.

Since 2008, a draft amendment to NOP 36A (NOP 36/A/1) has been tabled. The draft amendment mainly deals with changing the guidelines for the licensing of small and miniature broadcast installations, including determination of different licensing tracks (fast and standard) depending on the location and the public safety range of each installation, and indemnification arrangements for compensation claims under Section 197 of the Planning and Construction Law. If adopted, the draft amendment may give rise to practical difficulties which could impede Bezeq’s ability to provide the public with some of the services it is required by law to provide.

*NOP 36B.* Part B of NOP 36 contains guidelines for setting up large broadcasting facilities. In the January 2008 draft plan (which was presented to the government for approval in August 2010, but is yet to be approved), the definition of a large broadcast facility was changed so that the licensing of broadcast facilities which prior to the proposed amendment were classified as large, would be according to NOP 36/A/1 (if and when approved). The change in definition for small and large broadcasting facilities may give rise to practical difficulties which could impede Bezeq’s ability to provide the public with the services it is required by law to provide.

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

NOP 36B has not yet been approved by the government and there is no certainty as whether it will be approved. As mentioned above, at this stage, before publication of the final text of the NOP, Bezeq is unable to estimate the full impact of the amendments on Bezeq.

NOP 56. NOP 56 came into force in June 2008, and regulates the manner of erection and licensing of communications facilities in the Administered Territories. The Plan contains transition provisions for facilities erected with a permit for small installations. The Plan also includes a requirement for production of a communications license and receipt of the consent of the Commissioner of Government Property at the Civil Administration.

Bezeq has arranged licensing for 76 installations in the Administered Territories, and is in the process of licensing the remaining five installations in the Administered Territories. Moreover, in November 2016, Bezeq received a notice from the Civil Administration (Communications Staff Officer) that it must also organize the licensing of facilities on the customer's premises (as opposed to the foregoing facilities in Bezeq's possession). Bezeq estimates that this means obtaining licensing for dozens of sites and it is reviewing its position on the subject.

*Exemption from a permit to add antennas to existing lawful broadcasting facilities.* 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, which are set out in the Planning and Building (Works and Buildings that are Exempt from a Permit) Regulations, 2014. Bezeq is taking the required steps to add antennas to its broadcast facilities according to the mechanism set out in these regulations.

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Pelephone

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

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

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

The issuance of an Erection Permit is contingent upon the assessment of the maximum radiation levels to which human beings and the environment are expected to be exposed from the radiation source when in operation, including in the event of a malfunction, and the required measures for limiting the levels of exposure of human beings and the environment to the expected radiation from the radiation source when operating, including implementation of technological means that are in use, or the Limiting Measures.

The issuance of an Operating Permit is contingent upon application of the Limiting Measures and to measuring the levels of exposure of human beings and the environment to the radiation generated while the radiation source is operating. The law further provides that the Operating Permit is contingent upon presentation of a license under the Communications Law and in certain cases, a construction permit pursuant to the Building and Planning Law. The Ministry of Environmental Protection supervises and monitors broadcast sites to check that they comply with the provisions of the Law. The law includes a punitive chapter under which the construction or operation of a source of radiation in contravention of the provisions of the permit and the construction or operation of a source of radiation without a permit, after having been warned in writing by the Commissioner, are strict liability offenses.

The regulation of the maximum permissible human exposure levels to radiation from a source of radiation and the safety ranges from communication broadcasting installations, including a limit on the placing of radiation masts on roof terraces, is pending in the Knesset's Interior Committee for Environmental Quality, as part of a proposed amendment to the regulations under the Non-Ionizing Radiation Law.

In January 2009, the Radiation Supervisor at the Ministry of Environmental Protection published guidelines regarding safety ranges and maximum permitted exposure levels with respect to radio frequency radiation, including from cellular antennas. Discussions are underway regarding these ranges following the World Health Organization's International Agency for Research on Cancer (IARC) announcement to the effect that radio frequency electromagnetic fields associated with the use of mobile phones may be carcinogenic to humans.

Cellular phones also emit non-ionizing radiation (also known as electromagnetic radiation). Consumer Protection Regulations (Information regarding Non-Ionizing Radiation from a Cellular Telephone) 2002, specify the maximum permitted radiation level for a cellular phone which is measured in units of Specific Absorption Rate (SAR) and requires that Pelephone informs its customers of such measurements. All the cellular phones that it markets comply with the relevant SAR standards.

*Pelephone's environmental risk management policy.* Pelephone conducts periodic radiation tests to ascertain its compliance with permitted operating and international standards. These tests are outsourced and carried out by companies authorized by the Ministry of Environmental Protection. Pelephone applies an internal enforcement procedure for monitoring implementation of the provisions of the Non-Ionizing Radiation Law, under the supervision of a senior manager.

*Transparency for consumers.* Pelephone is required to publicize and inform customers about the radiation sources that it operates and the mobile handsets that it supplies. The Radiation Supervisor of the Ministry of Environmental Protection publishes information on the Ministry's website concerning active cellular broadcast facilities and Pelephone publishes information on its website regarding the SAR levels emitted from cellular phones and Ministry of Health regulations regarding preventive steps to be taken when using cellular phones.

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*Communications Law.* The cellular services provided by Pelephone are subject to the provisions of the Communications Law and its regulations. The law authorizes the Director General of the Ministry of Communications to impose financial sanctions for violations of the provisions of the law and of orders and directives issued thereunder, and for violations of the terms of the license.

*Wireless Telegraph Ordinance.* The Telegraphy Ordinance regulates the use of the electromagnetic spectrum, including Pelephone's use of radio frequencies as part of its infrastructure. Setting up and operating a system using radio frequencies requires a license and the use of radio frequencies is subject to designation and allocation of a suitable frequency. The Telegraph Ordinance imposes license fees and fees for designation and allocation of frequencies. Due to the current shortage of frequencies for public use in Israel resulting from the designation of numerous frequencies for security uses and other uses, the government limits the number of licenses granted for the use of frequencies.

*Pelephone's mobile telephony licenses.* Pelephone's mobile telephony license and its general license for providing cellular services in Judea and Samaria are valid through September 2022. The primary provisions of Pelephone's mobile telephony license include:

Under certain circumstances, the Minister may modify the terms of the license, restrict or suspend it, and in certain instances revoke it.

The license is non-transferable and contains restrictions on the acquisition or transfer (including by way of a charge), directly or indirectly, of control or of 10% or more of any means of control in Pelephone, including a pledge on said means of control, unless the Minister has given prior consent.

Pelephone is obliged to provide interconnect services to all other operators on equal terms and it must refrain from any discrimination in carrying out such interconnect service.

Pelephone is required to refrain from granting infrastructure service priority to an affiliate licensee company (as defined in the license) over another licensee.

Pelephone may not sell, lease or mortgage any of the assets used for the implementation of the license without the consent of the Minister of Communications, other than certain exceptions as set out in the license.

In times of emergency, whoever is statutorily competent shall have the authority to issue instructions on Pelephone's mode of operation and/or manner of provision of services.

The license stipulates the types of payments Pelephone may bill its subscribers for cellular services and the reports that it is required to submit to the Ministry of Communications. The license also determines the Minister's power to intervene in tariffs, in certain cases.

The license obligates Pelephone to provide services at a minimum standard of service.

To secure Pelephone's undertakings and to compensate and indemnify the State of Israel for any damage that may be caused by Pelephone's acts, Pelephone is required to furnish NIS 84 million of bank guarantees to the Ministry of Communications.

*Ministry of Communications' decision regarding amendments to the license.* In January 2017, the Ministry of Communications issued new guidelines that include dozens of changes to the cellular operators' license regarding various issues relating to their ongoing handling of customers (including the way billing data is presented, method for joining services, pro rata charges, options for cancelling services, etc.). The applicability dates range from immediate applicability and up to six months from the date of issuance of the guidelines. Pelephone is reviewing these amendments and is preparing to apply them. Implementing the guidelines will require substantial preparation from operational, mechanical and other aspects.

*Site construction licensing.* Pelephone's cellular service is provided through cellular sites deployed throughout Israel in accordance with engineering requirements. The constant need to upgrade and improve the quality of cellular services necessitates setting up cellular sites, configuration changes and changes in existing deployment of antennas. Pelephone uses two main types of broadcast sites along two tracks: macro sites that require a building permit from planning and construction committees (see reference to NOP 36) and wireless access devices which do not require a building permit under the Communications Law and the Building and Planning Law.



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*Building permits for erecting a cellular broadcasting facility under NOP 36.* Licensing for the construction of cellular broadcast sites that require building permits is governed under NOP 36. The licensing procedure under NOP 36 requires, among other things, that the following permits be obtained: (i) an erection and operating permit from the Ministry of Environmental Protection; (ii) approval of the Civilian Aviation Administration in certain cases; and (iii) IDF approval.

In addition, in order to obtain a permit for erecting a cellular communications broadcasting facility a deed of indemnity must be submitted to the local committee for impairment compensation claims. Pelephone has deposited 234 such indemnity notes with various local councils.

Pelephone and its competitors continue to encounter difficulties in obtaining some of the required permits, especially permits from planning and construction authorities. In view of the criticism with respect to NOP 36 by various entities, a proposed amendment was published. The terms of the amendment are more stringent and onerous than the current version and could result in making the permitting process for cellular sites using this track more difficult. The amended NOP 36 is currently pending government approval.

*Access devices exempt from building permits.* The second track under which Pelephone sets up broadcast sites is the access installation track. The access installations are subject to obtaining specific radiation permits, but are exempt from obtaining a construction permit provided that they are erected under the conditions that are set out in the exemption provision. Some local authorities have disputed the applicability of the exemption provision on cellular network access installations and their use. Pelephone's position on the applicability of the exemption was accepted in a number of rulings and decisions by local affairs courts and the use of such facilities and the supporting equipment was approved. Appeals have been filed against some of these rulings and decisions, some of which are still pending before the Supreme Court.

A petition is pending in the Supreme Court regarding this exemption and other matters connected to the grant of permits for access installations tracks. Due to this petition, a draft Planning and Construction (Installation of a Cellular Wireless Communication access installation) Regulations, 2010, or the Access Installation Regulations, was published in 2010. The proposed Access Installation Regulations include restrictive conditions for application of the building permit exemption for a wireless access installation.

In view of the delays in the legislation process, the High Court of Justice issued a temporary injunction forbidding the erection of additional wireless access installations for holders of mobile telephony licenses under the exemption from obtaining a permit: however, cellular providers may, under certain conditions, replace access installations that are no longer in use or that are out of order.

Pelephone believes that if the Access Installation Regulations are approved as proposed, the option of using the building permit exemption track 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 increased obstacles to the construction of new broadcast sites and access installations and may have an adverse effect on the quality of the cellular network.

Pelephone currently operates 400 wireless access installations. A few sites constructed years ago still lack approvals from the Civil Aviation Administration and the IDF, even though applications for such approvals were submitted a long time ago. Consequently, Pelephone operates several broadcast sites that have not yet been granted the requisite building permits.

Construction of a broadcast site without a building permit constitutes a breach of the law and in some cases, it has led to the issuance of demolition orders, the filing of indictments and the initiation of civil proceedings against Pelephone and some of its officers. Pelephone has succeeded in avoiding the demolition of sites or 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 licenses. These understandings did not require admission of guilt or the conviction of Pelephone's officers. No assurance can be given that this situation will not continue in the future, or that demolition orders will not be issued or indictments filed because of the failure to obtain building permits.

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

*Standardization.* Pelephone conducts routine durability and quality control tests of its facilities. The quality control and supervision do not detract from Pelephone's responsibility towards its customers for the quality of the services it provides. Pelephone complies with the 2015 version of Israeli ISO 9001 requirements for mobile radio telephony (cellular) services and undergoes periodic inspections by the Institute of Quality & Control (IQC) to verify compliance with the standard. The current IQC approval is valid until December 2019. Once a year, an inspection is conducted to ensure that Pelephone's operations comply with the requirements of the standard. The last inspection was carried out in January 2018, and was successful.

*Material Agreements.* On July 14, 2016 a new online tender was held by the Ministry of Finance Accountant General for the provision of mobile telephony services to State employees. Pelephone, which has provided various mobile telephony services to the State and its employees for several years after winning previous RFPs also participated in this RFP and was awarded the tender. As a result, Pelephone will continue to be the primary provider of mobile telephony services for State employees.

On July 31, 2016 Pelephone and the State entered into an agreement under which Pelephone will provide mobile telephony services for an estimated 100,000 State employees for three years, with the State having an option to extend the agreement for up to 45 months in addition to the 36 basic months.

Bezeq International

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

Since 2013 the Ministry of Communications has conducted hearings with regard to the re-regulation of the international telecommunications market. Originally, the proposed regulation enabled any fixed-line domestic operator or mobile telephony operator to provide international telecommunications services as part of the service bundles they offer to their subscribers, with conditions, as well as international data transmission and configuration

services. Resolutions adopted subsequent to this hearing could have a significant impact on the structure of competition in the international telecommunications sector, and consequently also on the results of Bezeq International's operations. Bezeq International is unable to estimate the scope of the new regulations that are expected to be adopted subsequent to the hearing.

DBS

Operations of the broadcasting licensees are subject to extensive communications regulation, particularly the Communications Law, a strict licensing and monitoring regime and Ministry of Communications policy decisions. These operations are also under the ongoing supervision of the Council, which sets policy, makes rules and monitors many areas of the sector, including broadcasting content, compliance regarding original Israeli productions, broadcasting ethics, consumer protection and approval of the channels broadcast. Providing multi-channel television services by non-licensed broadcasters is not subject to the foregoing supervision.

In March 2017, the Minister of Communications adopted most of the recommendations of an advisory committee, or the Broadcasting Committee, regarding the issue of regulation of the broadcasting and content sector, which were published in 2016, and ordered measures for regulating them by legislation and regulation.

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Key recommendations to be adopted:

Definition of subscriber content providers

It was recommended that the video-visual content providers be defined according to three categories based on their market share out of the total revenues in the market and continuity of holding such market share: small providers, stable small providers and substantial providers. DBS will be classified, according to these recommendations, as a substantial provider.

Narrow regulation will apply to small providers under the license granted to them, and they will be able to select either commercials or subscription fees as their source of financing. Narrow and broad regulation will apply to stable small providers and substantial providers, which will include obligations to invest in and present original productions.

Original productions

The Committee recommended a gradual reduction whereby the obligation of the substantial providers (HOT and DBS) to invest in original productions will gradually decrease from 8% to 6.5% of their revenues by 2021 and investment in high-end productions will increase from 4% to 5% of the provider's revenues.

Independent channels

The recommendation of a previous committee regarding the division of ownership of rights in original productions was adopted, based on the principles set out in the report and with respect to the obligation of independent channels to sell original productions.

The committee recommended applying to the Antitrust Authority to grant general permission for collaboration between the owners of the independent channels for marketing and billing, so as to enable them to provide joint content bundles to subscribers.

## Regulatory requirements for commercial license holders

The committee recommended granting a commercial license under the Second Authority Law to anyone broadcasting a channel financed by commercials (including a cable broadcasting license that broadcasts a designated channel that will be subject to the supervision of the Second Authority) and the applicability of various types of regulation to different types of commercial license holders.

In February 2018, Amendment No. 44 to the Second Authority Law was enacted, according to which a licensee broadcasting a channel financed by commercials, including a licensee broadcasting a designated channel, will be under Second Authority supervision and subject to compliance with the conditions prescribed under the Law. The Law also imposed different regulatory rules on various types of commercial licensees, and empowers the Minister of Communications to decide that these licensees will not be charged transfer fees for a period of five years.

In addition to adopting the foregoing recommendations, several remaining issues included in the Filber Committee report, as decided by the Minister, are being reviewed by a special team (that has not yet submitted its recommendations), including:

### *Must sell requirements and competition in the content sector*

The committee sought to avoid situations whereby certain content, primarily sports programs, will be inaccessible to subscribers of certain license holders, that could constitute a competition barrier against these license holders. The Committee recommended imposing a must sell obligation on sports channels towards licensed content providers, and a must sell obligation on sports operators towards sports channels.

A government bill was discussed in the Knesset, which deals, among other things, with the must sell issue for sports content, including the granting of a license for broadcasting a sports channel or a significant sports operator by their producers. At present, DBS is unable to estimate whether the aforementioned bill will be implemented in legislation, or in what format, and it is also unable to estimate what effect it will have on DBS's business.

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### *Cancellation of the basic package and the initial basic package*

It was recommended that the basic packages offered by HOT and DBS be canceled and that the existing basic package be simultaneously upgraded to become a “core package” that should include, apart from the must sell channels that the license holders are obliged to provide by law, a sports channel and children’s channel that will be produced in Israel. In addition, 75% of the original productions will be available to all core package subscribers on VOD, which will be given equally to all core package subscribers. The price of the core package will be set by the substantial providers so that its current price will serve as an upper price limit and its reasonableness will be reviewed by the Minister and the experts. If the price is found to be unreasonable, the Minister will set a binding maximum price.

As the implementation of the Broadcasting Committee recommendations, including those adopted by the Minister, require legislative amendments and appropriate regulatory decisions, some of which are still in legislation processes that are not yet concluded, Bezeq and DBS are unable to assess whether these recommendations will in fact be implemented in legislation in full or in part, or in what format, and they are also unable to assess the effect of such legislative amendments on DBS’s business, if they will be adopted and the format for adopting them.

### Tariff control

The broadcasting license provides provisions regarding the types of fees the licensee may collect from its subscribers for services provided under the license, and those fixed in DBS price list. The vast majority of DBS subscribers subscribe to campaigns offering DBS services, including various combination content packages, related services, and receipt and installation of terminal equipment, at prices below the listed price. The vast majority of subscribers join special offers, which offer the services of DBS, including different combinations of content packages, related services, as well as the receiving and installation of terminal equipment at prices which below the listed price for all components of the special offer and they appear in the DBS price list. The Council chairperson may intervene in campaigns or reductions offered by DBS if he/she finds that they are misleading to the public or discriminate between subscribers.

Under Section 6(49) of the Communications Law, the license may stipulate maximum prices that can be charged to subscribers. No such prices have been set to date. In addition, the Minister may fix the price of the basic packages.

In 2016, the Council’s decision regarding its policy on special offers and applicability of transparency provisions came into effect, the highlights being:

Each primary deal (that includes 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, or the Initial Pricing Period, during which no price increase will be allowed.

Notwithstanding the foregoing, it will be possible to grant an additional discount during the first four months of the Initial Price Period.

It will not be possible to cancel a special offer during the Initial Price Period, unless permitted by law.

It will be possible to agree in advance with a subscriber on the price that will apply after the Initial Price Period, or the Continuation Prices, subject to certain conditions concerning the Continuation Prices and method for notifying the subscriber regarding their coming into effect and regarding the subscriber's rights to give notice of the termination of the agreement during the period of the Continuation Prices.

All primary deals must be published on the website (excluding special retention offers). It is not mandatory to publish bonuses and compensation offers.

Customer service centers must offer subscribers the best deals that are relevant to them.

The provisions of the decision will not apply at this stage to business customers or large- scale customers, including kibbutzim, workers' committees, etc.

The Council does not intend to prevent differentiation between special deals targeting new customers and those targeting existing customers.



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*Obligation to invest in local productions.* Under the provisions of the broadcasting license and the Council's decisions, in 2017 and 2018 DBS is required 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 Council, DBS is required to invest various amounts of such investments in different genres of local productions.

In December 2017 the Council decided to defer until 2019 applicability of its previous decision according to which the obligation to invest in local productions would increase to 9%. The Council further decided that in 2018 it will hold a further discussion to review the prevailing legislative status and the financial situation of the license holders, including the formula fixed in the decision for the rate of investment and will issue provisions if it deems fit.

*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 payment to be determined in the agreement, and lacking agreement - in exchange for a payment to be determined by the Minister, after consulting with the Council. In February 2018 an Amendment was enacted to the Law, regulating the Minister's power to require that the broadcasts of small

*Content of the broadcasts and obligations with respect to subscription*

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

The broadcasting license also includes provisions regarding the subscriber service terms, including discrimination prohibition.

*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 from owning a new program producer.

*General provisions regarding the broadcasting license.* The Minister and the Council have parallel authority to amend the broadcasting license. The Minister was authorized to cancel or postpone the broadcasting license for causes set out in the Communications Law and the broadcasting license. The Communications Law and broadcasting license stipulate restrictions on the transfer, attachment and encumbrance of the broadcasting license and any of the assets of the broadcasting license. The broadcasting license requires receipt of the approval of the Minister for specific changes in the holding of the means of control in DBS and imposes a reporting requirement regarding the holders of the means of control; hurting competition by way of an agreement, arrangement or understanding with a third party in terms of provision of broadcasts and services is prohibited, unless approved in advance and in writing by the Council; the obligation to file reports to the Ministry of Communications was defined as well as conditions regarding the regulation of the activity of the licenses; an obligation was stipulated to provide bank guarantees to the Ministry of Communications in the amount of NIS 40 million (principal) to secure DBS's undertakings under the license. There is a dispute between DBS and the Ministry concerning the linkage mechanism of the guarantees which, according to the Ministry of Communications should currently be NIS 40 million.

*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.

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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, the adverse impact of such restrictions on DBS's results may increase if the restrictions on Bezeq's collaboration with DBS remain in place.

Regulation of the transmission of video content via media infrastructure.

DBS believes that the VOD services that it provides via the internet are not subject to the prevailing regulations applicable to multi-channel satellite television broadcasts or other regulations under the Communications Law, similar to the current regulatory situation for online television services (such as those offered by Cellcom, Partner and by DBS regarding its yesGo and Sting TV services). Nonetheless, from the Council's various decisions it appears that the Council believes it is authorized to also regulate DBS's VOD services. If the foregoing regulation of the transmission of video content via the internet will be implemented, it could 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 2017, 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) Juniper Networks for Metro transmission.

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.

On October 1, 2016, a new agreement came into effect with Apple Distribution International for the purchase and distribution of iPhones, under which Pelephone agreed to purchase a minimum annual quantity of phones over an additional period of three years at the manufacturer's current prices on the date of purchase. Pelephone believes that similar to prior years, these quantities will constitute a significant portion of the devices it expects to sell during the term of the contract.

The UMTS/HSPA and LTE network infrastructure equipment are manufactured by Ericsson. Pelephone has long-term agreements with Ericsson for maintenance, support and upgrading of software for the UMTS/HSPA and an agreement for the deployment of the 4G LTE networks with Ericsson. Pelephone believes that it may become dependent on Ericsson regarding support for the 4G LTE network and its expansion. In addition, the cellular network uses transmission networks, for which Bezeq is Pelephone's main supplier.

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Bezeq International

Bezeq International is dependent upon Bezeq for domestic capacity to provide its services. Most of the international capacity that Bezeq International uses is transmitted via its wholly owned submarine cable. As backup, Bezeq International uses capacity purchased from Med Nautilus. Under its agreement with Med Nautilus, Bezeq International purchased indefeasible rights of use to a particular non-specific part of the communication capacity transferred by the undersea cable system operated by Med Nautilus between Israel and Europe for a period of up to 15 years from the date on which it started using this capacity (with an option to extend the period of use). The periods of use are at least until 2022 – 2027, depending on the date of the start of use of the capacity. Bezeq International paid for these rights of use in a lump sum payment shortly before the date on which it started using the capacity.

DBS

Terminal Equipment.

DBS installs a receiver dish and other terminal equipment in its subscribers' homes, including decoders enabling reception of broadcasts and smart cards for decoding the encrypted broadcasts. The decoders are leased to subscribers for a fixed leasing fee paid during the entire period the services are received, or are lent to subscribers.

DBS purchased HD Zapper and 4KPVR decoders manufactured by Altech Multimedia International (Pty.) Ltd, or Altech. The 4KPVR decoders were purchased from Draco Inc. and the HD Zapper decoders were purchased mainly from OSI Maris Ltd, or OSI, which is an affiliate of Draco Inc., and a small number were purchased from Altech. The cumulative purchase volume from Draco and OSI in 2017 amounted to NIS 58 million. DBS is dependent on the decoder suppliers and on Altech. Purchasing decoders of other manufacturers does not involve in itself substantial additional cost, however it will require significant preparation for engaging with such other manufacturer (and possibly also another supplier) and modification of new decoders that will be manufactured for DBS's broadcasting and distribution. This could, particularly in the event of short notice termination of the contract, cause DBS loss of income. Switching from one supplier to another for purchasing Altech decoders is expected to involve a preparatory period required for engaging in alternative contracts and changes in the supply and maintenance system.

Terminal equipment for Sting TV service

Sting TV can be viewed via a wide range of terminal equipment, including via a streamer. DBS sells a streamer manufactured by Technicolor Delivery Technologies SAS that are imported by OSI, however the service can also be viewed via other compatible streamers.

*Broadcasting equipment and computer and communications systems.* DBS has its central broadcasting center in Kfar Saba and a secondary broadcasting center close to Re'em Junction from where it transmits its broadcasts. The broadcasting centers operate reception and broadcasting equipment, as well as computer and communication systems. The secondary broadcasting center is operated by a third party which provides services for operating and maintenance of the secondary broadcasting center for DBS under a contract which is valid until the end of 2018 (with DBS having an extension option).

*Operating and encryption systems.* DBS purchases from Cisco Group companies, or Cisco, 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 and applicable licenses for use in the systems and in the decoders, under a frame agreement. At present, these services are also provided with regard to the Sting TV service.

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 and streamers of each type, and the ratio of part of the payments is fixed in the agreement as minimum annual amounts. The term of the agreement with Cisco is until December 2020 (with an automatic extension mechanism, unless one of the parties decides to end the agreement, subject to prior notice period as set in the Cisco agreement. In 2017, DBS's payments to Cisco were not material. DBS is dependent upon the regular supply of these services and products, including integration of the various decoders that DBS uses for its operating system.

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*Computerized billing system.* DBS uses software and computer systems for managing its subscriber agreements, including its billing and collection system. In this context, DBS engaged in agreements with NetCracker Technology Solutions Ltd. and NetCracker Technology EMEA Limited, or together, NetCracker.

DBS is dependent upon NetCracker's system and services due to their importance for managing and monitoring services and content purchased by subscribers and for billing its subscribers. System malfunctions or shutdown of these services to DBS could cause operational difficulties until the fault is repaired or the system/supplier is replaced. The current project agreement for services and technical support is until the end of 2019. In 2017, DBS's payments to NetCracker were not material.

Space segment leasing agreement

Under the agreement with Spacecom, or the 2013 Agreement, DBS leases Amos satellite space segments. The 2013 Agreement's term expires in 2028, whereby in the initial stage, the space segments that were available for DBS to use were on Amos 2 and Amos 3 satellites.

According to the provisions of the 2013 Agreement, once Amos 2 ceases to operate, DBS is supposed to lease space segments on the Amos 3 satellite until 2022 and the Amos 6 satellite that was scheduled to be launched into space in the third quarter of 2016 and whose useful life was expected to end in 2028.

In September 2016, Spacecom reported that an explosion occurred during ground fueling of the launch rocket for the Amos 6 satellite causing total loss of the satellite, which was scheduled to replace the Amos 2 satellite for DBS's satellite broadcasts and space activities

Subsequently, in April 2017, the shareholders of Bezeq and of Spacecom approved an addendum to the 2013 agreement between DBS and Spacecom, or the 2017 Agreement.

The term of the 2017 Agreement is until December 31, 2028 (without changing the term of the 2013 Agreement), subject to the early termination options set out below.

The satellites on which DBS will lease space segments are: (a) Amos 3 satellite - that serves DBS at the present time; (b) Amos 7 satellite - an existing satellite on which Spacecom owns rights to lease space segments and which, according to Spacecom, positioning was completed at the end of February 2017; (c) Amos 8 satellite - a new satellite that is expected to serve DBS once it begins operating (regarding which Spacecom undertook to make all reasonable effort to ensure that this will be no later than February 2021).

Leased space segments - during the term of the agreement (and subject to unavailability) DBS will lease 12 space segments from Spacecom on two different satellites, according to a division as set in the agreement. The agreement also regulates the availability of alternative segments to the leased space segments during the term of the agreement, under the terms and restrictions set in the agreement.

Cost of leasing - the estimated total nominal cost for the duration of the term of the lease is USD 263 million, reflecting an average annual cost of USD 21.9 million, subject to discount and reimbursement mechanism as set out in the agreement.

Early termination of the agreement: The agreement stipulates a right for early termination without cause, subject to prior notice of 12 months and payment of a consideration according to a mechanism set in the agreement. The right for early termination was also provided for a delay in the agreement for the building of Amos 8 coming into effect, and for early termination at the end of Amos 3 useful life, due to unavailability of Amos 8 satellite, without requiring payment of any compensation and according to the conditions set in the agreement.

In April 2017, the Amos 2 satellite ceased its commercial activities. At present, DBS uses space segments on the Amos 3 and Amos 7 satellites pursuant to the 2017 Agreement. Leasing fees in 2017 amounted to NIS 78 million.



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In March 2018, Bezeq's audit committee and Board of Directors approved an amendment to be entered into the 2017 Agreement, according to which during the period from April 2018 through September 2018 (and for the duration of an additional year, if the parties agree), in place of one of the space segments leased by DBS on the Amos 3 satellite DBS will lease instead on the Amos 7 satellite, and for this swap, DBS will be entitled to a monthly discount of USD 80,000 during the interim period. This amendment has not been signed as yet.

DBS is dependent on Spacecom as the exclusive holder of the rights and the sole provider of space segments used by DBS. Spacecom is also responsible for operating the space segments.

## Property

## Bezeq

Bezeq's real estate assets derive from two sources: assets transferred to Bezeq by the State in 1984 under the Asset Transfer Agreement, and assets in which the rights were purchased or received by Bezeq after that date, including assets that it leases from third parties.

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

The following is a list of Bezeq's assets in accordance with the material rights on the asset. Furthermore, Bezeq has an interest (migration rights, etc.) in other real estate (such as for the construction of offices and 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 | 316              | 881                                | 121                          | Of this, 308 properties cover an area of 848 thousand sq. m. and 95 thousand sq. m. built up are for communication needs, and the remainder for administration needs. |

|   |   |        |                        |  |
|---|---|--------|------------------------|--|
|   |   |        |                        | 25 are jointly owned with the Ministry of Communications and/or the Israel Postal Company 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 provisions of the agreement, and to separate joint debits and systems. |
| Possession (authorized/possession rights by law)  | 40  | 1.5    | 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   | 324   | 26     | 64                     | 308 properties, of which 14 thousand sq. m. built up are for communication needs and the remainder for administration needs. Of which space, approximately 2 sq.m. of built up space is sublet.  |
|   |   |        |                        | These are rooms for cables and installations for residential communications.   |
| Miscellaneous rights in 'residential rooms'       | 2,160   | N/A    | 27 (based on estimate) | For most of the assets, the rights are for use granted to Bezeq under the Communications Law and regulations thereunder, and there are no written rights arrangement with the property owners. In Bezeq's estimation and based on past experience, this does not create material exposure.                                 |
|   |   |        |                        | The data was revised following data cleansing work recently completed by Bezeq.  |
| Right to receive areas for warehouses and offices | A property in Sakia (near the Mesubim junction) | 70 net | -                      | The property was sold.   |

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### Registration

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

### Real estate settlement agreement

On March 10, 2004, a settlement agreement which was signed on May 15, 2003 among Bezeq, the Administration and the State, or the Settlement Agreement, was validated as a court decision. The agreement concerns most of the real estate assets transferred to Bezeq under the asset transfer agreement signed for commencement of Bezeq's business activity. The Settlement Agreement stated that the assets remaining in Bezeq's possession have the status of capitalized lease, and subject to the execution of individual lease contacts, Bezeq will be entitled to make any transaction in the properties and to enhance them. The Agreement sets out a mechanism for payment to the Administration for enhancement actions in the properties (if undertaken), beyond the rights according to plans approved by 1993 as set out in the Agreement, at the rate of 51% of the increase in value of the property following the enhancement (and less part of amounts paid for a betterment levy or to the administration for an increase in value, if a betterment levy was paid). The Settlement Agreement also states that 17 assets must be returned to the State, through the Administration, on various dates (up to 2010), and on the terms enumerated in the Settlement Agreement. Bezeq returned 15 properties and two additional properties will be returned after Bezeq receives substitute properties, as provided in the Settlement Agreement.

### Sale of real estate

Following a new review by Bezeq's management, the Board of Directors of Bezeq approved further sales of assets which are inactive and/or which can be relatively easily vacated without incurring significant expenses, in accordance with a list presented to it from time to time. The migration 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 migration. During 2017, Bezeq sold (in addition to the sale of the Sakia property) 12 properties on a total area of 11,000 sq.m. of land and 26,000 sq.m. built up, for a total sum of NIS 97 million.

On January 21, 2018, Bezeq entered into an agreement for the sale of the Sakia property to Naimi Towers Ltd for a total of NIS 497 million plus VAT. This amount may increase up to a total of NIS 550 million if the buyer, according to its rights under the agreement, postpones the payment date of up to two thirds of the consideration to December 31, 2022. According to Bezeq's estimate, it will record a capital gain in the amount of NIS 400 million on the date it is

allowed to recognize a gain according to the accounting rules, and the final amount of the capital gain will depend on the amounts of the fees and levies imposed on Bezeq for the sale of the property. Bezeq is also expected to record financing revenues of up to NIS 50 million, depending on the date of receipt of the payments for the sale of the property.

In recent years, Bezeq sold land assets that were inactive or could be evacuated relatively easily and recorded material capital gains for such sales. Bezeq has completed the sale of most of the properties (in terms of value) which met this definition and also intends to complete the sale of the remaining properties of this type in the forthcoming years. Selling these remaining properties is likely to generate additional capital gains for Bezeq in material amounts (although at a substantially lower amount than the capital gains recorded by Bezeq in recent years).

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It is emphasized that the foregoing also relates to real estate assets for which a concrete sales decision has not yet been made and there can be no certainty regarding the timing of their sale (if at all). Furthermore, the sale of some of the properties may involve difficulties, including a lack of demand or various planning restrictions.

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 2018. 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 utilizes Veraz SoftSwitch switches. These switches are used to route Bezeq International's voice traffic. The value-added services, including dialing cards, are based on an intelligent network. Bezeq International's technological infrastructures, which support voice, data and Internet systems, are deployed at six sites, inside and outside Israel, to provide services with high survivability.

Bezeq International has long-term agreements for the lease of the two main buildings in which it is based. The lease period for one of the buildings is until March 2024, subject to 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 leases several real estate properties for its operations. Its head offices and main broadcasting center are located on leased land in Kfar Saba. The lease periods for these sites expire in 2019 and the lease periods for the other properties leased by DBS vary from 2.5 to 5.5 years (these periods are based on the assumption that DBS will exercise its options to extend these leases).

## 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."

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### Broadcast Rights and Copyrights

DBS has the broadcast rights of two types of video content.

Content purchased from third parties, including content and channels, that own the broadcasting rights thereto;

Content which DBS invests in producing (in full or in part), and in addition to the actual right to include the content in its broadcasts, DBS generally also has rights in such content, at the rates specified in agreements with the producers. In most instances, DBS is also entitled to issue authorizations to use the rights and share the revenues stemming from additional use of the content, in addition to DBS broadcasting thereof

The broadcast and distribution of content by DBS over various media involves payment of royalties to the owners of copyrights and performance rights to music, sound recordings, scripts and directing of content, and for secondary broadcasting included under the Copyright Law, 2007 and the Performers and Broadcasters Rights Law, 1984. Such royalties are paid to several organizations operating in Israel, for collecting royalties on behalf of the owners of the intellectual property rights, under blanket licenses. Royalty payments under these licenses are, at times, based on a fixed payment and sometimes on various pricing methods, and with respect to some of the organizations, DBS may be required to pay additional amounts as royalties for transmitting content via certain media, and in amounts that DBS estimates are not expected to be material.

Given the many content providers from which DBS purchases broadcast rights, DBS does not have a main content provider and is not materially dependent on any single content provider. However, with respect to broadcasts of Israeli sports, at the date of this report DBS is dependent on the purchase of the broadcast rights for local sports channels from two providers, and the term of the contract with one of them terminates at the end of 2018.

In 2017, DBS paid NIS 248 million for the purchase of broadcast rights.

### Employees

On December 31, 2017, we had six 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.

As of December 31, 2017, the Bezeq Group employed 11,677 persons, of whom 5,582 persons were employed by Bezeq, 2,551 persons were employed by Pelephone, 1,864 persons were employed by Bezeq International and 1,680 persons were employed by DBS.

## Bezeq

The number of Bezeq employees as at December 31, 2017 was 5,582 (compared with 5,649 employees at the end of 2016). The decrease in the number of employees in 2017 compared with 2016 stems primarily from streamlining as a result of continued improvement of processes and technological developments in the interface with the customers. 90% of Bezeq's employees are employed under a collective agreement (out of which 60% are permanent employees and the remainder are non-permanent employees). The remainder of Bezeq's employees (10%) are employed under personal agreements, not under collective agreements.

Bezeq has 13 directors, 6 recommended directly by B Communications, 5 external directors and 2 independent according to Israeli law.

The members of the senior management and members of the Bezeq Group's headquarters are employed under personal agreements that include pension coverage, payment of bonuses based on targets, and advance notice months before retirement.

Labor relations in Bezeq are regulated in collective agreements between Bezeq, 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.



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In December 2006, a special collective agreement was signed between Bezeq, the union and the Histadrut, or the Special Collective Agreement, regulating labor relations in Bezeq following the transfer of control in Bezeq from the State to Ap.Sb.Ar. Holdings Ltd., Bezeq's previous controlling shareholder, and set a new organizational structure for Bezeq.

Under the terms of the Special Collective Agreement, all the agreements, arrangements and traditional behavior in Bezeq prior to execution of the Special Collective Agreement, including the mechanism for linkage of wages to the public sector, would continue to apply only to the veteran permanent employees of Bezeq to which the Special Collective Agreement would apply, subject to changes inserted specifically into the Special Collective 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 Special Collective 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.

During the term of the Special Collective Agreement, two employee-directors who are proposed by the union will serve on Bezeq's Board of Directors (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.

The Special Collective Agreement also defines the "new permanent employee", whose terms of 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). As part of the retirement arrangements, Bezeq may, at its discretion, terminate the employment of 203 permanent employees (including new permanent employees) each year (relevant for 2017-2021).

The latest amendment to the Agreement was approved by Bezeq's Board of Directors on August 30, 2015, under which the Agreement and the retirement arrangement were extended to December 31, 2021.

In 2017, 80 permanent employees retired under the early retirement.

On March 22, 2017, the Board of Directors of Bezeq approved an expansion of the Bezeq Group's headquarters staff to assist the Board of Directors in implementing the tasks involved in setting out the strategy and oversight conferred upon it according to the Companies Law, and also in exercising certain performance and management powers stemming from assuming these powers with respect to the activity of the subsidiaries and activities that may be

absorbed by Bezeq in future, insofar as they are absorbed, within the context of mergers and acquisitions. This includes a decision to appoint a director of strategy and business development for the Bezeq Group and the appointment of a legal advisor.

*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 is implemented through alternative entities in place of Makefet Fund. On April 24, 2014, Bezeq and Menorah Mivtachim Insurance Ltd. signed an agreement regulating pension payments for the early retirement of Bezeq employees and provision for the payment of 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 Commissioner of Insurance approved the policy and it entered into force on March 31, 2016. Accordingly, as of May 1, 2016, Menorah issued policies for retiring employees, and payment of the annuities and related payments is made on the basis of these policies. The agreement period is until the end of 2016 and in February 2017 it was extended for a further three years.

Management agreement. On June 1, 2016, Bezeq entered an agreement between Bezeq and Eurocom Communications granting Bezeq regular management and advisory services for a period of three years as from June 1, 2016 in consideration of NIS 6,432 thousand per year. In view of the Investigation, payments under the existing management agreement are being withheld. Eurocom Communications is currently not providing chairperson and consultation services.

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Labor disputes

In response to the Ministry of Communications Notice to Bezeq to allow certain contractors to access Bezeq's infrastructures to perform work for the service providers instead of Bezeq employees, on October 21, 2017, Bezeq received a letter from the Chairman of the State Employees Union and holder of the Bezeq portfolio in the Histadrut regarding "a labor dispute with respect to the entry of workers who are not Bezeq employees for core work". The letter states that the labor dispute declared by the Histadrut in December 2016 is still in effect, and that if an attempt is made by external entities to carry out work in the normal course of Bezeq's activity, such that the work is performed by workers who are not Bezeq employees (including contractor workers), the Histadrut will be forced to activate the aforementioned labor dispute. Subsequently, on October 25, 2017, the chairperson of Bezeq's labor union informed Bezeq of a cessation of development work on Bezeq's infrastructures, whether for Bezeq or for other communications providers. Bezeq applied to the Labor Court to issue an order instructing the workers to refrain from the cessation of work and to immediately return to full, regular work. At a hearing which took place on November 2, 2017 (attended by the Acting Director General of the Ministry of Communications, who was summoned to the hearing by the court), the court ruled that the employees have the right to protest against the direct harm they foresee to their employment conditions, but may, nevertheless, take only short and limited organizational measures. Consequently, the court allowed the workers to take reasonable organizational measures for two days only, in the context of which the employees may refrain from cooperating with external contractors on infrastructure work related to the dispute, but will be precluded from taking proactive steps to thwart or disrupt the performance of the work by a third party. An application for permission to appeal this decision, which was filed by the Histadrut representatives, was dismissed on November 27, 2017.

On December 19, 2017, Bezeq received notification of a strike or shutdown in accordance with the Settlement of Labor Disputes Law 1957, organized by the Histadrut, as of January 2, 2018. According to the notice, the issues under dispute are:

The Histadrut's demand to stop the serious harm to the safety and health of workers who are forced to work in poor safety conditions while endangering their health and in violation of Bezeq's obligations towards them.

A demand for negotiations with respect to the employees' exposure to disciplinary proceedings as a result of external contract workers' uncontrolled activity on the infrastructure.

The Histadrut's demand to sign a collective agreement that would ensure employment security and the preservation of rights and working conditions, with Bezeq undertaking that there will be no implications for the employment security and working conditions of the employees due to the entry of contractors to Bezeq's premises and facilities.

Bezeq employees took certain actions in the course of these labor disputes and caused harm of varying intensity to Bezeq's ongoing operations, while Bezeq acted with all means at its disposal, including by appealing to the Labor Court to stop the employee actions.

On December 19, 2017, another notice was received at Bezeq's offices of a strike or shutdown, in accordance with the Settlement of Labor Disputes Law 1957, organized by the Histadrut, as of January 14, 2018. According to the notice, the issue in dispute is "a demand to negotiate and sign a collective agreement regarding the implications of the deal being formulated for the transfer of control over the employees in Bezeq."

### Pelephone

The table below provides data with respect to the number of Pelephone employees at December 31, 2017 and December 31, 2016:

| <b>Department</b>                         | <b>Number of employees</b> |                          |
|---|----------------------------|--------------------------|
|   | <b>December 31, 2017</b>   | <b>December 31, 2016</b> |
| Management and HQ                         | 217                        | 189                      |
| Marketing                                 | 51                         | 48                       |
| Business customers                        | 1293                       | 1,367                    |
| Business customers                        | 349                        | 353                      |
| Logistics and terminal equipment division | 202                        | 202                      |
| Engineering and information systems       | 439                        | 435                      |
| Total                                     | 2,551                      | 2,594                    |

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The total number of employees in the above table includes employees employed in part time positions. The total number of positions at Pelephone at December 31, 2017 was 2,139 and 2,176 at December 31, 2016.

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.

On April 27, 2017, a new collective labor agreement was signed by Pelephone, the Histadrut and Pelephone's workers' committee, replacing the collective agreement that expired on December 31, 2016. The main points of this agreement are:

The agreement applies retroactively from January 1, 2017 and up to December 31, 2019. After this date, the agreement will be extended automatically for 18-month periods, unless one of the parties gives notice that it wishes to change it.

The inclusion of mechanisms which include the Committee in decisions concerning the termination of permanent employees, the implementation of disciplinary measures against them and restructuring of the organization, while allowing for administrative flexibility which would make it possible to operate in a competitive and dynamic market.

The determination of quotas for streamlining-related dismissals and annual salary increments, various financial benefits and annual bonuses based on Pelephone's business results to be given to employees during the term of the Agreement. The ongoing costs of the agreement are not materially different from the previous collective agreement.

Inventory of positions

Under the collective agreement, Bezeq employed security and sanitation staff who were previously employed as outsourcing staff.

The total number of employees in the above table includes employees employed in part time positions. The total number of positions at Pelephone at December 31, 2017 was 2,139 (at December 31, 2016 - 2,176).

#### 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. The rest of Pelephone's employees are employed under a monthly agreement.

#### Announcement of a labor dispute

On January 31, 2018 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 a strike starting February 15, 2018. According to one statement, the matter under dispute is the workers demand for consultation and negotiations regarding the sale of the controlling shares of Bezeq to new controlling shareholders and the arrangement of their rights under it. According to another statement, the matters under dispute are: organizational and structural changes, expansion of services and outsourcing that impact the employment security of the Bezeq's employees, without prior negotiations with the representatives of the employees.

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## Bezeq International

The following table provides data relating to the number of persons employed by Bezeq International, including outsourced employees, at December 31, 2017 and December 31, 2016:

| <b>Department</b>                 | Number of employees |                   |
|-----------------------------------|---------------------|-------------------|
|                                   | December 31, 2017   | December 31, 2016 |
| Head office employees             | 1,097               | 1,169             |
| Sales and service representatives | 767                 | 736               |
| Total                             | 1,864               | 1,905             |

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.

On January 12, 2016 Bezeq International signed a collective agreement with the New General Federation of Workers and the Bezeq International Workers Committee that expires on December 31, 2018. 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 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, 2017 and December 31, 2016:

|                       | Number of employees |                   |
|-----------------------|---------------------|-------------------|
|                       | December 31, 2017   | December 31, 2016 |
| Head office employees | 503                 | 532               |
| Sales                 | 241                 | 270               |
| Customer Division     | 936                 | 951               |
| Total                 | 1,680               | 1,753             |

DBS is party to a collective agreement between the New National Labor Federation (the representative labor union at DBS) and the DBS workers' committee from 2016. The agreement is in force for three years (from September 2016) and thereafter will automatically be renewed for further period of 12 months each time, unless one of the parties give notice of their intention to change the agreement. The agreement applies to all DBS employees (other than a certain number of employees and managers from department head and higher rank). The agreement provides, among other things, the periods after which DBS employees will become tenured employees, mechanisms for involving the Workers Committee in decision making concerning employment and termination of the employment of tenured employees at DBS, as well as annual wage increments and other general benefits DBS will grant to its employees during the term of the agreement.



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DBS employees are employed under personal employment agreements, on the basis of a monthly salary or an hourly wage, with some of the employees also entitled to performance-based compensation. The employment agreements are generally for an undefined period, and each party may terminate the agreement by prior notice in accordance with the agreement or the law.

Following the announcement by the National Labor Federation in November 2017 of a labor dispute and the intention to strike, which, according to the announcement, is due to the proposed structural reforms and changes in DBS, that includes proposed layoffs, a special collective agreement was signed in January 2018. Under the special collective agreement, the parties will act to implement the structural reforms and changes according to a mechanism set up in the collective agreement.

C. Organizational Structure

Mr. Shaul Elovitch, Mr. Yossef Elovitch, Eurocom Communications and Eurocom Holdings (1979) Ltd. may be deemed the beneficial owners of 11,633,966 ordinary shares of our company that are held by Eurocom Communications (1,125,000 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.

On April 22, 2018, the Tel Aviv-Jaffa District Court issued a liquidation order for Eurocom Communications effective May 3, 2018. According to the order, the official receiver will be the temporary liquidator of Eurocom Communications until the appointment of a permanent liquidator, and Attorneys Pinchas Rubin, Amnon Lorch and Uri Gaon were appointed as special managers. The liquidation order does not currently constitute a "change of control" regarding the Control Permit at this point but this may change in the future. Separately from the question of the Control Permit, Shaul Elovitch's effective control of Eurocom Communications is questionable.

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 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.

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### 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 and inflation, 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’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, 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.

### 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;

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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, 2015, 2016 and 2017, the Bezeq Group companies invested NIS 1.6 billion, NIS 1.4 billion and NIS 1.5 billion (approximately \$441 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.

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### 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 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 and Inflation

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.

The Israeli annual rate of inflation (deflation) amounted to 0.4%, (0.2%), and (1.0%) for the years ended December 31, 2017, 2016 and 2015, respectively. The annual appreciation (devaluation) of the NIS in relation to the U.S. dollar amounted to 9.8%, 1.5% and (0.3%) for the years ended December 31, 2017, 2016 and 2015, respectively. We cannot predict any future trends in the rate of inflation or deflation in Israel or the rate of appreciation or devaluation of the NIS against the U.S. dollar. A devaluation of the dollar in relation to the NIS has the effect of reducing the NIS value of any of our expenses or liabilities which are payable in dollars, unless those expenses or liabilities are linked to the dollar. This devaluation of the dollar also has the effect of decreasing the NIS value of any asset which consists of

dollars or receivables payable in dollars, unless the receivables are linked to the dollar.

#### Effective Corporate Tax Rate

Israeli corporate tax at the standard rate in 2018 and onwards is set at 23% (the corporate tax rate was 25% and 24% in 2016 and 2017, respectively)

As of December 31, 2017, we had tax loss carryforwards in the amount of NIS 165 million (approximately \$48 million) and capital loss carry forwards of NIS 335 million (approximately \$97 million). Under current Israeli tax laws, tax loss carryforwards do not expire and may be used to offset 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 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.



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**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 Pelephone 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. Pelephone 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.

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*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 on our redeemed Senior Secured Notes, 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, 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 corporate tax rate in Israel was 24% in 2017, 25% in 2016 and 26.5% in 2015. Effective as of January 1, 2018 the tax rate is 23%.

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## Results of Operations

The following table sets forth our consolidated results of operations in NIS in millions and as a percentage of revenues for the three years ended December 31, 2017:

|  | Year ended December 31, |       |          |       |         |       |
|--|-------------------------|-------|----------|-------|---------|-------|
|  | 2015                    |       | 2016     |       | 2017    |       |
|  | NIS                     | %     | NIS      | %     | NIS     | %     |
| Revenues   | 9,985                   | 100 % | 10,084   | 100 % | 9,789   | 100 % |
| Depreciation and amortization                          | 2,131                   | 21 %  | 2,161    | 21 %  | 2,117   | 22 %  |
| Salaries   | 1,960                   | 20 %  | 2,017    | 20 %  | 2,008   | 21 %  |
| General and operating expenses                         | 3,878                   | 39 %  | 4,024    | 40 %  | 3,911   | 40 %  |
| Other operating expenses (income)                      | (3 )                    | - %   | 21       | - %   | 149     | 1 %   |
| Operating profit                                       | 2,013                   | 20 %  | 1,861    | 18 %  | 1,604   | 16 %  |
| Finance expense  | 759                     | 8 %   | 1,108    | 11 %  | 625     | 6 %   |
| Finance income   | (164 )                  | (2 )% | (133 )   | (1 )% | (75 )   | (1 )% |
| Profit after financing expenses, net                   | 1,418                   | 14 %  | 886      | 10 %  | 577     | 5 %   |
| Share of losses (profit) in equity- accounted investee | (12 )                   | - %   | 5        | - %   | 5       | - %   |
| Profit before income tax                               | 1,430                   | 14 %  | 881      | 8 %   | 1,022   | 11 %  |
| Income tax expenses                                    | 347                     | 3 %   | 442      | 4 %   | 347     | 4 %   |
| Profit for the year                                    | 1,083                   | 11 %  | 439      | 4 %   | 675     | 7 %   |
| Profit (loss) attributable to owners of the company    | 87                      | 1 %   | (202 )   | (2 )% | (15 )   | (-)%  |
| Profit attributable to non-controlling interests       | 996                     | 10 %  | 641      | 6 %   | 690     | 7 %   |
| Net profit for the year                                | 1,083                   | 11 %  | 439      | 4 %   | 675     | 7 %   |
| Basic earnings (loss) per share                        | 4.54                    | --    | (10.52 ) | --    | (0.82 ) | --    |
| Diluted earnings (loss) per share                      | 4.47                    | --    | (10.52 ) | --    | (0.82 ) | --    |

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.

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The following three tables provide summary financial information regarding the operating results of the individual operating segments of the Bezeq Group on a consolidated basis for the three years ended December 31, 2017. Amounts are in NIS in millions. Beginning March 23, 2015, Bezeq began to consolidate the operations of DBS in its consolidated financial statements.

2017

|  | Domestic<br>fixed-line<br>communications | MRT<br>cellular<br>communications | International<br>telecommunications<br>internet and<br>ISP<br>services | Multi-<br>Channel<br>Television | Others       | Adjustments<br>to<br>consolidated <sup>(2)</sup> | Consolidated  |
|--|--|-----------------------------------|--|---------------------------------|--------------|--|---------------|
| <b>Total Revenues:</b>   |  |                                   |  |                                 |              |  |               |
| From externals   | 3,953                                    | 2,500                             | 1,466  | 1,650                           | 220          | -  | 9,789         |
| From Bezeq's other segments of operation   | 291                                      | 46                                | 71   | -                               | 17           | (425 )   | -             |
| <b>Total revenues</b>  | <b>4,244</b>                             | <b>2,546</b>                      | <b>1,537</b>   | <b>1,650</b>                    | <b>237</b>   | <b>(425 )</b>                                    | <b>9,789</b>  |
| <b>Total attributed costs:</b>   |  |                                   |  |                                 |              |  |               |
| Variable costs attributed to the operating segment <sup>(1)</sup>                      | 690                                      | 1,319                             | 805  | 626                             | 179          |  |               |
| Variable costs attributed to the operating segment <sup>(1)</sup>                      | 1,583                                    | 1,155                             | 559  | 860                             | 78           |  |               |
| <b>Total revenues</b>  | <b>2,273</b>                             | <b>2,474</b>                      | <b>1,364</b>   | <b>1,486</b>                    | <b>258</b>   | <b>(176 )</b>                                    | <b>7,679</b>  |
| Costs not constituting revenues in another area of operation                           | 2,197                                    | 2,362                             | 1,144  | 1,477                           | 250          | 249  | 7,679         |
| Costs constituting revenues from other areas of operation                              | 76                                       | 112                               | 220  | 9                               | 8            | (425 )   | -             |
| <b>Total revenues</b>  | <b>2,273</b>                             | <b>2,474</b>                      | <b>1,364</b>   | <b>1,486</b>                    | <b>258</b>   | <b>(176 )</b>                                    | <b>7,679</b>  |
| <b>Profit from regular operations attributable to Bezeq's controlling shareholders</b> | <b>1,971</b>                             | <b>72</b>                         | <b>174</b>   | <b>163</b>                      | <b>(20 )</b> | <b>(250 )</b>                                    | <b>2,210</b>  |
| <b>Total assets attributable to operations as at December 31, 2017</b>                 | <b>9,086</b>                             | <b>3,271</b>                      | <b>1,210</b>   | <b>1,502</b>                    | <b>178</b>   | <b>1,602</b>                                     | <b>16,849</b> |
| <b>Total liabilities attributable to the operating segment as at December 31, 2017</b> | <b>13,901</b>                            | <b>536</b>                        | <b>410</b>   | <b>1,154</b>                    | <b>54</b>    | <b>1,350</b>                                     | <b>14,705</b> |

<sup>(1)</sup>Group companies that are service providers (as opposed to manufacturing companies) do not have a dedicated costing system that distinguishes between fixed and variable costs. The foregoing division is for reporting purposes alone. Variable costs are costs over which have companies management and control flexibility in short term and that have a direct effect on output, compared with fixed costs that are not flexible in the short term and do not directly

affect output (in this matter, with regard to the definition of fixed and variable costs, it is hereby clarified that “short term” means a period of up to one year).

(2) Details of the nature of the adjustments to the consolidated – transactions between operating segments.

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2016

|  | Domestic<br>fixed-line<br>communications | MRT<br>cellular<br>communications | International<br>telecommunications<br>and<br>ISP<br>services | Multi-<br>Channel<br>Television | Others     | Adjustments<br>to<br>consolidated <sup>(2)</sup> | Consolidated  |
|--|--|-----------------------------------|---|---------------------------------|------------|--|---------------|
| <b>Total Revenues:</b>   |  |                                   |   |                                 |            |  |               |
| From externals   | 4,063                                    | 2,587                             | 1,478   | 1,745                           | 198        | -  | 10,071        |
| From Bezeq's other segments of operation   | 320                                      | 43                                | 70  | -                               | 20         | (440 )   | 13            |
| <b>Total revenues</b>  | <b>4,383</b>                             | <b>2,630</b>                      | <b>1,548</b>  | <b>1,745</b>                    | <b>218</b> | <b>(440 )</b>                                    | <b>10,084</b> |
| <b>Total attributed costs:</b>   |  |                                   |   |                                 |            |  |               |
| Variable costs attributed to the operating segment <sup>(1)</sup>                      | 575                                      | 1,421                             | 817   | 593                             | 179        |  |               |
| Variable costs attributed to the operating segment <sup>(1)</sup>                      | 1,732                                    | 1,177                             | 555   | 888                             | 73         |  |               |
| <b>Total revenues</b>  | <b>2,307</b>                             | <b>2,598</b>                      | <b>1,372</b>  | <b>1,481</b>                    | <b>252</b> | <b>(247 )</b>                                    | <b>7,763</b>  |
| Costs not constituting revenues in another area of operation                           | 2,243                                    | 2,437                             | 1,161   | 1,471                           | 245        | 193  | 7,750         |
| Costs constituting revenues from other areas of operation                              | 64                                       | 161                               | 211   | 10                              | 7          | (440 )   | 13            |
| <b>Total revenues</b>  | <b>2,307</b>                             | <b>2,598</b>                      | <b>1,372</b>  | <b>1,481</b>                    | <b>252</b> | <b>(247 )</b>                                    | <b>7,763</b>  |
| Profit from regular operations attributable to Bezeq's controlling shareholders        | 2,076                                    | 32                                | 176   | 264                             | (34 )      | (193 )   | 2,321         |
| <b>Total assets attributable to operations as at December 31, 2016</b>                 | <b>7,111</b>                             | <b>3,294</b>                      | <b>1,188</b>  | <b>2,026</b>                    | <b>204</b> | <b>2,124</b>                                     | <b>15,947</b> |
| <b>Total liabilities attributable to the operating segment as at December 31, 2016</b> | <b>11,988</b>                            | <b>569</b>                        | <b>380</b>  | <b>1,434</b>                    | <b>104</b> | <b>(730 )</b>                                    | <b>13,744</b> |

Group companies that are service providers (as opposed to manufacturing companies) do not have a dedicated costing system that distinguishes between fixed and variable costs. The foregoing division is for reporting purposes alone. Variable costs are costs over which have companies management and control flexibility in short term and that have a direct effect on output, compared with fixed costs that are not flexible in the short term and do not directly affect output (in this matter, with regard to the definition of fixed and variable costs, it is hereby clarified that "short term" means a period of up to one year).

<sup>(2)</sup>Details of the nature of the adjustments to the consolidated – transactions between operating segments.



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2015

|  | Domestic<br>fixed-line<br>communications | MRT<br>cellular<br>communications | International<br>telecommunications<br>and<br>ISP<br>services | Multi-<br>Channel<br>Television | Others     | Adjustments<br>to<br>consolidated <sup>(2)</sup> | Consolidated  |
|--|--|-----------------------------------|---|---------------------------------|------------|--|---------------|
| <b>Total Revenues:</b>   |  |                                   |   |                                 |            |  |               |
| From externals   | 4,122                                    | 2,831                             | 1,485   | 1,774                           | 197        | (440 )   | 9,969         |
| From Bezeq's other segments of operation   | 285                                      | 59                                | 93  | -                               | 24         | (445 )   | 16            |
| <b>Total revenues</b>  | <b>4,407</b>                             | <b>2,890</b>                      | <b>1,578</b>  | <b>1,774</b>                    | <b>221</b> | <b>(885 )</b>                                    | <b>9,985</b>  |
| <b>Total attributed costs:</b>   |  |                                   |   |                                 |            |  |               |
| Variable costs attributed to the operating segment <sup>(1)</sup>                      | 522                                      | 1,469                             | 837   | 606                             | 174        |  |               |
| Variable costs attributed to the operating segment <sup>(1)</sup>                      | 1,737                                    | 1,264                             | 501   | 918                             | 63         |  |               |
| <b>Total revenues</b>  | <b>2,259</b>                             | <b>2,733</b>                      | <b>1,338</b>  | <b>1,524</b>                    | <b>237</b> | <b>(676 )</b>                                    | <b>7,415</b>  |
| Costs not constituting revenues in another area of operation                           | 2,181                                    | 2,540                             | 1,177   | 1,507                           | 230        | (233 )   | 7,402         |
| Costs constituting revenues from other areas of operation                              | 78                                       | 193                               | 161   | 17                              | 7          | (443 )   | 13            |
| <b>Total revenues</b>  | <b>2,259</b>                             | <b>2,733</b>                      | <b>1,338</b>  | <b>1,524</b>                    | <b>237</b> | <b>(676 )</b>                                    | <b>7,415</b>  |
| Profit from regular operations attributable to Bezeq's controlling shareholders        | 2,148                                    | 157                               | 240   | 220                             | (15 )      | (180 )   | 2,570         |
| Profit from regular operations attributable to non-controlling interests               | -  | -                                 | -   | 30                              | -          | (30 )  | -             |
| <b>Total assets attributable to operations as at December 31, 2015</b>                 | <b>7,311</b>                             | <b>3,269</b>                      | <b>1,170</b>  | <b>1,667</b>                    | <b>676</b> | <b>2,586</b>                                     | <b>16,679</b> |
| <b>Total liabilities attributable to the operating segment as at December 31, 2015</b> | <b>12,117</b>                            | <b>513</b>                        | <b>343</b>  | <b>6,685</b>                    | <b>104</b> | <b>(5,494 )</b>                                  | <b>14,268</b> |

Details of the nature of the adjustments to the consolidated – transactions between operating segments and (1) transactions in the multi-channel television segment in the first quarter (prior to gaining control and consolidation of DBS).

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Year Ended December 31, 2017 Compared with Year Ended December 31, 2016

*Revenues.* Our revenues decreased by 2.9% to NIS 9.80 billion (approximately \$2.8 billion) in the year ended December 31, 2017 from NIS 10.1 billion in the year ended December 31, 2016. For both periods, our consolidated revenues consisted entirely of Bezeq's consolidated revenues. The decrease in revenues in 2017 was primarily due to lower revenues across the Bezeq Group's main segments, primarily in the Cellular Communications segment.

Bezeq's revenues decreased by 3.2% to NIS 4.24 billion (approximately \$1.2 billion) in the year ended December 31, 2017 from NIS 4.38 billion in the year ended December 31, 2016. The decrease in the segment's revenues was primarily due to a NIS 111 million (approximately \$32 million), or 8%, decrease in telephony services revenues as a result of a reduction of 5.3% in average revenue per line in 2017 as well as a decrease of 4.7% in the number of access lines. The decrease in revenues was partially offset by a NIS 44 million (approximately \$13 million), or 2.9%, increase in broadband Internet revenues as a result of continued growth in the number of wholesale Internet lines, which increased by 41.1% during 2017, partially offset by a decrease of 6.6% in the number of retail Internet lines.

Pelephone's revenues decreased by 3.2% to NIS 2.55 billion (approximately \$734 million) in the year ended December 31, 2017 from NIS 2.6 billion in the year ended December 31, 2016. Revenues from services decreased to NIS 1.78 billion (approximately \$514 million), or 2% decrease in the year ended December 31, 2017 from NIS 1.82 billion in the year ended December 31, 2016. The decrease in revenues from cellular services was due to a decrease in tariffs as a result of increased competition in the cellular market as well as from the transition of government customers to new tariff plans. Revenues from terminal equipment repairs and services were also down by 5.9% to NIS 764 million (approximately \$220 million) in the year ended December 31, 2017 from NIS 812 million in the year ended December 31, 2016.

Bezeq International's revenues decreased by 0.7% to NIS 1.54 billion (approximately \$443 million) in the year ended December 31, 2017 from NIS 1.55 billion in the year ended December 31, 2016. The decrease in revenues was primarily due to a reduction of NIS 57 million in ILD revenues in 2017 compared with 2016, and were offset by an increase of NIS 46 million in ISP revenues in 2017 compared with 2016.

DBS had revenues of NIS 1.65 billion (approximately \$476 million) for the year ended December 31, 2017, while its revenues were NIS 1.75 billion for the year ended December 31, 2016.

*Depreciation and Amortization.* We recorded depreciation and amortization expenses of NIS 2.12 billion (approximately \$611 million) in the year ended December 31, 2017 compared to NIS 2.16 billion in the year ended December 31, 2016, a decrease of approximately 2%. The decrease was primarily due to a decrease in the

amortization of excess acquisition costs accrued upon assuming control of DBS, and was partially offset by depreciation costs, mainly in the Cellular Communications segment, following amortization of a subscriber acquisition asset after early adoption of IFRS 15.

The Bezeq Group recorded consolidated depreciation and amortization expenses of NIS 1.72 billion (approximately \$495 million) in the year ended December 31, 2017 compared to NIS 1.74 billion in the year ended December 31, 2016, a decrease of 1.4%. The decrease in depreciation and amortization expenses in 2017 was primarily due to a reduction in the amortization of purchase price allocation costs recorded in connection with the acquisition of a controlling stake in DBS.

Bezeq's depreciation and amortization expenses were NIS 728 million (approximately \$210million) in the year ended December 31, 2017 compared with NIS 717 million in the year ended December 31, 2016, an increase of 1.5%.

Pelephone's depreciation and amortization expenses in the year ended December 31, 2017 were NIS 383 million (approximately \$110 million) compared to NIS 380 million in the year ended December 31, 2016, an increase of 0.8%.

Bezeq International's depreciation and amortization expenses in the year ended December 31, 2017 were NIS 135 million (approximately \$39 million) compared to NIS 137 million in the year ended December 31, 2016, a decrease of 1.5%.

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DBS's depreciation and amortization expenses in the year ended December 31, 2017 were NIS 285 million (approximately \$82 million) while its depreciation and amortization expenses were NIS 296 million for the year ended December 31, 2016, a decrease of 3.7%.

*Salaries.* Our salaries expenses decreased by 0.4% to NIS 2.01 billion (approximately \$579 million) in the year ended December 31, 2017 from NIS 2.02 billion in the year ended December 31, 2016.

The Bezeq Group recorded consolidated salary expenses of NIS 2.01 billion (approximately \$578 million) in the year ended December 31, 2017, approximately the same as in the year ended December 31, 2016.

Bezeq's salary expenses decreased by 0.8% to NIS 891 million (approximately \$257 million) in the year ended December 31, 2017 from NIS 898 million in the year ended December 31, 2016. The decrease was due to a reduction in the workforce and an increase in salaries attributed for investment, offset by salary increases.

Telephone's salary expenses increased by 1.6% to NIS 384 million (approximately \$106 million) in the year ended December 31, 2017 from NIS 378 million in the year ended December 31, 2016.

Bezeq International's salary expenses decreased by 1.8% to NIS 324 million (approximately \$93 million) in the year ended December 31, 2017 from NIS 330 million in the year ended December 31, 2016.

DBS's salary expenses in the year ended December 31, 2017 were NIS 246 million (approximately \$71 million) while its salary expenses were NIS 249 million for the year ended December 31, 2016.

*General and operating expenses.* Our general and operating expenses decreased by 2.8% to NIS 3.9 billion (approximately \$1.1 billion) in the year ended December 31, 2017 from NIS 4.0 billion in the year ended December 31, 2016. The decrease in operating expenses was due to a reduction in most of the expense categories of the group, which were influenced, among other factors, by the early adoption of accounting standard IFRS 15.

The Bezeq Group recorded consolidated general and operating expenses of NIS 3.9 billion (approximately \$1.1 billion) in the year ended December 31, 2017 compared to NIS 4.0 billion in the year ended December 31, 2016, a decrease of 3.0%.

Bezeq's general and operating expenses decreased by 4% to NIS 677 million (approximately \$195 million) in the year ended December 31, 2017 from NIS 705 million in the year ended December 31, 2016. The decrease in operating expenses in 2017 was primarily due to a reduction in interconnect payments to telecom operators as well as lower building maintenance expenses partially offset by an increase in subcontractor expenses.

Telephone's general and operating expenses decreased by 7.2% to NIS 1.7 billion (approximately \$492 million) in the year ended December 31, 2017 from NIS 1.8 billion in the year ended December 31, 2016. The decrease was primarily due to a reduction in distributor fees, which were recognized as an asset following early adoption of IFRS 15, and a reduction in the cost of handset sales. Results were also affected by a decrease in engineering expenses, updates to site leasing estimates, and continued cost-cutting efforts. The decrease was partially offset by an increase in call completion fees.

Bezeq International's general and operating expenses increased by 1.6% to NIS 901 million (approximately \$260 million) in the year ended December 31, 2017 from NIS 887 million in the year ended December 31, 2016. The increase was primarily due to an increase in cost of sales for telecom solution equipment for businesses. Internet service expenses were also up. The increase was partially offset by lower expenses on call transfers between global operators, lower expenses on international calls corresponding with the aforesaid decrease in revenues, plus a decrease in customer recruitment commission expenses which were recognized as an asset following early adoption of IFRS 15.

DBS's general and operating expenses increased by 2.1% to NIS 956 million (approximately \$276 million) in the year ended December 31, 2017 from NIS 936 million for the year ended December 31, 2016.

*Other Operating Expenses, net.* We had other operating expense, net of NIS 149 million (approximately \$43 million) in the year ended December 31, 2017 compared to NIS 21 million in the year ended December 31, 2016. The increase in other operating expenses was primarily due to the NIS 87 million (approximately \$25 million) impairment of goodwill of DBS and the NIS 42 million (approximately \$ 12 million) impairment of goodwill of the cellular communications segment.

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The Bezeq Group recorded other operating expense, net of NIS 68 million (approximately \$20 million) in the year ended December 31, 2017 compared to NIS nil in the year ended December 31, 2016. The increase in other operating expenses, net was primarily due to the NIS 87 million (\$25 million) impairment of goodwill of DBS.

Finance expenses, net. Our consolidated net finance expenses decreased by 40.8% to NIS 577 million (approximately \$166 million) in the year ended December 31, 2017 from NIS 975 million in the year ended December 31, 2016. Net financial expenses in 2016 included NIS 270 million of one-time refinancing expenses related to the early redemption of B Communications' 7 % Senior Secured Notes.

Our unconsolidated net finance expenses in the year ended December 31, 2017 increased by 36.4% to NIS 60 million (approximately \$17 million) from NIS 44 million in the year ended December 31, 2016. The increase was primarily attributable to a one-time loss of NIS 12 million (approximately \$3 million) arising from the exchange of Series C Debentures for Series D Debentures.

B Communications' unconsolidated net finance expenses decreased by 79.4% to NIS 100 million (approximately \$29 million) in the year ended December 31, 2017 from NIS 485 million in the year ended December 31, 2016. The decrease was primarily attributable to one-time refinancing expenses related to the early redemption of B Communications' 7 % Senior Secured Notes along with the lower interest on B Communications' Series C Debentures.

The Bezeq Group's net finance expenses decreased by 6.7% to NIS 417 million (approximately \$120 million) in the year ended December 31, 2017 from NIS 447 million in the year ended December 31, 2016. The decrease in financing expenses was primarily due to a change in the recording of the second contingent consideration paid in connection with the acquisition of DBS. The decrease was partially offset by an increase in financing expenses in respect of a change in the fair value of the financial assets held by DBS.

*Income Tax.* Our consolidated income tax expenses decreased by 21.5% to NIS 347 million (approximately \$100 million) in the year ended December 31, 2017 from NIS 442 million in the year ended December 31, 2016. The decrease in income tax expenses was primarily due to decreased earnings and a decrease in the corporate tax rate in 2017.

Bezeq's consolidated income tax expenses in the year ended December 31, 2017 represented 26.8% of its pre-tax profit, compared to 33.4% in the year ended December 31, 2016.

The Bezeq Group's consolidated income tax expenses decreased by 27.5% to NIS 453 million (approximately \$131 million) in the year ended December 31, 2017 from NIS 625 million in the year ended December 31, 2016. The decrease in income tax expenses was primarily due to a reduction in the tax asset and recognition of NIS 143 million in deferred tax expenses last year, following a reduction in the corporate tax rate.

*Profit (Loss) Attributable to the shareholders of Our Company.* Net loss attributable to the shareholders of our company amounted to NIS 15 million (approximately \$4 million) in the year ended December 31, 2017 compared with a net loss of NIS 202 million in the year ended December 31, 2016. The loss in 2016 is primarily attributable to the one-time refinancing expenses related to the early redemption of B Communications' 7 % Senior Secured Notes.

*Profit Attributable to Our Non-Controlling Interests.* Net profit attributable to our non-controlling interests increased to NIS 690 million (approximately \$199 million) in the year ended December 31, 2017 from NIS 641 million for the year ended December 31, 2016. The increase is primarily attributable to the one-time refinancing expenses related to the early redemption of B Communications' 7 % Senior Secured Notes in 2016 which was partially offset by an increase in the net amortization related to Bezeq PPA in 2017 compared with 2016.

Year Ended December 31, 2016 Compared with Year Ended December 31, 2015

*Revenues.* Our revenues increased by 1.0% to NIS 10.1 billion (approximately \$2.6 billion) in the year ended December 31, 2016 from NIS 10.0 billion in the year ended December 31, 2015. For both periods, our consolidated revenues consisted entirely of Bezeq's consolidated revenues. The increase in revenues in 2016 was primarily due to the consolidation of DBS's revenues for a full year (consolidation began in the second quarter of 2015). Revenues declined across the Bezeq group's main segments, primarily in the Cellular Communications segment.

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Bezeq's revenues decreased by 0.5% to NIS 4.38 billion (approximately \$1.14 billion) in the year ended December 31, 2016 from NIS 4.41 billion in the year ended December 31, 2015. The decrease in the segment's revenues was primarily due to a NIS 96 million (approximately \$25 million), or 6.1%, decrease in telephony services revenues as a result of a reduction of 3.3% in average revenue per line in 2016 as well as a decrease of 2.8% in the number of access lines. The decrease in revenues was partially offset by a NIS 55 million (approximately \$14 million), or 3.6%, increase in broadband Internet revenues as a result of continued growth in the number of wholesale Internet lines, which increased by 133,000 during 2016, partially offset by a decrease in the number of retail Internet lines and by a NIS 19 million (approximately \$5 million), or 1.8%, increase in transmission and data revenues. The increase in revenues from transmission and data communication services resulted from growth in the number of business customers and data lines as well as the expansion of communication solutions offered to customers.

Pelephone's revenues decreased by 9.0% to NIS 2.6 billion (approximately \$684 million) in the year ended December 31, 2016 from NIS 2.9 billion in the year ended December 31, 2015. Revenues from services decreased to NIS 1.8 billion (approximately \$473 million), or 9.1%, in the year ended December 31, 2016 from NIS 2.0 billion in the year ended December 31, 2015. The decrease in revenues from cellular services was due to a decrease in tariffs as a result of increased competition in the cellular market as well as from the transition of government customers to new tariff plans. Revenues from repair services were also down in the year ended December 31, 2016. Revenues from the sale of terminal equipment decreased by 8.9% to NIS 812 million (approximately \$211 million) in the year ended December 31, 2016 from NIS 891 million in the year ended December 31, 2015.

Bezeq International's revenues decreased by 1.9% to NIS 1.55 billion (approximately \$403 million) in the year ended December 31, 2016 from NIS 1.58 billion in the year ended December 31, 2015. The decrease in revenues was primarily due to a reduction in hubbing revenues. After excluding hubbing revenues, total revenues increased by approximately 0.5% in 2016 compared to 2015 due to the continued growth in Internet services delivered across the submarine cable infrastructure, which was partially offset by lower revenues in the international long-distance call market.

DBS had revenues of NIS 1.75 billion (approximately \$454 million) for the year ended December 31, 2016, while its revenues were NIS 1.33 billion for the nine months ended December 31, 2015 after its consolidation.

*Depreciation and Amortization.* We recorded depreciation and amortization expenses of NIS 2.2 billion (approximately \$563 million) in the year ended December 31, 2016 compared to NIS 2.1 billion in the year ended December 31, 2015, an increase of approximately 2.4%. The increase was primarily due to the consolidation of DBS for a full year, which was partially offset by a reduction in depreciation expenses at Pelephone.

The Bezeq Group recorded consolidated depreciation and amortization expenses of NIS 1.74 billion (approximately \$452 million) in the year ended December 31, 2016 compared to NIS 1.68 billion in the year ended December 31,



2015, an increase of 3.3%. The increase was primarily due to the consolidation of DBS for a full year, which was partially offset by a reduction in depreciation expenses at Pelephone.

Bezeq's depreciation and amortization expenses were NIS 717 million (approximately \$186 million) in the year ended December 31, 2016 compared with NIS 725 million in the year ended December 31, 2015, a decrease of 1.1%.

Pelephone's depreciation and amortization expenses in the year ended December 31, 2016 were NIS 380 million (approximately \$99 million) compared to NIS 419 million in the year ended December 31, 2015, a decrease of 9.3%.

Bezeq International's depreciation and amortization expenses in the year ended December 31, 2016 were NIS 137 million (approximately \$36 million) compared to NIS 132 million in the year ended December 31, 2015, an increase of 3.8%.

DBS's depreciation and amortization expenses in the year ended December 31, 2016 were NIS 296 million (approximately \$77 million) while its depreciation and amortization expenses were NIS 246 million for the nine months ended December 31, 2015 after its consolidation.

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Salaries. Salaries increased by 2.9% to NIS 2.02 billion (approximately \$524 million) in the year ended December 31, 2016 from NIS 1.96 billion in the year ended December 31, 2015. The increase was primarily due to the consolidation of DBS starting in the second quarter of 2015.

Bezeq's salary expenses decreased by 1.5% to NIS 898 million (approximately \$234 million) in the year ended December 31, 2016 from NIS 912 million in the year ended December 31, 2015. The decrease was due to a reduction in the workforce and an increase in salaries attributed for investment, offset by salary increases.

Pelephone's salary expenses decreased 0.8% to NIS 378 million (approximately \$98 million) in the year ended December 31, 2016 from NIS 381 million in the year ended December 31, 2015.

Bezeq International's salary expenses increased 8.9% to NIS 330 million (approximately \$86 million) in the year ended December 31, 2016 from NIS 303 million in the year ended December 31, 2015. The increase was mainly due to salary updates after signing the collective agreement in the first quarter of 2016.

DBS's salary expenses in the year ended December 31, 2016 were NIS 249 million (approximately \$65 million) while its salary expenses were NIS 201 million for the nine months ended December 31, 2015 after its consolidation.

*General and Operating Expenses.* General and operating expenses increased by 3.7% to NIS 4.02 billion (approximately \$1.04 billion) in the year ended December 31, 2016 from NIS 3.88 billion in the year ended December 31, 2015. The increase was primarily due to the consolidation of DBS beginning in the second quarter of 2015, partially offset by a decrease in expenses in most of the Bezeq Group segments and primarily at Pelephone.

Bezeq's general and operating expenses decreased by 2.2% to NIS 705 million (approximately \$183 million) in the year ended December 31, 2016 from NIS 721 million in the year ended December 31, 2015. The decrease in operating expenses in 2016 was primarily due to a reduction in interconnect payments to telecom operators as well as lower building maintenance expenses partially offset by an increase in subcontractor expenses.

Pelephone's general and operating expenses decreased by 4.6% to NIS 1.8 billion (approximately \$478 million) in the year ended December 31, 2016 from NIS 1.9 billion in the year ended December 31, 2015. The decrease was primarily due to a decrease in the cost of handset sales, mirroring the change in the sales mix. The decrease was also attributable to a reduction in engineering expenses, call completion fee expenses, and expenses for doubtful debts. This decrease in expenses was partially offset by an increase in frequency leasing fees following the acquisition of

new 4G LTE frequencies.

Bezeq International's general and operating expenses decreased by 1.8% to NIS 887 million (approximately \$231 million) in the year ended December 31, 2016 from NIS 903 million in the year ended December 31, 2015. The decrease was primarily due to a reduction in the cost of call transfers between global operators and international call expenses, offset by higher Internet service costs driven by growth in the subscriber base and increased demand for high bandwidth rates, corresponding to revenues.

DBS's general and operating expenses in the year ended December 31, 2016 were NIS 92 million (approximately \$24 million) while its general and operating expenses were NIS 70 million for the nine months ended December 31, 2015 after its consolidation.

*Other Operating Expenses, net.* We had other operating expense, net of NIS 21 million (approximately \$5 million) in the year ended December 31, 2016 compared with other operating income, net of NIS 3 million in the year ended December 31, 2015. The decrease was primarily due to a reduction in capital gains from the sale of real estate at Bezeq Fixed-Line.

*Finance expenses, net.* Our consolidated net finance expenses increased by 64% to NIS 975 million (approximately \$253 million) in the year ended December 31, 2016 from NIS 595 million in the year ended December 31, 2015.

Our unconsolidated net finance expenses in the year ended December 31, 2016 decreased by 26.7% to NIS 44 million (approximately \$11 million) from NIS 60 million in the year ended December 31, 2015. The decrease was primarily attributable to an increase in our finance income from short term investments and due to the decrease in our debt as a result of principal payments.

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B Communications' unconsolidated net finance expenses increased by 65.7% to NIS 484 million (approximately \$126 million) in the year ended December 31, 2016 from NIS 293 million in the year ended December 31, 2015. The increase was primarily attributable to one-time refinancing expenses related to the early redemption of its 7 % Senior Secured Notes due 2021.

The Bezeq Group's consolidated finance expenses, net increased by 70% to NIS 447 million (approximately \$116 million) in the year ended December 31, 2016 from NIS 263 million in the year ended December 31, 2015. Net finance expenses of the Bezeq Group included a change in a liability on a contingent consideration following the DBS business combination in the amount of NIS 55 million. Finance expenses in 2015 reflect a reduction in a provision for interest on previous years' taxes in the amount of NIS 76 million following an agreement that was reached with the tax assessor relating to the Domestic Fixed-Line Communications segment.

*Income Tax.* Consolidated income tax expenses increased by 23.5% to NIS 442 million (approximately \$115 million) in the year ended December 31, 2016 from NIS 358 million in the year ended December 31, 2015. The increase in income tax expenses was primarily due to the decrease in deferred tax assets following a reduction in the corporate tax rate for 2017 and 2018.

Bezeq's consolidated income tax expenses in the year ended December 31, 2016 represented 33.4% of its pre-tax profit, compared to 25.9% in the year ended December 31, 2015.

*Profit (Loss) Attributable to the Owners of Our Company.* Loss attributable to the owners of our company amounted to NIS 202 million (approximately \$53 million) in the year ended December 31, 2016 compared with net profit of NIS 87 million in the year ended December 31, 2015. The loss is primarily attributable to the one-time refinancing expenses related to the early redemption of B Communications' 7 % Senior Secured Notes.

*Profit Attributable to Our Non-Controlling Interests.* Profit attributable to our non-controlling interests decreased to NIS 641 million (approximately \$167 million) in the year ended December 31, 2016 from NIS 1.0 billion for the year ended December 31, 2015. The decrease is primarily attributable to the decrease in the Bezeq Group's net profit in 2016 compared with 2015.

**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.

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.

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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 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.

During October 2017, we conducted two private placements of approximately NIS 227 million par value of our Series D Debentures to certain institutional, “qualified” and private investors in Israel in exchange for approximately NIS 205 million par value of our outstanding Series C Debentures. Upon completion of the exchange offer, an aggregate principal amount of NIS 40.5 million par value of Series C Debentures and NIS 757.3 million par value of Series D Debentures remain outstanding.

As of December 31, 2017, NIS 40.5 million par value 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 is 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).

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As of December 31, 2017, NIS 757 million par value 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. In February 2017, Midroog affirmed the A3.il local rating of our Series C and D Debentures with a stable outlook. In April 2018, Midroog reduced the A3.il rating to Baa1.il and retained the negative outlook.

In connection with the issuance of our Series D Debentures, we undertook to comply with the “hybrid model disclosure requirements” as determined by the ISA and as described in the prospectus governing our Series D Debentures. This model provides that in the event certain financial “warning signs” exist, and for as long as they exist, we are subject to certain disclosure obligations towards the holders of our Series D Debentures.

Our board of directors noted that our unconsolidated cash flow statement as of and for the year ended December 31, 2017 reflect that we had, as expected, a continuing negative cash flow from operating activities of NIS 4 million for 2017. The Israeli regulations provide that the existence of a continuing negative cash flow from operating activities could be deemed to be a “warning sign” unless our board of directors determines that the possible “warning sign” does not reflect a liquidity problem.

Such continuing negative cash flow from operating activities results from the general and operating expenses of NIS 4 million in the year ended December 31, 2017. Also, as a holding company, we do not have any cash inflows from operating activities. Our main source of cash inflows is generated from dividends (classified as cash flow from investing activities) or debt issuances (classified as cash flow from financing activities). We did not have any such inflows in 2017. We believe such continuing negative cash flow from operating activities does not affect our liquidity position. Our board of directors reviewed our financial position, outstanding debt obligations and our existing and anticipated cash resources and uses and determined that the continuing negative cash flow from operating activities does not reflect a liquidity problem. In February 2018, we announced that we were examining the possibility of a new issuance of unsecured debentures, or “Series E Debentures” to Israeli “classified”/“institutional” investors (as defined under the exemptions of section 15 of the Securities Law, 5728-1968 and the First Schedule of The Securities Law) (and which are not “U.S. persons”, as such term is defined in Regulation S under the Securities Act), in an aggregate amount of up to NIS 250 million par value.

If issued, the Series E Debentures will be listed on the TACT-Institutional System maintained by the TASE, subject to approval by the TASE.



The Series E Debentures may not be resold in the United States or to any “U.S. person” absent registration under the Securities Act or the availability of an applicable exemption from the registration requirements under the Securities Act.

According to the proposed offering, the principal of the Series E Debentures will be payable in six installments, consisting of: (a) five equal installments, each equal to 10% of the principal of the Series E Debentures, payable on December 15 of each of the years 2020 to 2024 (inclusive); and (b) one installment of 50% of the principal of the Series E Debentures, payable on December 15, 2025. It is expected that the Series E Debentures will bear annual interest at a fixed rate to be determined in an interest-rate auction. The offering is also subject to the confirmation by Midroog Ltd., an Israeli rating company.

As of December 31, 2017, and 2016, we had on an unconsolidated basis cash and cash equivalents as well as marketable securities of NIS 195 million (approximately \$56 million) and NIS 382 million, respectively.

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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 transferred to Norisha 396,860 additional ordinary shares of B Communications without any further payment.

January 2016 Sale of B Communications Shares

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.

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-subsiary 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 proceeds of the February 2014 Note offering were used to repay all of the outstanding balances under the loans B Communications incurred to acquire its controlling interest in Bezeq.

The Notes, which were redeemed in October 2016 were senior obligations that were guaranteed by our two subsidiaries, SP1 and SP2, on a senior secured basis. The Notes and the guarantees were secured by first priority liens over all of the capital stock of SP2, the capital stock of Bezeq held by SP2, which, as of the date of the issuance of the Notes, constituted approximately 30% of the outstanding voting capital stock of Bezeq, and additional collateral.

The indenture for the Notes, or the Indenture, among other things, restricted 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.

On February 2, 2016, B Communications sold 115,500,000 Bezeq shares and received net proceeds of NIS 978 million in the aggregate (approximately \$254 million). The sale took place in accordance with the provisions of Section 3(a3) of the Communications Order. B Communications retained a 26.34% ownership interest in Bezeq following the closing of the transaction.

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According to the terms of the Indenture, the net proceeds from the sale of the Bezeq shares held were deposited into a “Lockbox Account” and were subject to certain conditions and covenants relating to asset sales and release of liens on sold assets. B Communications was required to make an offer within 365 days of the sale of the Bezeq shares 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. On June 28, 2016, B Communications announced the final results of its modified Dutch auction tender offer pursuant to a Tender Offer Memorandum dated May 26, 2016 to purchase a portion of the Notes. Approximately \$ 18,600,000 in aggregate principal amount of the Notes were validly tendered.

In August 2016, B Communications announced its intention to raise further funds to redeem its outstanding Notes through the offering of new non-convertible debentures in Israel pursuant to a shelf prospectus in Israel. Midroog issued an Aa3.il rating with a stable outlook for B Communications’ new Series C Debentures, in a scope of up to NIS 1.9 billion par value. In September 2016 B Communications completed the offering of NIS approximately 1.88 billion (approximately \$489) par value of the Series C Debentures.

B Communications fully redeemed the Notes on October 25, 2016. Following this process, the Bezeq shares which served as collateral for the Notes and were held by SP2 became free and clear of any pledges (subject to the general governmental control permit) and all of the Bezeq shares that were held by Mishmeret Trust Company Ltd., the trustee and security agent for the Notes, were transferred back to SP2.

### B Communications’ Series C Debentures

In September 2016, B Communications announced that it received NIS 1.85 billion of binding commitments (out of about NIS 3.0 billion of offers) from Israeli institutional investors to purchase new Series C Debentures maturing in 2024. The net proceeds from the offering were used to redeem B Communications’ outstanding 7 % Senior Secured Notes, and further strengthened B Communications’ balance sheet. Midroog Ltd. approved an Aa3.il Rating for the Series C Debentures. In January 2017, B Communications announced a private placement of NIS 118,000,000 par value of its Series C Debentures to Israeli institutional investors for an aggregate consideration of approximately NIS 118 million (approximately US\$ 34 million). In January 2018, B Communications announced a private placement of NIS 240,000,000 par value of its Series C Debentures to Israeli institutional investors for an aggregate consideration of approximately NIS 249 million (approximately \$72 million). The two private placements were carried out as an increase to the outstanding Series C Debentures. Midroog issued an Aa3.il rating with a stable outlook for the new Series C Debentures

The principal of the Series C Debentures is payable in four equal annual installments payable on November 30 of each of the years 2020 through 2023 and one installment payable on November 30, 2024. Each of the first four installments will be equal to 7.5% of the principal amount of the aggregate amount of the Series C Debentures sold and the last

installment will equal to 70% of such principal amount. The annual interest rate is 3.6%. The interest on the outstanding principal of the Series C Debentures is payable in semi-annual payments on May 31 and November 30 of each year, while the first interest payment will be paid on May 31, 2017 and the last interest payment will be payable together with the last principal payment on November 30, 2024.

The indenture governing the Series C Debentures restricts B Communications' creating a lien in favor of any third party over its direct and/or indirect holdings of 691,361,036 ordinary shares of Bezeq, or the Bezeq Shares, including any of the rights accompanying such shares without the prior consent of the holders of the Series C Debentures. B Communications' also agreed to refrain from making any disposition of the Bezeq Shares without obtaining the prior consent of the holders of the Series C Debentures. Notwithstanding the foregoing, and subject to the provisions of applicable law and/or permit, B Communications may sell all or a portion of the Bezeq Shares to any third party, provided that in such instance, we use the net proceeds from such sale, less taxes, expenses and deductions associated with the sale of such shares to make a full or partial early redemption of the Series Debentures.

Pursuant to the terms of the Series C Debentures indenture B Communications may not assume additional debt, with the exception of:

financial debt that does not exceed NIS 400 million;

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the financial debt is not secured by any collateral and does not have priority over the Series C Debentures upon insolvency: and

the total par value of the Series C Debentures will not exceed an aggregate of NIS 2.3 billion.

B Communications also undertook to hold (directly and/or indirectly) at least 25% of Bezeq's issued and paid-up capital, unless a regulatory permit/approval is received to reduce such ownership percentage. Similarly, Eurocom Communications Ltd. undertook to refrain from transferring control of B Communications (directly or indirectly) to a party which has not been authorized in advance by the necessary regulatory entities, to the extent such approvals are required, at the relevant time.

Pursuant to the terms of the Series C Debentures indenture, B Communications also undertook that its equity (capital attributed to our shareholders, without non-controlling interests) will not be less than NIS 650 million for two or more consecutive calendar quarters. The indenture includes a mechanism to adjust the interest rate in the event that B Communications' equity falls below NIS 650 million for two consecutive calendar quarters or in the event of a downgrade in the rating of the Series C Debentures.

B Communications also undertook not to distribute a dividend to its shareholders, buyback any of its ordinary shares or make any other distribution as defined in the Israeli Companies Law unless all the following conditions are satisfied:

the distribution will not cause a downgrade in the rating of the Series C Debentures;

B Communications is not in violation of any of the covenants;

no grounds for immediate repayment exist at the time a resolution to make a distribution is adopted, and no such grounds exist as a result of such distribution;

B Communications' equity post-distribution is not less than NIS 800 million;

until full repayment of the principal of the Series C Debentures, B Communications may not distribute a dividend exceeding 75% of the balance of B Communications' distributable surpluses (the surplus balance or surpluses accrued in the last two years, in accordance with the definitions provided in the Companies Law) in accordance with its consolidated financial statements. In addition, B Communications may not make a distribution if it recorded an aggregate net loss in the last four quarters preceding the distribution date, on the basis of its last financial statements

and/or the quarterly financial report published prior to the distribution date; and

notwithstanding the foregoing, the restrictions will not apply with respect to the balance of B Communications' profits/surpluses which are distributable in accordance with the provisions of the Companies Law as of June 30, 2016 (i.e. a total of NIS 416 million were excluded from the distribution restrictions).

The Series C Debentures indenture also requires that B Communications' equity may not be less than 15% of its total balance sheet in accordance with its audited or reviewed (unconsolidated) financial statements (or, alternatively, the quarterly financial report figures), for two or more consecutive calendar quarters.

#### 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 6, 2018, Bezeq's Board of Directors updated the dividend distribution policy, whereby Bezeq will distribute to its shareholders, on a semi-annual basis, a dividend of 70% of the half-yearly profit (after tax) based on the Bezeq's consolidated financial statements, commencing with the upcoming distribution. In accordance with the decision, capital gains from the sale of Bezeq's Sakia property (near the Mesubim junction)), insofar as they shall be recognized in 2018, will not be distributed in 2018, unless the full consideration for the transaction is received in cash during the year. Bezeq's Board may decide on a dividend distribution for Sakia profits at a later date based upon the circumstances and in accordance with the law.

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Bezeq paid total cash dividends of NIS 1.8 billion, NIS 1.4 billion and NIS 1.3 billion (approximately \$370 million) in the years ended December 31, 2015, 2016 and 2017, respectively, out of which B Communications received NIS 545 million, NIS 379 million and NIS 338 million (approximately \$97 million) respectively.

On April 26, 2018, Bezeq's shareholders approved a distribution of a cash dividend in the amount of NIS 368 million to the shareholders of Bezeq. The dividend was paid by Bezeq on May 10, 2018 and B Communications' share of such dividend was NIS 97 million (approximately \$28 million).

B Communications and Bezeq Dividend Distributions

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.

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. 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 and approximately NIS 67 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 and approximately NIS 22 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 or NIS 1.27 per share. We received NIS 25 million (approximately \$6 million) from the dividend distributed by B Communications on December 23, 2015.

On May 25, 2016, B Communications declared a dividend of NIS 355 million (approximately \$92 million), or NIS 11.88 per share (approximately \$3.09). We received NIS 230 million (approximately \$60 million) from the dividend distributed by B Communications on May 29, 2016.

Bezeq paid total cash dividends of NIS 1.4 billion (approximately \$375 million) in the year ended December 31, 2016, out of which B Communications received NIS 379 million (approximately \$100 million).

Bezeq paid total cash dividends of NIS 1.3 billion (approximately \$370 million) in the year ended December 31, 2017, out of which B Communications received NIS 338 million (approximately \$97 million).

As of December 31, 2017, our liquidity balances comprised of cash and cash equivalents and short-term investments on an unconsolidated basis totaled NIS 195 million (approximately \$56 million).

In addition, as of December 31, 2017, we held 19.4 million unencumbered ordinary shares of B Communications having a value at December 31, 2017 of NIS 1.2 billion (64.78% of B Communications' outstanding share capital). These shares can, if necessary, be used to support the refinancing of existing debt or may be sold for cash (up to 4.4 million shares can be sold without endangering our controlling interest in B Communications).

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We believe that we have sufficient funds (including 4.4 million shares of B Communications that can be sold without endangering our controlling interest in B Communications) to service our debt service requirements through December 31, 2019 and we expect to have sufficient funds to serve our expected indebtedness beyond 2019.

Liquidity and Capital Resources of the Bezeq Group

As of December 31, 2017, the Bezeq Group had cash and cash equivalents and short-term investments of NIS 2.5 billion (approximately \$712 million) compared to NIS 1.23 billion at December 31, 2016.

The Bezeq Group incurred consolidated capital expenditures of NIS 1.53 billion (approximately \$441 million) in the year ended December 31, 2017, compared with NIS 1.42 billion in the year ended December 31, 2016. The increase was primarily due to an increase in investments in all group segments.

In the year ended December 31, 2017, the Bezeq Group repaid debt and paid interest of NIS 2 billion (approximately \$577 million), compared with NIS 2.3 billion for year ended December 31, 2016. In addition, the Bezeq Group paid dividends of NIS 1.3 billion (approximately \$371 million) in 2017 compared to NIS 1.4 billion in 2016.

The Bezeq Group's average debt (including current maturities) to financial institutions and debenture holders for the year ended December 31, 2017 was NIS 11.3 billion (approximately \$3.2 billion). The average supplier credit for the year ended December 31, 2017 was NIS 929 million (approximately \$268 million), the average short-term customer credit for the year ended December 31, 2017 was NIS 2 billion (approximately \$568 million), and average long-term customer credit was NIS 415 million (approximately \$120 million).

The Bezeq Group's working capital surplus as of December 31, 2017 was NIS 966 million (approximately \$279 million) compared with a deficit of NIS 407 million on December 31, 2016. Bezeq (according to its separate financial statements) had a working capital surplus of NIS 592 million (approximately \$171 million) as of December 31, 2017, compared with a working capital deficit of NIS 944 million as of December 31, 2016.

The Board of Directors of the Bezeq Group reviewed its 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 these factors, the Bezeq Group'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

At 31 December 2017, Bezeq is not financed by any short-term credit (less than one year). The following table shows the distribution of long-term loans (including current maturities):

| Loan term       | Source of financing | Principal amount (NIS million) | Currency or linkage | Type of interest and change mechanism | Average interest rate | Effective interest rate | Interest range in 2017 |
|-----------------|---------------------|--------------------------------|---------------------|---------------------------------------|-----------------------|-------------------------|------------------------|
| Long-term loans | Banks               | 675                            | Unlinked NIS        | Variable, based on prime rate*        | 1.78 %                | 1.79 %                  | 1.75%-1.80%            |
|                 | Banks               | 2,597                          | Unlinked NIS        | Fixed                                 | 4.01 %                | 4.22 %                  | 2.40%-6.85%            |
|                 | Non-bank sources    | 734                            | Unlinked NIS        | Variable, based on annual STL rate**  | 1.54 %                | 1.57 %                  | 1.49%-1.57%            |
|                 | Non-bank sources    | 3,662                          | Unlinked NIS        | Fixed                                 | 3.83 %                | 3.94 %                  | 3.65%-6.65%            |
|                 | Non-bank sources    | 3,964                          | CPI-linked NIS      | Fixed                                 | 2.30 %                | 2.34 %                  | 2.20%-3.70%            |

\*Prime interest rate as at March 2018 – 1.6%.

\*\* STL yield per year (219) – 0.124% (average last 5 trading days of February 2018) for the interest period that commenced on March 1, 2018.

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Credit received:

Following is a breakdown of the credit received by Bezeq in 2017, some by exercising of commitments to extend credit:

| Credit extension date        | Credit in NIS millions | Average life (years) and repayment dates                  | Total average interest rate (fixed, NIS and unlinked) | Notes                                     |
|------------------------------|------------------------|---|---|---|
| June 2017 and September 2017 | 1,400                  | 5<br>(Repayment as from June 2020 until December 2024)    | 4.2 %   | Exercising of commitment to extend credit |
| December 2017                | 600                    | 6.7<br>(Repayment in June of each of the years 2024-2026) | 3.2 %   | Ordinary loan                             |

On March 2018, Bezeq completed a further financing of NIS 320 million through a private loan from an institutional entity with an average life of 6.7 years and fixed NIS interest of 3.2%

All these loans include similar terms to those provided with respect to other loans taken by Bezeq set out in Note 13.3 of the 2017 Financial Statements, including: an undertaking not to create any other charges on Bezeq's assets (with certain restrictions), an undertaking that should it make a commitment to any entity in connection with financial covenants, Bezeq will undertake the same commitment also in connection with these loans (subject to certain exceptions), and standard terms for immediate repayment (such as a violations, insolvency, liquidation or receivership, etc., changes in control without receiving approval for control in accordance with the provisions of the Communications Law and/or the Communications Order, and cross default, with certain restrictions).

Reportable credit

Debentures and loan terms

|                      |                      |
|----------------------|----------------------|
| December 31,<br>2017 | December 31,<br>2016 |
|----------------------|----------------------|

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|   | Carrying<br>amount<br>NIS<br>million | Nominal<br>value<br>NIS<br>million | Carrying<br>amount<br>NIS<br>million | Nominal<br>value<br>NIS<br>million | Interest rate<br><br><b>range</b> |   |
|---|--------------------------------------|------------------------------------|--------------------------------------|------------------------------------|-----------------------------------|---|
| Bank loans:   |                                      |                                    |                                      |                                    |                                   |   |
| Unlinked loans at variable interest                             | 675                                  | 675                                | 978                                  | 978                                | Prime -0.33% to prime<br>+0.2     | % |
| Unlinked loans at fixed interest                                | 631                                  | 631                                | 1,084                                | 1,084                              | 5%-6.85                           | % |
| Unlinked loans at fixed interest                                | 300                                  | 300                                | 300                                  | 300                                | 2.4                               | % |
| Unlinked loans at fixed interest                                | 1,725                                | 1,700                              | 914                                  | 900                                | 3.5%-4.2                          | % |
| Total bank loans  | 3,331                                | 3,306                              | 3,276                                | 3,262                              |                                   |   |
| Loan from financial institutions:                               |                                      |                                    |                                      |                                    |                                   |   |
| Unlinked loans at fixed interest                                | 1,695                                | 1,700                              | 500                                  | 500                                | 4.15                              | % |
| Unlinked loans at fixed interest                                | 67                                   | 67                                 | 147                                  | 147                                | 5%-5.25                           | % |
| Total loans from financial institutions                         | 1,762                                | 1,767                              | 647                                  | 647                                |                                   |   |
| Total loans   | 5,093                                | 5,073                              | 3,923                                | 3,909                              |                                   |   |
| Debentures issued to the public                                 |                                      |                                    |                                      |                                    |                                   |   |
| Series 6 - linked to the CPI, at fixed interest                 | 3,176                                | 3,000                              | 3,041                                | 2,874                              | 3.7                               | % |
| Series 7 - unlinked loans at variable interest                  | 732                                  | 734                                | 734                                  | 734                                | Makam for one year<br>+1.4        | % |
| Series 9 - unlinked loans at fixed interest                     | 1,645                                | 1,595                              | 1,144                                | 1,103                              | 3.65                              | % |
| Series 10 - unlinked loans at fixed interest                    | 900                                  | 882                                | 400                                  | 400                                | 2.2                               | % |
| Series 8 - linked to the CPI, at fixed interest                 | -                                    | -                                  | 443                                  | 443                                | 5.7                               | % |
| Total debentures issued to the public                           | 6,453                                | 6,211                              | 5,762                                | 5,554                              |                                   |   |
| Non-marketable debentures issued to financial institutions:     |                                      |                                    |                                      |                                    |                                   |   |
| Debentures issued by DBS - linked to the CPI, at fixed interest | 15                                   | 15                                 | 868                                  | 753                                | 5.35%-8.4                         | % |
| Unlinked loans at fixed interest                                | 300                                  | 300                                | 400                                  | 400                                | 6.65                              | % |
| Total non-marketable debentures                                 | 315                                  | 315                                | 1,268                                | 1,153                              |                                   |   |
| Total debentures  | 6,768                                | 6,526                              | 7,030                                | 6,707                              |                                   |   |
| Total loans and debentures                                      | 11,861                               | 11,599                             | 10,953                               | 10,616                             |                                   |   |

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| Lender                | Date of loan     | Date of final repayment | Type of loan                | Amount of the original loan or par value (NIS million) | Estimated reserve (plus interest payable) December 31, 2017 (NIS million) | Number of principal payments as of December 31, 2017 | Principal payments from | Number of interest payments in December 2017 | Interest rate | Fair value of the liability as at December 31, 2017 (NIS million) | Imputed effective interest at fair value as at December 31, 2017 | Imputed effective interest at fair value as at December 31, 2016 | Special conditions     |
|-----------------------|------------------|-------------------------|-----------------------------|--|---|--|-------------------------|--|---------------|---|--|--|------------------------|
| Debentures (Series 6) | July 3, 2011     | December 1, 2022        | CPI-linked fixed interest   | 3,000  | 3,092   | 1  | 2018                    | 2  | 3.70%         | 3,392   | 0.34%  | 1.08%  | Notes 13.3.1 to 13.3.4 |
| Debentures (Series 9) | October 15, 2015 | December 1, 2025        | Unlinked fixed interest NIS | 1,595  | 1,600   | 1  | 2022                    | 2  | 3.65%         | 1,745   | 2.19%  | 3.13%  | Note 13.3              |

| Source of financing                | Amount at December 31, 2015 (NIS millions) | Currency or linkage | Average interest rate | Effective interest |
|------------------------------------|--|---------------------|-----------------------|--------------------|
| Long-term loans                    |  |                     |                       |                    |
| Banking sources                    | 34   | NIS                 | 3.41 %                | 3.44 %             |
| Non-banking sources <sup>(1)</sup> | 434  | CPI-linked NIS      | 5.35 %                | 5.42 %             |

## Bezeq's debentures

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

Public issuance of NIS 384,467,000 par value debentures (Series 9) by way of an expansion of series, in accordance with a shelf prospectus from May 2014, as amended due to a clerical error in June 2014 and a shelf offering report dated May 25, 2017.

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

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

In addition to the foregoing, on January 14, 2018 Bezeq and a number of institutional bodies recognized as investors according to the First Addendum to the Securities Law signed subordinate notes whereby, subject to compliance with the preconditions below, the institutional investors undertook to purchase from Bezeq and Bezeq undertook to issue to the institutional investors, in a future private offering on December 2, 2018 (or at a date shortly thereafter under the terms of the letter of undertaking) NIS 550 million par value of Bezeq's Debentures (Series 9), by way of an extension of the existing Debenture series (Series 9) that Bezeq offered, which have been issued and registered for trading for the first time on the TASE based on a shelf offering report that Bezeq published on October 13, 2015. The offering will take place at a rate of NIS 1.0515 per debenture reflecting an annual yield of 2.7%.

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

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### Credit rating

Bezeq's debentures are rated by S&P Maalot Ltd. with an il/AA/negative outlook and by Midroog Ltd. with an Aa2 rating with a stable outlook.

In 2018, Bezeq expects to repay NIS 1.94 billion on account of loan principal and interest (including debentures).

In December 2018, Bezeq expects, subject to compliance with preconditions, to complete a future private offering for a total amount of NIS 578 million. Between December 2017 and March 2018, Bezeq also raised a total of NIS 920 million by means of private loans from banks/institutional entities.

Bezeq raises capital from time to time to finance its cash flow. The financing options at Bezeq's disposal are raising debt by means of new bank loans from banks and/or private or negotiable debt.

### Pelephone

Pelephone's operations are financed out of cash flow from operating activities. As at December 31, 2017, 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 2018 for its ongoing operations.

### Fair Credit Law

The Fair Credit Law that was legislated in August 2017 cuts (statutorily) the interest rate ceiling that may be charged for credit transactions, and sets it at the Bank of Israel interest rate + 15%. The law applies to all credit transactions, other than types of transactions that are specifically excluded. The Law applies to transactions to be executed in November 2018. In so far as these transactions are not irregular, the Law is relevant to Pelephone's operations with regard to the sale of devices, accessories and other equipment, in installments for which the interest rate is higher than the foregoing statutory rate. The Law is not expected to have a material effect on Pelephone.



## Bezeq International

Bezeq International has no outstanding debt other than to Bezeq.

## DBS

Average interest rate on loans

(1) The non-banking borrowing, which is valid until December 31, 2015, is made up of debentures.

## Institutional financing

In July 2017 DBS made a final redemption repayment of a debenture series issued to institutional investors in 2017 (Series A), that was secured with certain collateral. Following the foregoing redemption, these liens were lifted.

DBS has an outstanding series of debentures (Series B) that was issued to institutional investor in 2010 and listed on the TACT institutional system at the TASE under a deed of trust between DBS and Hermetic Trusts (1975) Ltd., that was extended in 2011, 2012, 2013, 2014 and 2015.

This deed of trust set out usual events (such as insolvency proceedings, violation, execution 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.

In September 2015, Bezeq signed a deed of guarantee to meet DBS's liabilities to the holders of Debentures (Series B), against: (a) reducing the interest rate on Debentures (Series B); (b) cancellation of collateral registered in favor of the Trustee for Debentures (Series B) and (c) cancellation of various provisions in the Deed of Trust, and all in accordance with the terms provided therein. If Bezeq's rating is downgraded to below a rating of -AA, the interest rate will increase, and the canceled provisions and collateral pledged in favor of the Trustee for Debentures (Series B) will be reinstated.



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In March 2018, DBS Debentures (Series B) held by Bezeq were converted into premium on DBS's share capital, and subsequently the outstanding balance of Debentures (Series B) is currently NIS 15 million.

## S&amp;P Maalot ratings for DBS and its debentures

DBS was rated by S&P Maalot with a ilAA (stable) issuer rating, following the acquisition of all holdings in it by Bezeq. The debentures issued by DBS are rated by S&P Maalot as ilAA. In July 2016, S&P ratified DBS's ilAA rating with stable outlook. In April 2018, S&P re-affirmed the credit ratings of Bezeq (ilAA) and its subsidiaries including DBS and updated the outlook to negative following the increased competition facing Bezeq and the instability of Bezeq's management given the current situation.

## Cash Flows

## Cash Flows of Our Company

The following table summarizes our consolidated cash flows on a consolidated basis for the periods presented:

|  | Year ended December<br>31, |         |        |
|--|----------------------------|---------|--------|
|  | 2015                       | 2016    | 2017   |
|  | (NIS in millions)          |         |        |
| Net cash provided by operating activities            | 3,644                      | 3,457   | 3,480  |
| Net cash (used in) provided by investing activities  | 381                        | (1,036) | (966 ) |
| Net cash used in financing activities                | (4,138)                    | (2,230) | (916 ) |
| Net increase (decrease) in cash and cash equivalents | (113 )                     | 191     | 1,598  |
| Cash and cash equivalents at beginning of year       | 732                        | 619     | 810    |
| Cash and cash equivalents at end of year             | 619                        | 810     | 2,408  |

## Operating Activities

Consolidated cash provided by operating activities in 2017 amounted to NIS 3.5 billion (approximately \$1 billion), the same as in 2016.

### Investing Activities

Consolidated cash used in investing activities in the year ended December 31, 2017, was NIS 966 million (approximately \$279 million) compared with NIS 1.04 billion provided by investing activities in the year ended December 31, 2016. The decrease in net cash used in investing activities was due to taxes paid on finance income from shareholder loans to DBS to the amount of NIS 461 million last year, and a decrease in net investments in bank and other deposits in the Domestic Fixed-Line Communications Segment. The decrease was partially offset by increased investment in deferred expenses following early adoption of IFRS 15, whereby sales commissions are recognized as subscriber acquisition assets.

### Financing Activities

Consolidated cash used in financing activities in the year ended December 31, 2017 was NIS 916 million (approximately \$264 million) compared to NIS 2.2 billion in the year ended December 31, 2016. The decrease was primarily attributable to an increase in loans received and a decrease in debenture repayments in the Domestic Fixed-Line Communications segment. In addition, payments to Eurocom D.B.S. for the purchase of DBS's shares and loans and the dividend payment were lower in the reporting year, as compared to last year. The decrease was partially offset by a decrease in debenture issuance and an increase in loan repayments in the Domestic Fixed-Line Communications segment.

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## 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, |         |         |
|---|-------------------------|---------|---------|
|   | 2017                    | 2016    | 2015    |
|   | (NIS in millions)       |         |         |
| Net cash provided by operating activities                   | 3,525                   | 3,526   | 3,740   |
| Net cash (used in) provided by investing activities         | (1,148)                 | (1,567) | 283     |
| Net cash provided by (used in) financing activities         | (844 )                  | (1,866) | (4,128) |
| Net increase (decrease) in cash and equivalents             | 1,533                   | 93      | (105 )  |
| Cash and cash equivalents as at the beginning of the period | 648                     | 555     | 660     |
| Cash and cash equivalents as at the end of the period       | 2,181                   | 648     | 555     |

## Operating Activities

Consolidated cash flows provided by operating activities of the Bezeq Group in the year ended December 31, 2017 amounted to NIS 3.5 billion (approximately \$1 billion) the same as in the year ended December 31, 2016. Net cash flows from operating activities remained stable, mainly due to higher net cash flows in the Domestic Fixed-Line Communications segment, as a result of changes in working capital and lower income tax payments. The increase was offset by lower net cash in the Multi-Channel Television segment, mainly due to lower operating profit and an increase in broadcasting rights.

## Investing Activities

Net cash used in investing activities in the year ended December 31, 2017 was NIS 1.15 billion (approximately \$331 million) compared to NIS 1.6 billion in the year ended December 31, 2016. The decrease in net cash used in investing activities was mainly due to taxes paid on finance income from shareholder loans to DBS in the amount of NIS 461 million in 2016, and a decrease in net investments in bank and other deposits in the Domestic Fixed-Line Communications Segment. The decrease was partially offset by increased investment in deferred expenses following early adoption of IFRS 15 - Revenue from Contracts with Customers, whereby sales commissions are recognized as subscriber acquisition assets.

## Financing Activities

Net cash used in financing activities by the Bezeq Group in the year ended December 31, 2017 was NIS 844 million (approximately \$243 million) compared to NIS 1.9 billion in the year ended December 31, 2016. The decrease in cash used in financing activities was primarily attributable to an increase in loans received and a decrease in debenture repayments in the Domestic Fixed-Line Communications segment. In addition, payments to Eurocom D.B.S. for the purchase of DBS's shares and loans and the dividend payment were lower in 2017, as compared to 2016. The decrease was partially offset by a decrease in debenture issuance and an increase in loan repayments in the Domestic Fixed-Line Communications segment.

#### 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.

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*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 included in the owners' share in equity of our company directly in retained earnings.

*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. 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.



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*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.

*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.

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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.

The estimated useful lives for the current period are as follows:

|  | Useful life             |
|--|-------------------------|
| Fixed line and international network equipment (switches, transmission, power) | 4-12                    |
| Network  | 12-33                   |
| Subscriber equipment and installations   | 4-8                     |
| Equipment and infrastructure for multichannel television                       | 3-15                    |
| Vehicles   | 6-7                     |
| Office and general equipment   | 5-10                    |
| Electronic equipment, computers and internal communication systems             | 3-7                     |
| Cellular network   | 4-10                    |
| Passive radio equipment at cellular network sites                              | up to December 31, 2037 |
| Buildings  | 25                      |
| Seabed cable   | 4-25 (mainly 25)        |

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.

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*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 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:

| <b>Type of asset</b>                                      | <b>Amortization period</b>  |
|---|---|
| Computer programs and software licenses                   | 3-10 years depending on the term of the license period or the estimated time of use of the software |
| Customer relationships acquired in a business combination | 5-7 years based on the estimated customer churn rate (using the accelerated depreciation method)    |
| Brand acquired in a business combination                  | 12  |
| Frequency usage right                                     | Over the license period up to 2028  |

Amortization methods and useful lives are reviewed at least at each reporting year and adjusted if appropriate.

## 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.

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### Inventory

Inventories are measured at the lower of cost and net realizable value. The group elected to base 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.



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*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, 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, 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 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.

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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

The Bezeq Group's revenues decreased to NIS 9.8 billion for the year ended December 31, 2017 due to reduced revenues in all of the Bezeq Group's main segments, mainly in the Cellular Communications segment. The continued decline in overall revenues reflects the continuing competition in the communications industry in Israel.

Based on the information which is currently known to the Bezeq Group, it has forecast that it will report a lower net profit in 2018. Bezeq provided the following forecast in its 2017 earnings press release:

Net profit attributable to shareholders is expected to be NIS 1 billion.  
EBITDA is expected to be NIS 3.9 billion.

The Group's free cash flow is expected to be NIS 1.5 billion.

The forecast data includes the effect of early implementation of IFRS 16 as from January 1, 2018 of NIS 400 million on EBITDA and a negligible amount on the net profit.

The forecast data does not include the effect of the disposal of the Bezeq's rights in the Sakia real estate property, which are subject to compliance with various conditions regarding the disposal of the property. The actual results may differ from these assessments, depending on the date on which the capital gain for the sale of the property is recorded, the final amount of the capital gain, which depends on the amounts of the fees and levies applicable to Bezeq regarding the sale of the property.

The Bezeq Group'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 2018.

#### 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.

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## 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, 2017 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<br>than 1<br>year | 1-3<br>years | 3-5<br>years | more<br>than 5<br>years |
| Long-term debt obligations (including interest) | 17,142                                      | 2,304                  | 4,612        | 4,407        | 5,819                   |
| Operating lease obligations                     | 1,020                                       | 310                    | 500          | 136          | 74                      |
| Purchase obligations                            | 283   | 283                    | -            | -            | -                       |
| Other long-term obligations                     | 8   | 8                      | -            | -            | -                       |
| Total   | 18,453                                      | 2,905                  | 5,112        | 4,543        | 5,893                   |

## 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>    |     |  |
| Ami Barlev <sup>(1)</sup>                     | 39  | Chairman of the Board of Directors         |
| Felix Cohen                                   | 63  | Director                                   |
| Yossef Elovitch                               | 66  | Director                                   |
| Dudi Ezra <sup>(2)</sup> <sup>(3)</sup>       | 48  | External Director                          |
| Shoshana Shidlo <sup>(2)</sup> <sup>(3)</sup> | 52  | External Director                          |
| Anat Winner <sup>(2)</sup> <sup>(3)</sup>     | 57  | Director                                   |
| Doron Turgeman                                | 50  | Chief Executive Officer                    |
| Itzik Tadmor                                  | 37  | Principal Financial Officer                |
| <b>Bezeq Group's Executive Management</b>     |     |  |
| Yaakov Paz                                    | 57  | Acting Chief Executive Officer of Bezeq    |
| Yehali Rotenberg                              | 47  | Chief Financial Officer of the Bezeq Group |

|                |    |  |
|----------------|----|--|
| Ran Guron      | 49 | Chief Executive Officer of Pelephone           |
| Moti Elmaliach | 59 | Chief Executive Officer of Bezeq International |
| Ron Eilon      | 53 | Chief Executive Officer of DBS                 |

|     |                                       |
|-----|---------------------------------------|
| (1) | Director of B Communications.         |
| (2) | Member of our Audit Committee.        |
| (3) | Member of our Compensation Committee. |

Mr. Ami Barlev, Mr. Felix Cohen, Ms. Anat Winner and Mr. Yossef Elovitch will serve as directors until our 2018 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 second three-year term until August 2020 (see Item 6C. “Directors, Senior Management and Employees - Board Practices - External and Independent Directors - External Directors”). Mr. Shaul Elovitch, our former chairman, and Mr. Yossef Elovitch are brothers. There are no other family relationships among our directors or executive officers.

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Following the Investigation, Mr. Shaul Elovitch first resigned as Chairman and in April 2018 resigned as a director, ending his direct relationship with the Bezeq Group.

Allon Raveh was appointed as the chief financial officer of Bezeq in October 2016 and in April 2017 quit to take up a senior position outside of the Bezeq Group. Stella Handler, Bezeq's former CEO who was already suspended following the Investigation, announced in March 2018 that she was resigning (officially her term will end in July 2018 but she is no longer involved with the Bezeq Group). Bezeq's former Deputy CEO for Business Development, Amikam Shorer is no longer involved with the Bezeq Group either.

Our Directors

*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.

*Ami Barlev* was elected as Acting Chairman of the Board of our company and of B Communications in February 2018. Mr. Barlev succeeded Shaul Elovitch. Mr. Barlev has served as General Counsel of the Eurocom Group since June 2008 and as Vice President since June 2014. Mr. Barlev has acted as our legal counsel since June 2008 until his appointment as Chairman. Mr. Barlev is also serving as a director on the Board of Directors of Bezeq, Walla Communications Ltd.; Pelephone Communications Ltd.; Bezeq International Ltd.; Bezeq Online Ltd.; DBS Satellite Services (1998) Ltd; Gilat Telecom Uganda Limited; TCL Teleserve Communication Ltd; Gilat Satcom Ghana Limited and Gilat Telecom Zambia. Mr. Barlev holds an LL.B degree from Bar Ilan University.

*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.

#### Our Senior Management

*Doron Turgeman* has served as our chief executive officer since October 2011. Mr. Turgeman also serves as the chief executive officer of B Communications. Mr. Turgeman was appointed as a Director of Bezeq in March 2018. Previously, Mr. Turgeman served as our and B Communications' Chief Financial Officer and Vice President of Finance and served as a member of our board of directors from January 2008 to February 2010. He 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.



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*Itzik Tadmor* has served as our company's Principal Financial Officer since May 2015. Mr. Tadmor served as our company's controller from September 2011 until May 2015. 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.

Executive Management of the Bezeq Group

*Yaakov Paz* was appointed as acting CEO of Bezeq on February 28, 2018 replacing Ms. Stella Handler who stepped down following the recent criminal investigations. Since November 2007, Paz serves as Vice President and Head of Bezeq's Business Division. Mr. Paz served as an External director of Nextcom Ltd. (TASE: NXTM) between 2006 to 2015 and is the CEO and owner of Kobi Paz Communications and Management Ltd.

*Yehali Rotenberg* has served as VP Finance of Bezeq and Chief Financial Officer of the Bezeq Group since September 2017. Between 2012 to 2017, Mr. Roteberg was the Deputy Chief Accountant, Head of Finance and Credit Division at Israel's Treasury Department. Mr. Rotenberg also served as a director of Ashdod Port Ltd. between 2014 and 2016. Mr. Rotenberg holds a B.A. degree in Economics from Touro University, New York, and an M.B.A. degree majoring in Finance from Bar Ilan University.

*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.

*Moti Elmaliach* has served as the chief executive officer of Bezeq International since May 2014. He served as the CEO of Eurocom Digital Communications, which markets the Panasonic brands and products in Israel, from 2006 to 2014. Prior to that, he was the chief executive officer of the communications companies Telit Ltd. and Elgadphone Ltd. Mr. Elmaliach also serves on the board of directors of Satcom Systems Ltd., and is the Chairman of DM (3000) Engineering Ltd., a Eurocom Group communications company, and Tafnit Discount Ltd., an investment company. Mr. Elmaliach holds a B.Sc. degree in Industrial Engineering and an M.B.A. degree from Tel Aviv University

*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 Mirs. Mr. Eilon holds a B.A. degree in Economics and an M.B.A. degree from the Hebrew University of Jerusalem. In February 2018, the Israeli Police and the ISA recommended that Mr. Eilon be indicted on suspicions of violation of Israeli Securities Laws and he is expected to be formally replaced as the chief executive officer of DBS.

## 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 four additional employees who are engaged in management, financial and administrative activities. The aggregate direct compensation we paid to our directors as a group (6 persons) for the year ended December 31, 2017 was NIS 644 thousand (approximately \$186 thousand). This amount includes directors compensation, 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, 2017, no amount was reserved for pension, retirement, recreation payments and vacation or similar benefits for our directors and executive officers.

We have entered into an arrangement with B Communications according to which our employees, including the chief executive officer and the principal financial officer will provide services to both companies and we pay one-third of their compensation and B Communications will pay two-third of their compensation.

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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, 2017 concerning compensation for our Named Executive Officers. All amounts are in US dollars:

|   | <b>Doron<br/>Turgeman</b>                             | <b>Itzik<br/>Tadmor</b>                      |
|---|---|--|
|   | <b>(Chief<br/>Executive<br/>Officer) <sup>1</sup></b> | <b>(Principal<br/>Financial<br/>Officer)</b> |
| Annual fixed salary   | 152,300   | 40,000                                       |
| Retention Bonus (treated as salary costs in the company's financial statements).  | 33,600  | 1,900  |
| Annual and special Bonus (treated as salary costs in the company's financial statements).   | 0   | 2,900  |
| Car Expenses, including lease costs, gas and maintenance, provided to the officers (treated as management and general costs in our company's financial statements). | 9,700   | 4,600  |

(1) 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, 2018:

- (a) 35% of the bonus will be paid if our company's securities are traded higher than the benchmarks for the respective year, but only an increase of at least 5% higher than the benchmark will entitle Mr. Turgeman to the bonus;
- 35% of the bonus will be paid if our company or one of our publicly traded debentures receives a higher rating
- (b) from a recognized credit rating agency, compared to the rating given in the previous year by the rating agency. A positive change in the rating outlook will entitle Mr. Turgeman to half of this bonus component;
- (c) 15% of the bonus will be paid if the company's securities' trading volume increases at least 20% higher than the previous year, on average; and
- (d)

15% of the bonus will be paid if the 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.

In June 2017, our shareholders approved our entering into a Services Agreement with Eurocom Communications pursuant to which it will provide us with the services of its Legal Department in consideration of a monthly fee of NIS 15,500, plus an annual fixed amount of up to NIS 6,000 in respect of various other expenses to be paid against receipts and documentation. Based on our prior experience, we estimated that the scope of the legal services provided to our company averaged approximately 48 hours per month on an annual basis. The legal services' portion of the Services Agreement was terminated March 31, 2018.

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In February 2018, our Board of Directors appointed Adv. Ami Barlev to serve as a director and as Acting Chairman of our Board of Directors until the next annual shareholders' meeting.

In March 2018, Eurocom and we terminated the rest of the Services Agreement. Our Compensation Committee and Board of Directors have confirmed, among other things, that upon termination of the Services Agreement, Messrs. Yossef Elovitch, Felix Cohen and Ami Barlev will be entitled to compensation as directors pursuant to the "Fixed" statutory amount in accordance with the Companies Regulations (Rules Regarding Compensation and Expenses for an External Director) 5760-2000 for companies within the range of our size. In addition, the directors will be entitled to receive reimbursement of expenses in accordance with the provisions of these Compensation Regulations, to receive coverage under the insurance policy that applies to all of our directors and officers, and to receive indemnification letter as given to all of our directors and officers. Mr. Barlev's compensation is effective starting February 7, 2018. The compensation of Messrs. Yossef Elovitch and Felix Cohen is effective starting April 1, 2018.

We currently pay each of our external directors, as well as to our independent director, annual fees of NIS 70,000 (approximately \$18,000) and a per meeting attendance fee of NIS 2,500 (approximately \$650). Such fees are paid based on the "Fixed" fees set forth in regulations promulgated under the Israeli Companies Law. According to the regulations, an external director (and our independent director) is entitled to 60% of the per meeting fee if he or she participated in the meeting by means of communication and not in person, and to 50% of the per meeting fee if resolutions were approved in writing, without convening a meeting. All of our non-employee directors are reimbursed for their expenses for each meeting of the board of directors and audit committee attended.

Our internal auditor, who is also deemed to be an "officer" in accordance with the Israeli Companies Law, received approximately NIS 46 thousand (approximately \$13 thousand) for his services in 2017. Such costs are treated as management and general costs in our financial statements.

### C. Board Practices

According to the Israeli Companies Law-1999, or the Israeli Companies Law, and our articles of association, the management of our business is vested in our board of directors. Our board of directors may exercise all powers and take all actions that are not specifically granted to our shareholders. Our executive officers are responsible for our day-to-day management and have individual responsibilities established by our chief executive officer and the board of directors. Executive officers are appointed by and serve at the discretion of our 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 two and no more than ten directors or such other number as may be determined from time to time at a general meeting of shareholders. Our current board of directors consists of six directors.

In accordance with our articles of association and the Israeli Companies Law, all of our directors (other than our external directors) are elected at annual meetings of our shareholders, which are required to be held at least once during every calendar year and not more than 15 months after the last preceding meeting. Except for our external directors, our directors are elected by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual meeting of shareholders following the annual meeting at which they were appointed. The general meeting of shareholders may remove any director from office, other than an external director, by an ordinary resolution, subject to applicable law. Our board of directors may temporarily fill vacancies in the board of directors until the next general meeting at which directors are appointed, if the total number of directors does not exceed the maximum number permitted under our articles of association. The board of directors is entitled to remove from office any director appointed by it.

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. Dudi Ezra, Mr. Felix Cohen, Ms. Shoshana Shidlo and Ms. Anat Winner have the requisite “accounting and financial expertise.”

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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.



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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 second three-year term until August 2020. 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 owns 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.

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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. 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.

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.

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 Israeli Companies Law. On December 21, 2017, an amended compensation policy was approved by our shareholders.

#### 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;



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reasonable litigation expenses, including attorneys' fees, expended by the office holder or for which the office holder is charged by a court:

in an action brought against the office holder by the company, on behalf of the company or on behalf of a third party,

in a criminal action from which the office holder is acquitted, or

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.

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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. The total annual coverage for a particular year may not exceed 125% of the cost of coverage for the preceding year. The total annual insurance premium for a particular year shall not exceed 145% of the cost of coverage for the preceding year.

D. Employees

On December 31, 2017, we had six 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.

As of December 31, 2017, the Bezeq Group employed 11,677 persons, of whom 5,582 persons were employed by Bezeq, 2,551 persons were employed by Pelephone, 1,864 persons were employed by Bezeq International and 1,680 persons were employed by DBS.

As of December 31, 2016, the Bezeq Group employed 11,901 persons, of whom 5,649 persons were employed by Bezeq, 2,594 persons were employed by Pelephone, 1,905 persons were employed by Bezeq International and 1,753 persons were employed by DBS.

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.

Israeli labor laws and regulations are applicable to our employees. 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 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, our employees and we 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 May 14, 2018, none of our directors and executive officers beneficially owns any of our ordinary shares. Mr. Shaul Elovitch, Mr. Yossef Elovitch, Eurocom Communications and Eurocom Holdings (1979) Ltd. are the beneficial owners of 11,633,966 of our ordinary shares. Eurocom Communications Ltd., or Eurocom Communications, holds 10,508,966 of our ordinary shares directly. Eurocom Communications is 99.33% owned by Eurocom Holdings (1979) Ltd., or Eurocom Holdings, and 0.67% by Mr. Shaul Elovitch. Mr. Shaul Elovitch and 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). Accordingly, Mr. Shaul Elovitch may be deemed to have the sole voting and dispositive power as to our ordinary shares held of record by Eurocom Communications. Mr. Shaul Elovitch may also be deemed to be the beneficial owner of 26,893 ordinary shares held of record by his wife, Mrs. Iris Elovitch, as well as shares 8,300 of our shares that are held by other family members of his family. On April 22, 2018, the Tel Aviv-Jaffa District Court issued a liquidation order for Eurocom Communications effective May 3, 2018. According to the order, the official receiver will be the temporary liquidator of Eurocom Communications until the appointment of a permanent liquidator, and attorneys Pinchas Rubin, Amnon Lorch and Uri Gaon were appointed as special managers. The liquidation order does not currently constitute a "change of control" regarding the Control Permit at this point but this may change in the future. Separately from the question of the Control Permit, Shaul Elovitch's effective control of Eurocom Communications is questionable though following the appointment of the special managers and his direct holdings of our shares are also in question following the criminal investigations against him.

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TRANSACTIONS

## A. Major Shareholders

The following table sets forth certain information as of May 14, 2018 regarding the beneficial ownership by all shareholders known to us to own beneficially 5% or more of our ordinary shares:

| Name                                  | Number of<br>Ordinary<br>Shares<br>Beneficially<br>Owned <sup>(1)</sup> | Percentage of<br>Ownership <sup>(2)</sup> |   |
|---------------------------------------|---|---|---|
| Eurocom Communications <sup>(3)</sup> | 11,633,966  | 60.58                                     | % |
| Yelin Lepidot <sup>(4)</sup>          | 1,631,226   | 8.49                                      | % |

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 May 14, 2018.

Mr. Shaul Elovitch, Mr. Yossef Elovitch, Eurocom Communications and Eurocom Holdings (1979) Ltd. are the beneficial owners of 11,633,966 of the ordinary shares. Eurocom Communications Ltd., or Eurocom Communications, holds 10,508,966 of the ordinary shares directly. Eurocom Communications is 99.33% owned by Eurocom Holdings (1979) Ltd., or Eurocom Holdings, and 0.67% owned by Mr. Shaul Elovitch. Mr. Shaul Elovitch and 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). Accordingly, Mr. Shaul Elovitch may be deemed to have the sole voting and dispositive power as to the Issuer's ordinary shares held of record by Eurocom Communications. Mr. Shaul Elovitch may also be deemed to be the beneficial owner of 26,893 ordinary shares held of record by his wife, Mrs. Iris Elovitch. 1,125,000 of the ordinary shares are held directly in a joint account of Messrs. Shaul and Yossef Elovitch. On April 22, 2018, the Tel Aviv-Jaffa District Court issued a liquidation order for Eurocom Communications effective May 3, 2018. According to the order, the official receiver will be the temporary liquidator of Eurocom Communications until the appointment of a permanent liquidator, and attorneys Pinchas Rubin, Amnon Lorch and Uri Gaon were appointed as special managers. The liquidation order does not currently constitute a "change of control" regarding the Control Permit at this point but this may change in the future. Separately from the question of the Control Permit, Shaul Elovitch's effective control of Eurocom Communications is questionable though following the appointment of the special managers and his direct holdings of our shares are also subject to criminal sanctions following the criminal investigations against him.

Based on a Schedule 13G/A filed by Dov Yelin, Yair Lapidot and Yelin Lapidot Holdings Management Ltd. on (4) January 31, 2018. 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

Eurocom Communications reported sales of our ordinary shares in its Schedules 13D/A filed on December 4, 2015, January 15, January 22, and June 3, 2016. According to the reports, in 2015, Eurocom sold 573,310 of our ordinary shares and in 2016, Eurocom sold 1,205,914 of our ordinary shares in private transactions in Israel. In 2017 Eurocom reported the sale of 60,099 ordinary shares.

As reported above, Shaul Elovitch and Eurocom Communications have been attempting to sell the controlling stake of our company to the Saidoff Group or to other investors. Shaul Elovitch's effective control of Eurocom Communications is questionable following the appointment of special managers to liquidate Eurocom Communications and his direct holdings of our shares are also subject to criminal sanctions.

Yelin Lepidot filed amendments to Schedule 13Gs reflecting ownership levels between 7.87% as of December 31, 2016 and 8.49% as of December 31, 2017.

#### 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 May 14, 2018, there were 23 holders of record of our ordinary shares, of which 18 record holders holding 55.3% 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 34.74% of our outstanding ordinary shares as of such date). According to the information available to us, as of our last annual general meeting, we had 799 beneficial holders in the United States.

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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 instances, 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, former 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 110,000 (approximately \$32,000) for each company. Eurocom Digital provides us and Internet Gold with additional services, such as computing services for an annual fee of NIS 24,000 (approximately \$7,000) All of these expenses are divided one-third to us and two-thirds to B Communications.

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.

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Pursuant to the registration rights agreement, on December 9, 2015 we filed a registration statement on Form F-3 including 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.

On January 30, 2017, we filed on behalf of Messrs. Shaul and Yossef Elovitch a registration statement on Form F-3 and a prospectus relating to the resale, from time to time, by Messrs. Shaul and Yossef Elovitch, as the selling securityholders, of up to 925,000 of our ordinary shares. The registration statement became effective on January 30, 2017.

## **Services Agreement**

In June 2017, our shareholders approved our entering into a Services Agreement with Eurocom Communications pursuant to which it will provide us with the services of its Legal Department. The legal services' portion of the Services Agreement was terminated on March 31, 2018.

In February 2018, our Board of Directors appointed Adv. Ami Barlev to serve as a director and as Acting Chairman of our Board of Directors until the next annual shareholders' meeting.

In March 2018, Eurocom and we terminated the rest of the Services Agreement. Our Compensation Committee and Board of Directors have confirmed, among other things, that upon termination of the Services Agreement, Messrs. Yossef Elovitch, Felix Cohen and Ami Barlev will be entitled to compensation as directors pursuant to the "Fixed" statutory amount in accordance with the Companies Regulations (Rules Regarding Compensation and Expenses for an External Director) 5760-2000 for companies within the range of our size. In addition, the directors will be entitled to receive reimbursement of expenses in accordance with the provisions of these Compensation Regulations, to receive coverage under the insurance policy that applies to all of our directors and officers, and to receive indemnification letter as given to all of our directors and officers. Mr. Barlev's compensation is effective starting February 7, 2018. The compensation of Messrs. Yossef Elovitch and Felix Cohen is effective starting April 1, 2018.

## **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, under which Eurocom Capital handles the execution of our financial investments pursuant to direct

instructions from our chief executive officer. The execution services agreement was terminated on November 30, 2017. 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 433,000, NIS 338,000 and NIS 228,000 (approximately \$66,000) for the years ended December 31, 2015, 2016 and 2017, respectively.

#### 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.

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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.

### Employee compensation costs

We have entered into an arrangement with B Communications according to which our employees, including the chief executive officer and the principal financial officer provide services to both companies and we pay one-third of their compensation and B Communications pays two-thirds of their compensation.

### 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 accordance with a recent amendment to the Israeli Companies Law, Bezeq's audit committee has determined that transactions of Bezeq or its subsidiaries 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.

In view of the restrictions imposed on the activities of Mr. Shaul Elovitch, and of other directors then serving on the Boards of Bezeq and its subsidiaries on behalf of Eurocom Communications as a result of the Investigation, on September 25, 2017, Bezeq's Board of Directors adopted the Compensation Committee's recommendation and resolved that the amount to be paid to Eurocom Communications under the management agreement for the services of the Acting Chairman of the Board and the subsidiaries and affiliates for the period from June 20, 2017 (and for as long as no material change will be made to the restrictions currently imposed on Shaul Elovitch) will be 50% of the amount stipulated in the agreement for this period. This decision remained in effect until the end of 2017 and continued into 2018.

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## Bezeq Group Transactions Deemed to be Significant

| Approval date of Bezeq's AGM (after approval of Bezeq's audit/compensation committee and Board of Directors), unless otherwise stated. | Nature of the transaction   | Amount of the transaction   |
|--|---|---|
| (1) March 23, 2015   | Approval of Bezeq's acquisition agreement with Eurocom DBS Ltd. whereby Bezeq will acquire the entire holdings of Eurocom DBS in DBS and all the shareholder loans provided by Eurocom DBS to DBS (including acceptance of the terms established by the Antitrust Commissioner's in his approval of the merger on March 26, 2014, both by Bezeq and by DBS, and announcement of the exercise of the option for the allotment of 6,221 DBS shares, at no cost, representing 8.6% of the share capital of DBS). | The total cost is comprised of:<br>A. Total cash of NIS 680 million<br>B. Total cash of up to NIS 200 million (subject to certain conditions)<br>C. Total cash of up to NIS 170 million (subject to certain conditions) |
| (2) October 19, 2015   | Approval of Bezeq's vote at the general meeting of shareholders of DBS in favor of DBS's agreement with Eurocom Digital Communications Ltd. and ADB for the order of yesMaxTotal3 decoders, under the existing agreement, until December 31, 2017   | Total cost of \$ 14 million   |
| (3) 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)   |
| (4) June 30, 2016  | Extension of the amended agreement with Eurocom Communications for ongoing management and consultation services for Bezeq. The agreement was approved for three years, with a term expiring on May 31, 2019, unless one of the parties submits three-months' notice of termination of the agreement.  | NIS 6.4 million per year  |
| (5) April 3, 2017  | Approval of Bezeq's vote at the general meeting of DBS in favor of the agreement between DBS and Spacecom with an amendment/addendum to the existing agreement between the parties dated November 4, 2013, for the lease of satellite segments in Spacecom's satellites, including in   | A total nominal cost of up to \$263 million for the entire term of the Agreement (until December 31, 2028), reflecting an average annual cost of USD 21.9 million. It should be noted                                   |

|   |  |
|---|--|
| <p>favor of implementation of the agreement. The term of the agreement remains the same as the original agreement, namely, until the end of 2028.</p> | <p>that the overall cost of the Agreement may be lower if surplus revenue sharing mechanisms are applied and/or the assumptions set out in the amendment to the Agreement.</p> |
|---|--|

Transactions with a controlling shareholder that were not irregular transactions that were authorized:

**Date of approval of Bezeq's Board of Directors after receiving the approval of Bezeq's audit committee**

**Nature of the transaction**

**Amount of the transaction**

|                          |   |   |
|--------------------------|---|---|
| <p>November 27, 2014</p> | <p>Bezeq's agreement to bring forward payments with Eurocom Digital, according to which DBS may advance, at the supplier's request, payments that are due, or will be due, to Eurocom Digital for orders of decoders.</p> | <p>Up to a total cost of \$ 6 million; this approval was not used in 2017.</p>  |
| <p>November 3, 2016</p>  | <p>Bezeq's agreement with Eurocom Digital for the additional acquisition of up to 90,000 VTECH N VDSL routers, valid until June 30, 2017.</p>   | <p>Approval of the acquisition in an amount of up to \$ 11.3 million (not including VAT)</p> <p>In addition, in 2017, additional N standard VDSL routers were acquired, but in amounts that do not exceed the negligibility level as described above.</p> |
| <p>July 5, 2017</p>      | <p>The agreement between Bezeq International and Eurocom Digital for the purchase of up to 100,000 TECH VDSL routers</p>  | <p>Approval of the acquisition in an amount of up to \$3.2 million (not including VAT)</p>  |

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C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

Financial Statements

See the consolidated financial statements of our company and Bezeq, including the notes thereto, listed in Item 18 “Financial Statements” and incorporated herein by this reference.

Export Sales

Not applicable.

Legal Proceedings (our company and B Communications)

On June 29, 2017, Plaintiff Lynne P. Maleeff commenced litigation on behalf of a purported class of all persons and entities who purchased or otherwise acquired B Communications shares between March 18, 2015 and September 6, 2017. The original defendants were B Communications, Doron Turgeman (our and B Communications’ CEO), Itzik Tadmor (our and B Communications’ CFO) and Ehud Yahalom (our and B Communications’ former CFO). On December 8, 2017, lead plaintiffs filed an amended complaint adding ten new defendants: Shaul Elovitch, Or Elovitch, Ron Eilon, Stella Handler, David Mizrahi, Micky Neiman, Allon Raveh, Linor Yochelman, DBS and Eurocom Communications.

The amended complaint alleges a single cause of action against B Communications for violation of Section 10(b) of the Exchange Act and SEC Rule 10b-5 promulgated thereunder. The complaint alleges that B Communications made false and misleading statements and omissions in SEC filings.

On February 20, 2018, B Communications moved to dismiss the litigation for failure to state a claim or, alternatively, to stay the litigation pending the outcome of criminal investigations in Israel. The motion to dismiss asserts, among other things, that plaintiffs failed to allege that B Communications had the required knowledge or scienter about the purported wrongdoing by other defendants and that B Communications did not make any materially false statements. Plaintiffs filed their opposition to the motion to dismiss or stay on April 17, 2018. The court may schedule oral argument on the motion to dismiss sometime in June or July, and it is possible that a decision will be issued before the end of October. While B Communications has solid arguments in its favor, it is impossible to predict how the court will rule on the motion to dismiss or stay. Similar class action lawsuits were filed in Israel, and are described in the table below.

Our company, B Communications and five members of our Board of Directors were named as respondents in a motion to certify a claim as a derivative claim instituted in the Tel Aviv District Court (Economic Affairs Division) on July 28, 2016. The plaintiff has alleged that NIS 133 million out of the dividends distributed in May 2016 was distributed unlawfully as such amount was not included in a profit and loss report, and therefore does not qualify as a “surplus” that may be lawfully distributed as dividends under the Israeli Companies Law. A pretrial hearing was held in March 2017, in which the court allows us to file an additional brief response and a supplementary expert opinion, in order to respond to the arguments. We filed the additional responses on in June 2017. The court further held that the parties should consider the possibility of a constructive dialogue regarding the issues in dispute and instructed the parties to inform the court about the results of this dialogue, and whether they want to set a date for an evidence hearing or additional preliminary motions. The dialogue process failed, and accordingly, the court set dates for the evidence hearing (as part of the motion to certify) for January 6, 2019.

On December 28, 2016, B Communications received a “best judgment” tax assessment for the years 2011 and 2012 of approximately NIS 50 million (not including interest and linkage differentials). The Israeli Tax Authority is claiming that additional taxes are due with respect to the alleged capital gain generated from the capital reduction of Bezeq during the period from 2011 to 2013. B Communications disagrees with the position of the Tax Authority and believe that we have good arguments to support our position. Accordingly, B Communications filed an appeal and believe that the tax liability arising from this assessment, if any, will not be material.

#### Legal proceedings against the Bezeq Group

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.

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Bezeq's reporting policy is based on qualitative and quantitative considerations. Bezeq decided that the bar of amount materiality would be events affecting Bezeq's net profit by 5% or more according to its latest annual consolidated financial statements. Accordingly, this section describes legal proceedings involving NIS 80 million or more (approximately NIS 60 million of the net profit), and legal proceedings in which the amount claimed is not stated in the statement of claim, except in the case of a claim which prima facie does not reach the above amount bar (and all unless Bezeq believes the claim has other aspects and/or implications beyond its monetary amount). In regards to class actions, Submission of class actions in Israel does not involve payment of a fee deriving from the amount of the claim. Accordingly, the amount of a claim in claims of this type may be significantly higher than the scope of true exposure for those claims.

On May 3, 2018, Bezeq received a request from the ISA to clarify information included in its financial statements regarding the investigation of the ISA and the Israeli Police. Bezeq's auditors also received a request from the ISA, requesting clarification regarding their opinion on the financial statements.

| <b>Date</b>  | <b>Parties</b>                    | <b>Instance</b>                                | <b>Type of proceeding</b>         | <b>Description</b>   | <b>Original Amount of the Claim (NIS in millions)</b>   |
|--------------|-----------------------------------|--|-----------------------------------|--|---|
| January 2015 | Shareholder v. Bezeq and 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: "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</p> | <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.</p> |

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.

As it emerges from Bezeq's reports to the public (and as indicated in the petition), Bezeq reported on these two matters via immediate reports to the public, as well as via its periodic reports (annual and quarterly reports), which included all the material and relevant information relative to these matters, and all reports were lawful.

|            |             |  |   |   |     |
|------------|-------------|--|---|---|-----|
| March 2015 | Shareholder | District Court (Tel Aviv, Economic Department) | Motion for approval of a claim as a derivative claim, including a statement of derivative claim | The claim was fined against Bezeq, Mr. Shaul Elovitch, the controlling shareholder (indirectly) of Bezeq and Chairman of its Board of Directors, and Bezeq directors on the relevant dates who voted for Bezeq's transaction under the application, as set out below. | 502 |
|------------|-------------|--|---|---|-----|

According to the allegations in the application, Bezeq decided, through the Respondents, to enter into a transaction to purchase all the holdings and shareholders loans of Eurocom DBS (a company indirectly controlled by Bezeq's controlling shareholder) in DBS in return for NIS 680 million in cash and contingent considerations of up to NIS 370 million.

The plaintiff claims that the consideration which is expected to be paid for the transaction is exorbitant and the decisions of the Respondents to enter into the transaction caused 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' holdings in DBS to sell the holdings as from the end of March 2015.

In view of the foregoing, the plaintiff requests that the court approve filing of a derivative claim on behalf of 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.



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| Date        | Parties           | Instance                  | Type of proceeding                                 | Description  | Original Amount of the Claim (NIS in millions) |
|-------------|-------------------|---------------------------|--|--|--|
|             |                   |                           |  | <p>On January 26, 2017, the court approved submission of a revised motion by the plaintiff that includes further claims relating to the independence of the parties advising Bezeq, alleged faults in the work of the Audit Committee, Board of Directors and general meeting, and alleged faults stemming from representation of Eurocom by entities serving as directors in Bezeq.</p>   |  |
|             |                   |                           |  | <p>In view of the Israel Securities Authority investigation in connection with the agreement, which is the subject of this claim and the ISA's position that this move should be delayed, the court decided upon a stay of proceedings in this case, at this stage, until March 5, 2018. In March 2018, the Authority submitted its position that the move should continue to be delayed and requested to resubmit its position on the matter by July 17, 2018. A decision on the matter has not yet been given.</p>   |  |
| August 2015 | Customer v. Bezeq | District Court (Tel Aviv) | Action and request to approve it as a class action | <p>For the decision from October 24, 2017, concerning the striking out of three motions to disclose documents prior to filing a motion to certify a derivative claim given that these motions raise factual and legal questions that, in principle, are similar to the questions raised in this motion as well as then application for instructions filed by Bezeq on January 21, 2018 regarding managing this move together with another motion to disclose documents prior to filing a motion to certify a derivative claim that was filed in December 2017. It was alleged that Bezeq abused its monopoly position to price its services in a manner that restricts the ability of Bezeq's competitors to offer fixed-line telephony services at competitive prices. This includes by offering its customers special offers in which it charges a lower price for its fixed-line telephony services than the price charged only for internet infrastructure services, namely for an input which is critical to the activity of its competitors in the market that operate using VoB technology. In November 2014, the Antitrust Authority ruled that Bezeq abused its position as a monopoly (on which to a large extent the motion to certify is</p> | 244  |

based). Bezeq filed an appeal with the Antitrust Tribunal against the ruling and on March 20, 2018 a judgment was handed in the appeal under which the Ruling was canceled. The plaintiff argues that the damage to the public resulting from the above was estimated by reviewing the difference between the fixed-line telephony market price and comparing it with the weighted hypothetical price that would be charged in a market with competition that would lead to a long-term reduction in prices. According to the plaintiff's claims, the members of the represented class 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.

In November 2016, the court approved Bezeq's 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. As noted above, the Ruling was canceled under this proceeding.

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| <b>Date</b>                  | <b>Parties</b>    | <b>Instance</b>        | <b>Type of proceeding</b>  | <b>Description</b>   | <b>Original Amount of the Claim (NIS in millions)</b>             |
|------------------------------|-------------------|------------------------|--|--|---|
| November 2015 and March 2018 | Customer v. Bezeq | Central District Court | Two actions together with motions for their certification as class actions | Motion of November 2015 - It was alleged that Bezeq abused its position as a monopoly by “preventing and blocking competition in general and effective competition in the Israeli telecommunications market”, and acted to delay and prevent the wholesale market reform, thereby causing damage to the Israeli public and earning unreasonable profits only as a result of abusing its power as a monopoly. According to the plaintiffs’ allegations, the damage caused by Bezeq to the communication market in Israel is expressed by Bezeq’s excessive and unreasonable profits and they wish to claim 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). | 550 in the November 2015 motion and 258 in the March 2018 motion. |

Another motion on the same matter filed against Bezeq in March 2016 was struck out in May 2016 due to the similarity to the above motion. Subsequently, and for the court’s approval, the above plaintiff filed a motion to certify a class action on the same matter.

In December 2017, the court approved inclusion in the case an immediate report published by Bezeq on October 22, 2017, in which Bezeq reported on a final supervision report issued by the Ministry of Communications concerning implementation of the wholesale telephony service and notice of the Ministry’s intention to impose a financial sanction

in this matter.

Motion of March 2018 - a similar motion to that of November 2015 that was filed by the same plaintiffs also alleging that Bezeq abused its monopoly position by preventing competition in the telecommunications market, thereby causing damage to the Israeli public and earning unreasonable profits as a result of abusing its power as a monopoly. While the relief and damage claimed in the November 2015 motion related to the period up to the date of filing that motion, in this motion the relief and damage claimed relate to a period from the date of filing the November 2015 motion through to the end of 2017, in view of the plaintiffs' allegation that Bezeq did not cease the actions alleged against it in the previous motion and in view of the allegation added to the tort, in addition to exploitation of the strength of Bezeq, "acts of corruption and unlawful activities for proscribed purposes of the Director General of the Ministry of Communications" According to the plaintiffs, the damage caused by Bezeq to the telecommunications market in Israel is reflected in the excess and unreasonable profitability of Bezeq. The claimed damage of NIS 258 million, in this motion is also based on 10% of Bezeq's surplus operating profit, arising from abuse of its monopolistic strength (in addition to the damages claimed in the previous motion).

Special motion to certify a class action (filed in June 2016) further to consolidation of several similar motions). It is alleged against Bezeq that it is intentionally limiting the surfing speed defined for the ISPs and refraining from repairing malfunctions on the matter. Against the ISPs (including Bezeq International) it is alleged that they are misleading their customers regarding the internet surfing speed by selling them packages at a speed that they are unable to provide.

|           |   |                              |  |  |                        |
|-----------|---|------------------------------|--|--|------------------------|
| June 2016 | Customers<br>against Bezeq,<br>Bezeq<br>International<br>and other ISPs | Central<br>District<br>Court | Action and<br>request to<br>approve it as<br>a class action. | Special motion to certify a class action (filed in June 2016) further to consolidation of several similar motions). It is alleged against Bezeq that it is intentionally limiting the surfing speed defined for the ISPs and refraining from repairing malfunctions on the matter. Against the ISPs (including Bezeq International) it is alleged that they are misleading their customers regarding the internet surfing speed by selling them packages at a speed that they are unable to provide. | Cannot be<br>estimated |
|-----------|---|------------------------------|--|--|------------------------|

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| Date                          | Parties             | Instance  | Type of proceeding   | Description   | Original Amount of the Claim (NIS in millions)         |
|-------------------------------|---------------------|---|--|---|--|
| September 2016                | Cellcom and Partner | Tel Aviv District Court                             | Opening order for declarative relief and orders for mandamus against Bezeq | In the context of the action, the court is asked: (1) to declare that Bezeq is obligated to market those ISPs who are among the Plaintiffs as part of the joint bundles marketed by Bezeq in an equal manner and in accordance with the Ministry's instructions, and to instruct Bezeq to do so. (2) To declare that the obligations imposed on Bezeq with respect to the supply of managed wholesale broadband access include an obligation to install and connect customers of 013 Netvision and 012 Smile to Bezeq's infrastructure up to the first socket in their home, and to instruct Bezeq to do so. (3) To declare that Bezeq is obligated to allow the Plaintiffs and/or any one of them to use the passive infrastructure that it owns and to instruct Bezeq to do so. | *  |
| August 2016 and December 2016 | Customer v. Bezeq   | District Court of Tel Aviv and the Central District | Two actions together with motions for their certification as class actions | Two motions claiming that Bezeq charges a monthly payment of NIS 5.93 for "support and/or liability" as part of using its internet infrastructure, unlawfully and without consent.  | * One action for an unknown amount and the other - 160 |
|                               |                     |   |  | Due to the similarity between the motions, the motion was transferred from the Central District Court to the Tel Aviv District Court and a motion was filed to strike out one of the actions.   |  |
|                               |                     |   |  | On March 26, 2017, the court resolved to strike out the later motion (motion of December 2016)  |  |

for NIS 160 million).

On May 14, 2017, Bezeq received notice of an appeal (that was filed in the Supreme Court on May 4, 2017) by the plaintiff in the later motion asking to strike out the earlier motion and continue the hearing in the later motion.

Two motions claiming that Bezeq collects payment from some of its customers for an anti-virus service, while in practice it does not provide them with such service, and that it starts charging for provision of the service from signing of the agreement with the customers and not from actual provision of the service. Accordingly, the Plaintiff requests requiring Bezeq to compensate its customers that purchased the service and did not actually receive it for the damages incurred by them, including refunding of amounts collected for the service.

\* There is no accurate estimation, estimated at NIS tens of millions.

Another action together with a motion for certification as a class action was filed with the Jerusalem District Court on the same matter.

Amount of the additional action - 11

On July 4, 2017, the Central District Court resolved to strike out the later motion (the motion for the amount of NIS 11 million) in view of the similarity between the two motions.

The motion pertains to Bezeq's B144 service, which enables businesses to advertise on the Internet. According to the plaintiff, the respondents charged subscribers unlawful charges for this service.

1,110 (based on an estimated 300,000 customers and compensation of NIS 3,700 per customer) in the first motion and

February 2017

Customer v. Bezeq

Central District Court

Two motions for certification as class actions

April 2017 and May 2017

Customers against Bezeq (motion of April 2017 also against the subsidiary Walla! Communications Ltd., Yad2 and an

Tel Aviv District Court

Two motions for certification as class actions

advertising company  
owned by Walla).

the second motion  
cannot be  
estimated

On January 25, 2018, the court resolved, further to motions filed by Bezeq and other respondents, to dismiss the first motion in limine on grounds that the application does not meet the criteria set out in the Class Actions Law and the existence of flaws in the motion, and in view of the existence of the second motion which is similar to the first (in February 2018, Bezeq was served a motion for exemption of fees and collateral filed in the Supreme Court, probably with regard to filing of an appeal against the resolution.) The second motion will continue to be heard in court.

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| <b>Date</b> | <b>Parties</b>  | <b>Instance</b>                                      | <b>Type of proceeding</b>            | <b>Description</b>  | <b>Original Amount of the Claim (NIS in millions)</b>  |
|-------------|---|--|--------------------------------------|---|--|
| June 2017   | Shareholders of Bezeq Against Bezeq, Chairman of Bezeq's Board of Directors, members of Bezeq's Board of Directors, and companies in the Eurocom Group (the first motion also against the CEO of Bezeq and the CEO and CFO of DBS). | At the Tel Aviv District Court (Economic Department) | Two motions to certify class actions | <p>The subject of the motions is the transaction from 2015 in which Bezeq acquired from Eurocom DBS Ltd (a company controlled by Bezeq's controlling shareholders) the balance of 568 shares of DBS that it held.</p> <p>The first motion was filed in the name of anyone who acquired Bezeq shares between February 11, 2015 and June 19, 2017 (excluding the respondents and/or those acting on their behalf and/or connected with them). In the motion it is argued that the report concerning the transaction was misleading and/or deficient, and on account of which, due to the opening of a public investigation into the transaction by the ISA, the public has become aware of details concerning the transaction and its implementation, which led to a drop in Bezeq's share price in the days following the disclosure and analysis of the new information. The plaintiff argues that the respondents acted contrary to the provisions of the Securities Law, and contrary to the provisions of additional laws, and caused holders of Bezeq's securities heavy financial losses, amounting to millions of shekels if not more.</p> <p>The second motion was filed in the name of three sub-classes - anyone who acquired (1) shares of Bezeq, (2) shares of B Communications Ltd, and (3) shares of Internet Gold - Golden Lines Ltd. on the Tel Aviv Stock Exchange between May 21, 2015 and June 19, 2017. The plaintiff argues that the public that invested in these shares was seriously misled, which was uncovered following the opening of a public investigation into the transaction by the ISA on June 20,</p> | 1,300 in the first motion and 568 in the second motion |



2017, whereby the increase in the cash flow of DBS as reported in Bezeq's financial statements was artificially inflated, according to their claim, thereby misleading reasonable investors who based themselves on DBS cash flow data to estimate its worth, which led to over-valuation of the above companies. The plaintiff also claims additional damage caused to the groups of shareholders in B Communications and Internet Gold.

On October 25, 2017, a ruling was given ordering the striking out of another (third) class action certification motion filed in the same court in July 2017 concerning a transaction for the purchase of DBS shares and a transaction to continue the agreement between DBS and Spacecom, after the court ruled that the above motions should be preferred and after failing to find any added value in the other motion to advancing the class's interests or facilitating the hearing.

In accordance with a procedural arrangement approved earlier by the court, the plaintiffs agreed in the above motions to administer the motions jointly and they will file a consolidated motion.

On December 10, 2017, the court resolved to postpone the hearing in the case for 4 months after the Attorney General's attorney submitted his position whereby the hearing in this case should be delayed at this stage for 4 months, to enable the evidence in connection with the ISA investigation to be examined by the District Attorney's office, to allow the investigation to be completed to the extent that this is necessary, and so that the District Attorney's office can formulate its position.

On May 2, 2018 the Court granted the Attorney General's request and ordered the proceeding

stayed for an additional four months. The Attorney General is required to update the Court by August 12, 2018.

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| <b>Date</b>                                      | <b>Parties</b>  | <b>Instance</b>         | <b>Type of proceeding</b>   | <b>Description</b>  | <b>Original Amount of the Claim (NIS in millions)</b> |
|--|---|-------------------------|---|---|---|
| June-August 2017 and a motion from December 2017 | Bezeq shareholders against Bezeq and DBS (not including two motions that were filed only against Bezeq) | Tel Aviv District Court | Various motions to disclose documents prior to filing a motion to certify a derivative claim under Section 198A of the Companies Law filed further to the ISA investigation | <p>In some of these motions (three in all), the court was moved to instruct Bezeq (and DBS, as applicable) to submit to the plaintiffs, documents and information in connection with the agreement for Bezeq's purchase of DBS, and specifically in connection with the Second Contingent Payment according to that agreement (payment of NIS 170 million which is contingent on DBS meeting free cash flow targets in the period 2015-2017). On October 24, 2017, the court resolved to strike out the three motions after accepting the plaintiff's request in the motion to certify a derivative action in the matter of an agreement for Bezeq to purchase DBS (see above), and this after concluding that these motions give rise to questions of fact and law that are essentially similar to the questions that arise in the Earlier Motion. In its decision, the court also noted that if the plaintiff in the Earlier Motion does not submit a motion to amend the motion for certification (such that it also applies to the matters included in the disclosure motions) or, alternatively, it files such a motion and its motion is dismissed, the plaintiffs in the foregoing three motions will have the right to initiate legal proceedings should they so determine.</p> <p>In some of the motions, the court was moved to instruct Bezeq (and DBS, as applicable) to submit to the plaintiffs, certain documents in connection with an interested party transaction between DBS and Spacecom from 2013, as amended early in 2017. On December 10, 2017, the plaintiffs in three motions notified they were "joining forces" and cooperating with each other. A hearing on the</p> |   |

question of which motions should be dismissed and which should remain was held on January 8, 2018 and a ruling on the matter has not yet been given. Further to ISA's position that in view of the investigation the proceedings in these cases should be delayed, the court ordered the proceedings to be delayed until April 10, 2018.

In an additional motion, the court was moved to instruct Bezeq and DBS to submit to the plaintiffs, documents and information also in connection with the agreement for Bezeq's purchase of DBS and in connection with the DBS - Spacecom Transaction. In this motion, the plaintiff wishes to explore the filing of a motion to certify a derivative claim against officers in Bezeq and DBS who were in breach of their fiduciary duty against Bezeq in these transactions, according to the plaintiff, where the relief requested is to return all the benefits they received for the positions they held in Bezeq or DBS (salary, bonuses, management fees, etc.). The court consolidated the preliminary hearing in this case with the preliminary hearing on the motions to disclose documents prior to filing the motion to certify a derivative claim, detailed above.

Motion from December 2017 - motion to order Bezeq to disclose various documents to the plaintiff with respect to advance payments on account of the second contingent payment in the DBS transaction, claiming that the decision to pay advances and to pay them without any collateral was flawed. On January 21, 2018, Bezeq filed an application for instructions and requesting the court to strike out one of the two motions, either this motion or the motion to certify a derivative claim since they deal with overlapping issues.

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| Date          | Parties   | Instance                                      | Type of proceeding                   | Description  | Original Amount of the Claim (NIS in millions) |
|---------------|---|---|--------------------------------------|--|--|
| December 2017 | Action originally filed in the name of holders of B Communications securities against B Communications and its officers. Under a revised claim, DBS and officers (past and present) of DBS and Bezeq were added for the first time to the list of respondents. Bezeq was not added to the proceeding. | Court in New York State, USA                  | Motion to certify a class action     | <p>The motion alleges false and misleading declarations made by the respondents concerning the transaction in 2015 in which Bezeq acquired from Eurocom DBS the balance of DBS shares it held, including in connection with the second contingent consideration paid by Bezeq in accordance with the terms of the transaction.</p> <p>According to the respondents, they were made aware of this matter after the opening of the public investigation by the Israel Securities Authority and the price of B Communications securities dropped significantly from that date until September 7, 2017.</p> <p>Accordingly, the plaintiffs have petitioned the court to order the respondents to compensate the class members for the damages caused to them as a result of the above.</p> | *  |
| February 2018 | Bezeq shareholders against Bezeq as a formal respondent and against Bezeq directors at the relevant times to the motion and against the controlling shareholders (indirectly) of Bezeq, Mr. Shaul Elovitch and Mr. Yossef Elovitch (“the Respondents”).   | Tel Aviv District Court - Economic Department | Motion to certify a derivative claim | According to the allegations in the motion, it concerns Bezeq’s execution of an assessment agreement with the Tax Authority which was signed on September 15, 2016, whereby Bezeq paid the Tax Authority NIS 462 million in tax for financing revenue from loans to DBS, whereas on the other hand, it was agreed that DBS’ losses in respect of financing expenses for Bezeq’s shareholder  | 65 minimum<br>219 minimum                      |

loans to DBS would be fully recognized for Bezeq after the merger between Bezeq and DBS.

The plaintiffs claim that as a result of execution of the Assessment Agreement, Bezeq paid an aggregate of NIS 660 million, of which NIS 462 million was paid to the Tax Authority and NIS 198 was paid to the controlling shareholders as a contingent consideration, which was set out in an agreement for acquisition of all the holdings and shareholder loans of Eurocom DBS.

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| Date | Parties | Instance | Type of proceeding | Description  | Original Amount of the Claim (NIS in millions) |
|------|---------|----------|--------------------|--|--|
|      |         |          |                    | <p>According to the plaintiffs, Bezeq's execution of the Assessment Agreement constituted an exceptional transaction of a public company in which the controlling shareholder has a personal interest, and it was unlawfully executed, since it was contrary to Bezeq's interests and because the approvals required by law to enter into the transaction were not obtained.</p>   |  |
|      |         |          |                    | <p>According to the plaintiffs, the damage caused to Bezeq as a result of execution of the Assessment Agreement ranges between a minimum of NIS 65 million (if Bezeq will be permitted to offset DBS' losses with respect to financing expenses) and a maximum of NIS 219 million (if Bezeq will not be permitted to offset all of DBS' losses for financing expenses). The alleged damage is estimated by comparing the payments which Bezeq was charged (the tax liability and contingent consideration) and the tax asset created for it in the Assessment Agreement, to the payments it would have been liable for and the tax asset that would have been created for it had it entered into a settlement agreement with the tax authorities proposed by the tax authorities on the date of approval of the DBS Transaction.</p> |  |
|      |         |          |                    | <p>The plaintiffs claim that the respondents who are directors violated their duty of caution and fiduciary obligations (and with respect to the respondents who are controlling shareholders of Bezeq, also their duty of fairness), and accordingly the plaintiffs request that the court approve filing of a derivative claim in Bezeq's name against the respondents, and to require them to compensate Bezeq for the damage allegedly</p>   |  |

suffered by it as a result of breach of their obligations towards Bezeq.

April  
2018

Bezeq  
shareholders  
against Bezeq

Tel Aviv  
District  
Court

Motion to  
certify a  
class action

The motion alleges that Bezeq is in breach of the prohibition prescribed by the Communications Law by means of text messages to customers who contact it, which include a link to Bezeq 's website.

The petitioners estimate the class action amount at approximately NIS 85 million, which is comprised of monetary damage (estimation of damage for the alleged time wasted handling spam messages) and non-monetary damage due to mental anguish, causing a nuisance and so forth.



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The following four claims were dismissed:

| <b>Date of Filing of the Claim</b>                  | <b>Parties</b>                                 | <b>Instance</b>                                      | <b>Type of Proceeding</b>                                  | <b>Description</b>  | <b>Original Amount of the Claim (NIS in millions)</b> |
|---|--|--|--|---|---|
| July 2012   | Two shareholders vs. Bezeq officers            | District Court (Tel Aviv,                            | 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 alleged that the resolutions passed by the Board of Directors with respect to the aforementioned loans created a tax exposure for Bezeq because the financing expenses are not recognized for tax purposes. Declarative relief was requested for nullification of loans taken by Bezeq from the date of the change of control, and restitution of dividends by Bezeq's controlling shareholder. | 900, one claim  |
| November 2012<br><br>(Two claims that were unified) | (including those that are no longer in office) | Economic Department) and appeal in the Supreme Court | Declarative reliefs  |   | 2,640 (net) in the other                              |
|   |  |  |  | On September 17, 2014, a decision was made 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.   |   |
|   |  |  |  | On December 28, 2016, a Supreme Court ruling was handed down in two appeals filed against the District Court's ruling by the Plaintiffs of both motions, unanimously dismissing the appeals   |   |

after the Supreme Court accepted Bezeq's arguments and charging the Plaintiffs expenses.

On August 30, 2017, the petition to hold another hearing on the case that was filed by one of the appellants was dismissed.

It was alleged that Bezeq was deceptive by offering a campaign to upgrade the internet surfing speed to certain customers without any additional fee and it subsequently actually charged some of the customers.

|               |  |                         |  |  |     |
|---------------|--|-------------------------|--|--|-----|
| June 2016     | Customer v. Bezeq  | Tel Aviv District Court | Action and motion for certification as a class action. | On April 3, 2017, a ruling was handed down on this action certifying the plaintiff's application to abandon the motion to certify the claim as a class action and dismissing the plaintiff's personal claim, and this after, in its response, Bezeq drew attention to advertisements in which it had specified the exclusions to the campaign. | 112 |
| August 2016   | A customer v. Bezeq and an ISP                                     | Tel Aviv District Court | Action and motion for certification as a class action  | It is argued that the defendants act unlawfully with respect to the transfer of internet subscribers from one ISP to another in that the subscriber is not disconnected immediately from the abandoned ISP and as a result is charged * twice for the same service.  |     |
| February 2017 | HOT v. the Ministry of Communications and others (including Bezeq) | Supreme Court           | Petition to the Supreme Court                          | On September 13, 2017, a ruling was given approving the plaintiff's withdrawal from the motion. A demand for a hearing regarding the wholesale market prices for HOT, claiming that the prices which are expected to be fixed are lower than the cost price for HOT. On May 8, 2017, the petition was dismissed.                               |     |

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

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## Bezeq International

| <b>Date</b>   | <b>Parties</b>                  | <b>Court</b>       | <b>Type of Action</b>  | <b>Details</b>  | <b>Amount of claim NIS million</b>  |
|---------------|---------------------------------|--------------------|--|---|---|
| December 2011 | Customer v. Bezeq International | District (Central) | Civil class action   | According to the plaintiffs, during October 2011, Bezeq International failed to provide its internet customers with the browsing speed it had undertaken in the contract. The plaintiffs claim refund of the monthly fees and compensation for mental anguish. On March 13, 2016, the court certified the claim as a class action.  | Approximately 120   |
| January 2015  | Customer v. Bezeq International | District (Central) | A financial claim filed with a motion to certify it as a class action. | They claim that the 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. It is further claimed that Bezeq International must compensate the customers who purchased content filtering services and who were not offered the basic filtering service which is provided free of charge. On April 10, 2018, the court partially approved to certify the claim as a class action. | Approximately 65 with the addition of NIS 1,000 for each of the members of the class (every pupil in the Israeli education system). |
| Sept 2016     | Customer v. Bezeq International | District (Central) | A financial claim filed with a motion to certify it as a class action. | The claimants contend that Bezeq International charges excessive and unreasonable rates in contravention of section 17 of the Communications Law, for outgoing international calls.   | Not noted.  |

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| <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>  |
|---------------|---|----------------------|---|--|---|
| November 2015 | Customer v. Bezeq International                         | District (Central)   | A financial claim filed with a motion to certify it as a class action.                | They claim that Bezeq International charged the listed customers for an overseas dialing plan at “premium prices” that were higher than the agreed price fixed in the communications plan. The plaintiffs contend that Bezeq International exceeded the applicability of the plan, fixed line destinations overseas and defined them as “premium destinations”, without basis and by misleading customers.   | Not noted.  |
| June 2016     | Customer v. Bezeq International                         | District (Jerusalem) | A financial claim filed with a motion to certify it as a class action.                | On December 26, 2017 the court approved the applicant’s withdrawal of the motion to certify a class action without ordering expenses.<br>The claimants allege that Bezeq International misleads its customers by marketing fast internet packages at 100MB, while the actual speed provided is much lower.<br>On February 14, 2017 the claim was dismissed after the court ruled that a similar claim with motion to certify as a class action that was filed earlier (in March 2016) would be heard. The hearing on the earlier motion was consolidated with a similar claim which had also been filed against Bezeq. | Approximately 187   |
| DBS           |   |                      |   |  |   |
| <b>Date</b>   | <b>Parties</b>  | <b>Court</b>         | <b>Type of Action</b>   | <b>Details</b>   | <b>The amount of the claim</b>  |
| June 2014     | Customer and apartment building representatives vs. DBS | District (Tel Aviv)  | A financial claim filed with a motion (consolidated) to certify it as a class action. | It is claimed that DBS unlawfully charged residents in apartment buildings (subscribers and non-subscribers of DBS) for the electricity consumption for the satellite dishes and/or amplifiers   | NIS 80 million is for monetary and non-monetary damages allegedly caused due to the electricity consumption for DBS |

and/or other devices that DBS uses, systems and an  
that are located on these apartment injunction ordering DBS  
buildings. The applicant has petitioned to install electricity  
the court to order DBS to refund to the meters for measuring the  
members of the group, the amount electricity consumption  
collected for electricity consumption. of DBS's systems.

The second lawsuit (that was originally filed with the District Court in Haifa, and was moved for hearing before the District Court in Tel Aviv in September 2014) includes a claim that DBS installed equipment in apartment buildings that operate on electricity and according to their claim, DBS connected the outside equipment without approval and consent of the apartment buildings in which the equipment was connected to the communal electricity and also consumed electricity without paying for it.

In October 2015, the court ruled to consolidate the proceedings in both motions for certification and filing of consolidated statements. In December 2016, the claimants' request for interlocutory remedies against DBS regarding the disconnection of subscribers who refuse to bear the electricity costs and the signing of intermediate representatives on agreements to bear these expenses, was struck.

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| <b>Date</b> | <b>Parties</b>  | <b>Court</b>        | <b>Type of Action</b>  | <b>Details</b>  | <b>The amount of the claim</b>  |
|-------------|-----------------|---------------------|--|---|---|
| Sept 2014   | Customer v. DBS | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action. | A claim regarding electronic advertisements sent by DBS to its customers, allegedly in contravention of Section 30A of the Communications Law, in breach of DBS's license and breach of the agreement between DBS and its customers. The applicants petitioned the court for relief for the inconvenience caused to the customers of DBS, harassment, loss of time, etc. and relief in an amount that will be determined at the court's discretion, for enrichment of DBS as a result of sending these messages.  | NIS 402 million (with additional relief to be determined at the court's discretion).  |
| July 2015   | Customer v. DBS | District (Central)  | A financial claim filed with a motion to certify it as a class action. | A claim of discrimination 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 Bezeq's employees, over other new members. This, according to the allegations, is contrary to DBS obligation under its license and by law to refrain from discriminating with regard to the price for the services it provides. The applicant requests that DBS will compensate members of the group for the monetary difference between the price that each of them actually paid to DBS for the services, and the lowest price they could have paid for those services. In addition, the applicant requests that the court order DBS to offer and provide its services to everyone requesting its services at the same terms and to publish them in its various publications. In September 2015, following the filing of another motion to certify a class action against DBS which engages as alleged, in price discrimination, the court held that the two actions will be defined as related cases and in November 2015 the court ordered the consolidation of two motions to certify. | The applicant does not specify the amount of the claim, but the extent of the damage is estimated to be tens of millions of shekels.<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, |

With the consent of the parties the court decided to suspend the hearing of the case due to the simultaneous suspension of corresponding cases against other defendants, while there is a pending motion to transfer the hearing on the petitions to another court, as previously mentioned. In August 2017, the court held that it does not deem it necessary to separate the cases against DBS and against HOT from the corresponding cases against the cellular companies. In the same month, DBS filed a notice regarding the differences between the proceedings against DBS and those against the

cellular companies. In December 2017, the Attorney General filed his position on the case, according to which he does not believe it necessary to file a further position on his behalf. This notice further stated that the positions of the Antitrust Authority and of the Council in this suit are irrelevant to the question of whether the cellular companies violated the provisions prescribed in their licenses.

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| <b>Date</b>   | <b>Parties</b>  | <b>Court</b>        | <b>Type of Action</b>  | <b>Details</b>   | <b>The amount of the claim</b>   |
|---------------|-----------------|---------------------|--|--|--|
| December 2015 | Customer v. DBS | District (Central)  | A financial claim filed with a motion to certify it as a class action. | <p>A claim that DBS and HOT operate illegally by providing their customers with premium content services, (as part of the VOD service of DBS and HOT), that is provided under transactions for fixed periods and automatically renewable, while charging their customers for the service unilaterally, without the clients' consent and in violation of the law. Thus, allegedly, they charge their customers illegal amounts and while enriching themselves unjustly.</p> <p>In April 2016, a claim was filed against DBS in the Tel Aviv District Court together with a motion to certify it as a class action.</p> <p>According to the claimants, who are DBS subscribers, the condition included in the agreement between DBS and its customers, which allows a subscription to be put on hold for a limited period thus avoiding the payment of a subscription fee for this period, and provided that the freeze is for a period of at least 30 days is a discriminatory condition and is unreasonable in a standard contract.</p> <p>Furthermore, the claimants contend that DBS allows customers to have their subscription frozen for shorter periods if they make the request by phone - which the plaintiffs argue misleads consumers and is unfair conduct and, among other things, is in breach of the provisions of the Contracts Law, the consumer protection laws and Unjust Enrichment Law and not in court.</p> | <p>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.</p>   |
| April 2016    | Customer v. DBS | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action. | <p>for a limited period thus avoiding the payment of a subscription fee for this period, and provided that the freeze is for a period of at least 30 days is a discriminatory condition and is unreasonable in a standard contract.</p> <p>Furthermore, the claimants contend that DBS allows customers to have their subscription frozen for shorter periods if they make the request by phone - which the plaintiffs argue misleads consumers and is unfair conduct and, among other things, is in breach of the provisions of the Contracts Law, the consumer protection laws and Unjust Enrichment Law and not in court.</p>   | <p>The claimants have asked the court to order the cancellation of the condition of the agreement and alternatively to determine that DBS's conduct as described above is misleading and not in good faith. The court was also petitioned to instruct DBS to compensate the subscribers who are members of the group in the total amount of NIS 736 million.</p> |
| March 2017    | Customer v. DBS | District (Central)  | A financial claim filed with a motion to certify it as a class action. | <p>The subject of the action is the allegation that DBS was in breach of the agreement with its customers and the conditions of the license issued by the Ministry of Communications when it discontinued broadcasts of the Children's Channel on January 1, 2017 and instead started to broadcast a channel called Yes KIDZ ("discontinuation of the channel broadcasts"), which the applicant argues is not an appropriate substitute. The applicant requests that DBS refunds to each of the members of the class group the amounts that it collected or overcharged (the "excess</p>   | <p>The applicant does not expressly mention the amount of the action against DBS, but defines the group as all DBS customers on the date of discontinuation of the channel's broadcasts, excluding those customers who have ostensibly already received specific compensation from DBS for discontinuation of the</p>  |



amount” as argued by the applicant will not be channel’s broadcasts. less than NIS 100 per month), from the date of discontinuation of the channel broadcasts, and that it should compensate all members of the group for the inconvenience caused as a result of the discontinuation of the channel’s broadcasts (a loss which is estimated in the amount of NIS 250 for each group member).

In May 2017, DBS received a letter from the Council with regard to the termination of the proceeding against the substituting of the Children’s Channel, in which the Council stated that DBS had complied with the Council’s decisions on this matter, and that the response offered by Bezeq “provides a worthy alternative for the channel that was discontinued”. In view of this, DBS sent a letter to the applicant’s counsel requesting that they inform it as soon as possible whether he intends to continue the proceeding or to file for the motion to certify to be withdraws. To date, no written response has been received from the applicant. In November 2017, DBS submitted its response to the motion to certify and in December 2017 the applicant submitted its reply to the response.

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| <b>Date</b>  | <b>Parties</b>  | <b>Court</b>                                     | <b>Type of Action</b>   | <b>Details</b>   | <b>The amount of the claim</b> |
|--|---|--|---|--|--------------------------------|
| June 2017  | Shareholders of Bezeq<br><br>v. Bezeq, the Chairman of the Board of Directors of Bezeq, members of the Board of Directors of Bezeq, as well as companies of the Eurocom Group and against the CEO of Bezeq and the CEO and CFO of DBS.  | District Court (Economic Department) in Tel Aviv | Motion to certify a class action  | For details of this class action against Bezeq, DBS and others, see the Bezeq section. |                                |
| June - August 2017 and a motion filed in December 2017 | Shareholders of Bezeq v Bezeq and DBS   | District Court at Tel Aviv – Yafo                | Various motions for disclosure of documents prior to filing a motion to certify a derivative claim pursuant to section 198A of the Israeli Companies Law, which were filed pursuant to an investigation by the ISA. |  |                                |
| December 2017  | Holders of B Communications securities, originally against B Communications and its officers. Under the amended claim, DBS, and officers (present and former) of DBS and of Bezeq, were among the defendants that were attached for the first time. Bezeq itself was not attached to the proceeding | A Court in the State of New York USA             | Motion to certify a class action  |  |                                |

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| <b>Date</b> | <b>Parties</b>        | <b>Court</b>        | <b>Type of Action</b>  | <b>Details</b>   | <b>Amount of claim</b>  |
|-------------|-----------------------|---------------------|--|--|---|
|             |                       |                     |  |  | <b>NIS million</b>  |
| 1. Aug 2010 | Customer v. Pelephone | District (Central)  | A financial claim filed with a motion to certify it as a class action. | The claimant claims that Pelephone should refrain from collecting Value Added Tax from customers who use its services when they are outside Israel. The motion also contains relief for an order instructing Pelephone to cease charging its customers VAT for such services which they use outside Israel, and an order instructing that the moneys collected to date be refunded. In August 2014 the Court dismissed the application for recognition. In October 2014 an appeal of the ruling was filed. On February 3, 2007, a Supreme Court ruling was handed down according to which the applicants' appeal to dismiss the decision was accepted and the hearing will be returned to the District Court for ruling on the question of whether VAT was unlawfully collected in respect of overseas cellular services. According to the Supreme Court ruling, if the District Court rules in favor of the issue and Pelephone is required to refund the collected VAT to its customers, a claim for indemnification against the Tax Authority will be possible for the amounts that it will be required to refund. Furthermore, it was determined that in the context of prepaid service bundles for use overseas, the VAT rate is zero. According to Pelephone's initial estimate, the implication of the Supreme Court ruling is that the results of the aforementioned process will have no significant repercussions for Pelephone. | The amount of the claim is not stated, but the application is estimated in the tens of millions of shekels. |
| 2. May 2012 | Customer v. Pelephone | District (Tel Aviv) | Financial class action suit  | The claimant alleges that Pelephone does not inform customers wishing to join its services using a handset that was not purchased from Pelephone, that if the handset does not support the 850 MHz frequency, they will only get partial reception over one frequency rather than two. In March 2014, the court certified the claim as a class action, and this subsequent to  | Approximately 124   |

Pelephone announcing its agreement (for reasons of efficiency) to conduct the claim as a class action, while retaining its arguments.

|    |               |                       |                      |  |  |                   |
|----|---------------|-----------------------|----------------------|--|--|-------------------|
| 3. | December 2012 | Customer v. Pelephone | District (Jerusalem) | A financial claim filed with a motion to certify it as a class action. | The claimants allege that Pelephone allowed unlawful charging of subscribers for mobile content services that were not ordered, by the content service company, E-interactive.   | Approximately 107 |
| 4. | 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 benefits 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 benefits. A stay was ordered for hearing the case for six months in order to enable the Ministry of Communications to formulate its position on the matter following the RFI hearing that the Ministry is conducting. | Approximately 300 |

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|    | <b>Date</b>  | <b>Parties</b>  | <b>Court</b>              | <b>Type of Action</b>  | <b>Details</b>  | <b>Amount of claim</b><br><b>NIS million</b>  |
|----|--------------|---|---------------------------|--|---|---|
| 5. | July 2014    | Customer v. Pelephone and other mobile telephony companies. | District (Tel Aviv)       | A financial claim filed with a motion to certify it as a class action. | The claimants allege that Pelephone, together with three other mobile telephony companies, registered subscribers for content services without obtaining their consent and in contravention of the law, and thereby creating a “platform” for iQtech Group to unlawfully charge tens of thousands of people for content services.   | Approximately 100 with regard to the mobile telephony companies and 300 against all the defendants.   |
| 6. | 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 proceedings in the case were consolidated with another case due to the similarity between the proceedings. | The amount of the claim is not stated, but the application is estimated to be in millions of shekels. |
| 7. | October 2016 | Customer v. Pelephone, Partner and Cellcom                  | District (Lod)            | A financial claim filed with a motion to certify it as a class action. | The claimants allege that the defendants do not allow their subscribers to make full use of their overseas package and this through discriminatory terms under which the package can be used for a very short period (between one week to one month only) and that at the end of that period, the unused balance of the package expires and no reimbursement is given.  | The amount of the claim is not stated, but is estimated in the tens of millions of shekels.           |
| 8. | Sept 2017    | Customer v. Pelephone                                       | District Court (Nazareth) | A financial claim filed with a motion to certify it as a class action. | The plaintiff argues that Defendant fails to block access to foreign internet browsing services for its subscribers who did not purchase a package for web-browsing abroad or who asked for voluntary access to the surfing services, and that it charges these subscribers   | Approximately 262.5   |

|     |              |                                   |                     |  |   |
|-----|--------------|-----------------------------------|---------------------|--|---|
|     |              |                                   |                     | retroactively when they purchase a web-browsing package and after accumulating a debt for browsing services. The plaintiff argues that Pelephone therefore practices unjust enrichment.  |   |
| 9.  | October 2017 | Customer v. Pelephone and Partner | Central District    | A financial claim filed with a motion to certify it as a class action.   | Approximately 850   |
|     |              |                                   |                     | The plaintiff claims that the Defendants make unlawful use of their customers' location data, thus violating the agreements with them, the operating licenses and various laws, including the Protection of Privacy Law, 1981. The claim is filed primarily on the grounds that the respondent markets and sells its customers repair services while requiring customers to commit to unreasonable periods of time and without the possibility in the agreement of canceling the transaction during the commitment period and/or of transferring the service to another cellular device. |   |
| 10. | April 2018   | Customer v. Pelephone,            | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action.   | The petitioners do not explicitly state the amount of the claim against the respondent, but estimate that the value of the damage caused to each class member by the inability to cancel the repair service until the end of the commitment period is estimated at hundreds of shekels each year for each class member. |

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The following three claims were dismissed:

| <b>Date of filing of the action</b> | <b>Parties</b>        | <b>Court</b>         | <b>Type of Action</b>  | <b>Details</b>   | <b>Amount of the original claim</b><br><b>NIS million</b>                                   |
|-------------------------------------|-----------------------|----------------------|--|--|---|
| 11. 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 violated the mobility plan/rules. Thus, when attempting to move to another operator (the receiving operator) the applicant found out that she was deliberately blocked by Pelephone (the deserted operator) from moving. When calling Pelephone to clarify the issue, she found out that the unacceptable reason for blocking her was an attempt to retain her and prevent her from moving to a competitor. Furthermore, injunctions are sought to prevent such blocking. On March 28, 2017, the court approved abandonment of the motion, striking out of the motion for certification and dismissal of the Plaintiff's personal claim. | The amount of the claim is not stated, but is estimated in the tens of millions of shekels. |
| 12. May 2016                        | Customer v. Pelephone | District (Jerusalem) | A financial claim filed with a motion to certify it as a class action. | The claimants allege that Pelephone opted subscribers to its Smart Call service without their consent or their knowledge, and this in contravention of the provisions of the law, including its license and the Smart Call service portfolio. On May 7, 2017 the Court approved the withdrawal of the applicant from the motion to certify a class action against Pelephone and dismissed his personal claim against it.   | Approximately 200   |
| 13. June 2016                       | Customer v. Pelephone | District (Jerusalem) | A financial claim filed with a motion to certify it as a class action. | The claimant alleges that Pelephone overcharges for calls made overseas to Israel in the overseas Travel track and charges at the higher rate for a direct dialing call instead the rate for a call via the savings service, and this only because of the fact that the calls were dialed using the 972 code, as the phone numbers are saved in the claimant's phone. On June 4, 2017 the court handed a ruling dismissing the motion to certify and dismissed the claimant's personal claim without awarding  | Approximately 86  |

costs.



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Walla:

| <b>Date of filing of the action</b> | <b>Parties</b>    | <b>Court</b>        | <b>Type of Action</b>  | <b>Details</b>   | <b>Amount of the original claim</b> |
|-------------------------------------|-------------------|---------------------|--|--|-------------------------------------|
|                                     |                   |                     |  |  | <b>NIS million</b>                  |
| 1. April 2018                       | Customer v. Walla | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action. | The claim is filed on grounds that Walla publishes “advertising-related articles” on its site without due disclosure of the fact that reference is made to marketing content. The petitioner further asserts that the publication of marketing content without due disclosure, as alleged, constitutes, among other things, a violation of the Consumer Protection Law, a violation of the Rules of Journalistic Ethics, a tort and unjust enrichment. | NIS 60,000,000                      |

## 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 does not currently have a dividend distribution policy in place either. 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 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.

On May 21, 2015, B Communications declared a dividend of NIS 2.24 per share and approximately NIS 67 million in the aggregate. 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 and approximately NIS 22 million in the aggregate. 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 and approximately NIS 38 million in the aggregate. The record date for the distribution of the dividend was December 10, 2015 and the payment date was December 23, 2015.

On May 25, 2016, B Communications declared a dividend of NIS 11.88 per share and approximately NIS 355 million in the aggregate. The record date for the distribution of the dividend was June 15, 2016 and the payment date was June 29, 2016.

#### B. Significant Changes

Except as otherwise disclosed in this annual report, no significant change has occurred since December 31, 2017.

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## 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 Global Select Market and the TASE:

|      | NASDAQ   |         | TASE      |           |
|------|----------|---------|-----------|-----------|
|      | High     | Low     | High      | Low       |
| 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 |
| 2016 | \$ 17.82 | \$ 9.50 | NIS 65.45 | NIS 37.67 |
| 2017 | \$ 11.50 | \$ 6.06 | NIS 47.10 | NIS 22.21 |

## 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       |
| 2016           |          |          |           |           |
| First Quarter  | \$ 17.82 | \$ 9.50  | NIS 65.45 | NIS 37.67 |
| Second Quarter | \$ 15.32 | \$ 12.17 | NIS 57.90 | NIS 48.43 |
| Third Quarter  | \$ 15.00 | \$ 12.30 | NIS 55.48 | NIS 47.65 |
| Fourth Quarter | \$ 13.55 | \$ 10.58 | NIS 50.36 | NIS 41.47 |
| 2017           |          |          |           |           |
| First Quarter  | \$ 11.44 | \$ 10.08 | NIS 47.10 | NIS 37.49 |
| Second Quarter | \$ 11.50 | \$ 9.16  | NIS 41.02 | NIS 31.04 |
| Third Quarter  | \$ 9.30  | \$ 6.06  | NIS 32.76 | NIS 22.21 |

|                                 |         |        |          |          |
|---------------------------------|---------|--------|----------|----------|
| Fourth Quarter                  | \$8.51  | \$6.76 | NIS30.41 | NIS23.97 |
| 2018                            |         |        |          |          |
| First Quarter                   | \$10.70 | \$5.35 | NIS35.83 | NIS17.51 |
| Second Quarter (through May 14) | \$5.10  | \$3.51 | NIS17.69 | NIS12.65 |

#### 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 2017             | \$8.00  | \$6.76 | NIS28.19 | NIS23.97 |
| December 2017             | \$8.50  | \$7.41 | NIS30.41 | NIS25.70 |
| January 2018              | \$10.70 | \$8.61 | NIS35.83 | NIS29.65 |
| February 2018             | \$9.05  | \$7.29 | NIS29.87 | NIS25.26 |
| March 2018                | \$7.81  | \$5.35 | NIS26.86 | NIS17.51 |
| April 2018                | \$5.10  | \$3.51 | NIS17.69 | NIS12.84 |
| May 2018 (through May 14) | \$4.24  | \$3.53 | NIS15.32 | NIS12.65 |

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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

No 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

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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 Bezeq, to appoint a director or general manager of Bezeq, to participate in the profits of Bezeq or a share of the remaining assets of Bezeq after payment of its debts upon liquidation. We received explicit governmental approval to keep the Control Permit even at a level of a 25% ownership interest.



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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.

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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 chairperson of the board of directors presides at each of our general meetings. The chairperson of the board of directors is not entitled to a vote at a general meeting in his capacity as chairperson.

### 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.

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In addition, pursuant to the Communications Order, so long as we (through B Communications) 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.

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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

In 2017, the corporate tax rate was 24% and as of January 1, 2018 the corporate tax rate is 23%.



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### 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. The Real Gain accrued on the sale of our Shares is generally taxed at a rate of 25% for corporations. 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% of the gross amount of the dividend paid. This reduced rate will not apply if more than 25% of the Israeli company’s gross income for such prior tax year 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.

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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.-Israel 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 TAX CONSIDERATIONS

The following is a description of the 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 (“Code”), or the 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.

Careful attention should be given to the extensive changes recently introduced to the Code under Public Law No. 115-97, formerly known as H.R. 1, the Tax Cuts and Jobs Act (“Tax Reform Law”). This new legislation includes significant changes to the taxation of individuals and business enterprises, and investors should consult with their own tax advisors to determine the full impact of the Tax Reform Law on their U.S. tax liability.

<sup>1</sup> An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018.

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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. In addition, this description does not account for the specific circumstances of any particular investor, such as:

broker-dealers;

financial institutions;

certain insurance companies;

investors liable for alternative minimum tax;

regulated investment companies, real estate investment trusts, or grantor trusts;

dealers or traders in securities, commodities or currencies;

tax-exempt organizations;

non-resident aliens of the United States or taxpayers 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;

direct, indirect or constructive owners of 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, appreciated financial position, a hedging transaction or conversion transaction.

If a partnership or an entity treated as a partnership for U.S. federal income tax purposes owns our 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 our 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.

This summary does not address the effect of any U.S. federal taxation (such as estate and gift tax) other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or non-U.S. taxation. You are urged to consult your tax advisors regarding the non-U.S. and U.S. federal, state and local tax consequences of an investment in ordinary shares.

For purposes of this summary, as used herein, the term “U.S. Holder” means a person that is eligible for the benefits of the Treaty and is a beneficial owner of an ordinary share who is, for U.S. federal income tax purposes:

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 the income of which is subject to U.S. federal income taxation regardless of its source; or

a trust if such trust has validly elected to be treated as a U.S. person for U.S. federal income tax purposes or if (1) a court within the United States is able to exercise primary supervision over its administration and (2) one or more U.S. persons have the authority to control all of the substantial decisions of such trust.

Unless otherwise indicated, this discussion assumes that we are not, and will not become, a “passive foreign investment company,” or a PFIC, for U.S. federal income tax purposes. See “—*Passive Foreign Investment Companies*” below.

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Taxation of Distributions

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. Because we do not expect to maintain calculations of our earnings and profits under U.S. federal income tax principles, it is expected that the entire amount of any distribution will generally be reported as dividend income to you. Dividends are included in gross income as ordinary income. Distributions in excess of our current and accumulated earnings and profits would 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 gain from the sale of ordinary shares. See “—Disposition of Ordinary Shares” below for a discussion of the taxation of capital gains. Our dividends would 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 received, 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 be treated as U.S.-source ordinary income or loss. U.S. Holders should consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of NIS.

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, at a rate not exceeding the applicable rate provided by the Treaty, will be a foreign income tax eligible for credit against a U.S. Holder’s U.S. federal income tax liability (or, alternatively, for deduction against income in determining such tax liability). Israeli taxes withheld in excess of the applicable rate allowed by the Treaty (if any) will not be eligible for credit against a U.S. Holder’s federal income tax liability. The limitation on foreign income taxes eligible for credit is calculated separately with respect to specific classes of income. Dividends generally will be treated as foreign-source passive category income or, in the case of certain U.S. Holders, general category income for U.S. foreign tax credit purposes. 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 if such U.S. Holder fails to satisfy certain minimum holding period requirements or to the extent such U.S. Holder’s position in ordinary shares is hedged. An election to deduct foreign taxes instead of claiming foreign tax credit applies to all foreign taxes paid or accrued in the taxable year. The rules relating to the determination of 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 (including the PFIC rules discussed below), “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 set at a maximum rate 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 (see discussion below). However, no assurance can be given that our ordinary shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied, nor does it apply to dividends received from a PFIC (see discussion below), in respect of certain risk-reduction transactions, 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.



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### Sale or Disposition of Ordinary Shares

Subject to the discussion of PFIC rules below, 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, in each case determined in U.S. dollars. 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 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 exchange. 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 be treated as ordinary income or loss.

An accrual basis U.S. Holder may elect the same treatment required of cash basis taxpayers with respect to 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 (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 currency gain or loss would be treated as U.S.-source 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 disposition of such ordinary shares.

### Passive Foreign Investment Companies

We believe that we were not a PFIC for U.S. federal income tax purposes for the taxable year of 2017. However, since PFIC status depends upon the composition of our income and assets and the market value of our assets from time to time, there can be no assurance that we will not be considered a PFIC for any future taxable year. If we were a PFIC for any taxable year during which a U.S. Holder owned an ordinary share, certain adverse consequences could apply to the U.S. Holder. Specifically, gain recognized by a U.S. Holder on a sale or other disposition of such ordinary share would be allocated ratably over the U.S. Holder's holding period for the ordinary share. The amounts allocated to the taxable year of the sale or other disposition and to any year before we became a PFIC would be taxed as ordinary

income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, for that taxable year, and an interest charge would be imposed on the resulting tax liability. Further, any distribution in excess of 125% of the average of the annual distributions received by the U.S. Holder on our ordinary shares during the preceding three years or the U.S. Holder's holding period, whichever is shorter, would be subject to taxation as described immediately above. Certain elections (such as a mark-to-market election) may be available to U.S. Holders and may result in alternative tax treatment. In addition, if we were a PFIC for a taxable year in which we pay a dividend or the prior taxable year, the favorable dividend rates discussed above with respect to dividends paid to certain non-corporate U.S. Holders would not apply. If we were a PFIC for any taxable year in which a U.S. Holder owned our shares, the U.S. Holder would generally be required to file annual returns with the IRS on IRS Form 8621.

#### Additional Tax on Investment Income

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 from the sale or exchange of our ordinary shares.

#### 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 24%. 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.

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Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules may be credited against a U.S. Holder's U.S. tax liability. A U.S. Holder may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS.

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 the U.S. Holder's tax advisor regarding the reporting obligation.

Any U.S. Holder who acquires more than \$100,000 of our ordinary shares or holds 10% or more in vote or value of our ordinary shares may be subject to certain additional U.S. information reporting requirements.

**The above description is not intended to constitute a complete analysis of all tax consequences relating to acquisition, ownership and disposition of our ordinary shares. You should consult your tax advisor concerning the tax consequences of your particular situation.**

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.

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I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES 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

Our unconsolidated net exposure to changes in foreign currency exchange rates (primarily the U.S. dollar) was NIS 95 million (approximately \$27 million) at December 31, 2017. Each increase or decrease of 1% in the NIS-US\$ exchange rate will result in an increase or decrease in our yearly financial income of NIS 950 thousand (approximately \$274 thousand).

B Communications' unconsolidated net exposure to changes in foreign currency exchange rates (primarily the U.S. dollar) was NIS 140 million (approximately \$40 million) at December 31, 2017. 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 1.4 million (approximately \$404 thousand).

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.

The Bezeq Group's net exposure to changes in foreign currency exchange rates was NIS 169 million (approximately \$49 million) at December 31, 2017. Each increase or decrease of 1% in the NIS-US\$ exchange rate will result in an immaterial increase or decrease in Bezeq's yearly financial expenses.

#### Effects of Changes in the Israeli Consumer Price Index

Our unconsolidated net exposure to changes in the Israeli CPI was NIS 800 million (approximately \$231 million) at December 31, 2017. Each increase or decrease of 1% in the Israeli CPI will result in an increase or decrease in our yearly financial income of NIS 8 million (approximately \$2 million).

B Communications' net exposure to changes in the Israeli CPI was NIS 25 million (approximately \$7 million) at December 31, 2017. 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 250 thousand (approximately \$75 thousand).

The Bezeq Group's net exposure to changes in the Israeli CPI was NIS 4.1 billion (approximately \$1.2 billion) at December 31, 2017. The exposure primarily consists of Bezeq's debentures which are linked to the Israeli CPI. As of December 31, 2017, Bezeq holds forward contracts on the Israeli CPI in the amount of NIS 2 billion (approximately \$577 million). Each increase or decrease of 1% in the Israeli CPI will result in an immaterial increase or decrease in the Bezeq Group's yearly financial expenses.

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### 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, 2017, we had NIS 21 million (approximately \$6 million) in cash, cash equivalents, and NIS 174 million (approximately \$50 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, such as the decreases experienced in 2008 and the first six months of 2009. In such case, the fair value of our investments may decrease. 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 extracted from such cables. The prices received are subject to the volatility of the copper market.

#### ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.



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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.

## **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).

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.

As a consequence of the investigations of Bezeq and several of its directors and senior officers by both the ISA and Israel's Police as described in this Annual Report, we attempted to assess these investigations through the scope of our own internal control over financial reporting. However, due to provisions of Israeli law concerning obstructing investigation proceedings both Bezeq and we are prevented from examining all matters known to us that were raised in the investigations and accordingly we are unable to fully assess the effects of the investigations on our financial statements and internal controls over financial reporting.

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Subject to these limitations, we nevertheless completed the work necessary to identify a material weakness pertaining to the design of Bezeq's internal control over financial reporting relating to certain matters, which are mainly the subjects of the investigations. Our management then assessed the effectiveness of our own internal control over financial reporting as of December 31, 2017. In conducting its assessment of internal control over financial reporting, our 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.

Due to the material weakness pertaining to the design of Bezeq's internal control over financial reporting, such material weakness is also considered a material weakness in our reports.

## **Remediation**

Bezeq reported that its management and board of directors have started implementation of a ten-point action plan, subject to the legal limitations, with assistance from outside professional advisors, in order to strengthen Bezeq's control process and to ensure that despite there being a material weakness in Bezeq's internal control, its reports are prepared in compliance with the law. Our Audit Committee and management have monitored and will continue to monitor the implementation of Bezeq's action plan.

In addition, and although we believe that there are no weaknesses in relation to the activity of our company, our Audit Committee engaged special legal counsel to assist us in designing and implementing certain prospective improvements to our existing internal processes and controls. While management believes that the existing work process was adequate and that there were no material deficiencies in our controls, and that the material weakness at Bezeq could not have been prevented by our company, we are continuing our efforts to strengthen our longstanding control processes.

The procedures and controls, which we are working to improve, include training processes; working procedures with Bezeq's finance departments and financial managers; procedures for appointing directors to the board of directors of Bezeq; and procedures for working with Bezeq's internal enforcement team.

We are committed to maintaining a strong internal control environment. We will provide further updates on Bezeq's action plan in future SEC filings.

## **Attestation Report of the Registered Public Accounting Firm**

Our independent registered accounting firm, Somekh Chaikin, a member firm of KPMG International, has issued an audit report on the effectiveness of our internal control over financial reporting. The report is included our audited consolidated financial statements set forth in “Item 18 - Financial Statements.”

### **Changes in Internal Control Over Financial Reporting**

Other than disclosed above, there were no changes in our internal control over financial reporting during the period covered by the Report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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.

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## 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 December 31, |               |                |               |
|--|-------------------------|---------------|----------------|---------------|
|  | 2016                    |               | 2017           |               |
|  | Unconsolidated          | Consolidated  | Unconsolidated | Consolidated  |
| Audit fees and audit-related fees (1)(2) | NIS 345,000             | NIS 6,555,000 | NIS 340,000    | NIS 6,802,000 |
| Tax fees and all other fees (3)          | NIS 82,000              | NIS 1,541,000 | NIS 82,000     | NIS 2,119,000 |
| Total                                    | NIS 427,000             | NIS 8,096,000 | NIS 422,000    | NIS 8,921,000 |

(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 2017.

ITEM 16F. CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANT

None.

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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.



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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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|--|------|
| <u>Index to Consolidated Financial Statements</u>              | F-1  |
| <u>Report of Independent Registered Public Accounting Firm</u> | F-2  |
| <u>Consolidated Statements of Financial Position</u>           | F-3  |
| <u>Consolidated Statements of Income</u>                       | F-5  |
| <u>Consolidated Statements of Comprehensive Income</u>         | F-6  |
| <u>Consolidated Statements of Changes in Equity</u>            | F-7  |
| <u>Consolidated Statements of Cash Flows</u>                   | F-10 |
| <u>Notes to the Consolidated Financial Statements</u>          | F-12 |

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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     | <u>Amended and Restated Articles of Association of the Registrant</u> <sup>(2)</sup>  |
| 2.1     | Specimen of Share Certificate <sup>(1)</sup>  |
| 4.1     | <u>Officers' Compensation Policy, April 2016 (as amended December 2017)</u> <sup>(3)</sup>  |
| 4.2     | Registration Rights Agreement, dated July 30, 1999, among the Registrant, Euronet Communications Ltd., Shaul Elovitch and Eli Holtzman <sup>(1)</sup>   |
| 4.3     | <u>English Translation of the Terms of the Bezeq – DBS Merger Agreement</u> <sup>(4)</sup>  |
| 4.4     | <u>Share Purchase Agreement between the Registrant and Norisha Holdings Limited dated June 27, 2013</u> <sup>(5)</sup>  |
| 4.5     | <u>Amendment No. 1 to the Share Purchase between the Registrant and Norisha Holdings Limited dated May 29, 2014</u> <sup>(6)</sup>  |
| 4.6     | <u>Form of Indenture entered into on February 23, 2013, between the Registrant and Reznik Paz Nevo Trusts Ltd.</u> <sup>(7)</sup>   |
| 4.7     | <u>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</u> <sup>(8)</sup> |
| 4.8     | <u>English translation of Deed of Trust dated September 14, 2016 between the Registrant and Reznik, Paz, Nevo Trustees Ltd.</u> <sup>(9)</sup>  |
| 8.1     | <u>List of Subsidiaries of the Registrant</u>   |
| 12.1    | <u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended</u>   |
| 12.2    | <u>Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended</u>   |
| 13.1    | <u>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</u>  |
| 13.2    | <u>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</u>  |
| 15.1    | <u>Consent of Somekh Chaikin, a member firm of KPMG International</u>   |
| 101.INS | XBRL Instance Document  |
| 101.SCH | XBRL Taxonomy Extension Schema Document   |
| 101.PRE | XBRL Taxonomy Presentation Linkbase Document  |
| 101.CAL | XBRL Taxonomy Calculation Linkbase Document   |
| 101.LAB | XBRL Taxonomy Label Linkbase Document   |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document  |

<sup>(1)</sup> Previously filed as an exhibit to the Registrant's Registration Statement on Form F-1 (Registration No. 333-10576), and incorporated herein by reference.

<sup>(2)</sup> 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) Filed as Exhibit 99.1 to the Registrant's Report on Form 6-K for the month of May 2016 (May 9, 2016), and incorporated herein by reference.
- (4) 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.
- (5) 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.
- (6) 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.
- (7) 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.
- (8) 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.
- (9) Previously filed as an exhibit to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2016, and incorporated herein by reference.

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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: May 15, 2018

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**Internet Gold - Golden Lines Ltd.**

**Consolidated Financial Statements**

**As at December 31, 2017**



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Internet Gold – Golden Lines Ltd.

**Consolidated Financial Statements**

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**Report of Independent Registered Public Accounting Firm**

To the Shareholders and Board of Directors

Internet Gold – Golden Lines Ltd.

*Opinion on the Consolidated Financial Statements*

We have audited the accompanying consolidated statements of financial position of Internet Gold – Golden Lines Ltd. and subsidiaries (the “Company”) as of December 31, 2017 and 2016, 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, 2017, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, except for the effects of the adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the investigation related to Bezeq The Israel Telecommunications Corp. Ltd., a subsidiary of the Company (“Bezeq”), Bezeq’s subsidiary DBS Satellite Services (1998) Ltd, and officers in these companies (collectively referred to as the “accused parties”) as described below, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2017, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

We also were engaged to audit, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated May 15, 2018 indicates that the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the effectiveness of the Company’s internal control over financial reporting.

As described in Note 1 to the consolidated financial statements, a joint investigation of the accused parties is being conducted by the Israel Securities Authority and the Israel Police. The basis of the investigation is the suspicion that the accused parties committed offenses under the Israel Securities’ Law and the Penal Code, with respect to transactions related to the Company’s controlling shareholder. Bezeq does not have complete information concerning the investigation, including any content, materials, or evidence which may be in the possession of the legal authorities. In addition, under the provisions of Israeli law regarding obstruction of justice at this stage, Bezeq is prevented from examining any matters related to the investigation. Accordingly, Bezeq is unable to fully assess the impact, if any, of the investigation, the findings, and the results on the assessment of Bezeq’s consolidated financial statements. As a result, we were unable to obtain sufficient appropriate audit evidence as to the effect, if any, of the investigation



proceedings on the Company's consolidated financial statements.

*Convenience Translation*

The accompanying consolidated financial statements as of and for the year ended December 31, 2017 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.

*Initial application of new standard*

As discussed in Note 3A to the consolidated financial statements, the Company has changed its method of accounting for revenue recognition as of January 1, 2017 due to the adoption of International Financial Reporting Standard No. 15 Revenue from Contracts with Customers.

*Legal Proceedings*

We draw attention to Note 1 to the consolidated financial statements regarding a number of legal proceedings which were filed against Bezeq subsequent to the commencement of the investigation mentioned above.

*Basis for Opinion*

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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

Except as discussed above, we conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence

regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Somekh Chaikin

Somekh Chaikin

Certified Public Accountants (Isr.)

Member Firm of KPMG International

We have served as the Company's auditor since 2000.

Tel Aviv, Israel

May 15, 2018

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Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors

Internet Gold- Golden Line Ltd.

*Disclaimer of Opinion on Internal Control Over Financial Reporting*

We were engaged to audit Internet Gold- Golden Line Ltd. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Since management was unable to perform necessary procedures relating to the investigation described below which impact on the Company's internal control over financial reporting, and we were unable to apply other procedures to satisfy ourselves as to the effectiveness of the Company's internal control over financial reporting, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the effectiveness of the Company's internal control over financial reporting.

As described in Management's Annual Report on Internal Control Over Financial Reporting under Item 15, Company management, including its Chief Executive Officer and principal financial officer did not conclude on the effectiveness of its internal control over financial reporting based upon the framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control-Integrated Framework (2013)* (COSO 2013 Framework). Investigations of Bezeq, The Israel Telecommunications Corp. Ltd., a subsidiary of the Company ("Bezeq"), Bezeq's subsidiary DBS Satellite Services (1998) Ltd ("DBS") and several of its directors and senior officers by both the ISA and Israel's Police as described in the Company's financial statements, prevented Company management from examining all matters related to the investigations. Accordingly, the Company was unable to fully assess the impact, if any, of the investigations, the related findings, and the results on the assessment of its internal controls over financial reporting.

As a result, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the effectiveness of the Company's internal control over financial reporting. However, during the course of the audit, we did identify the following material weaknesses, the disclosure of which is not fairly presented in all material respects in Item 15, Management's Annual Report on Internal Control Over Financial Reporting.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial

statements will not be prevented or detected on a timely basis. The material weakness described below has been identified but was not fairly presented in management's assessment:

The following material weakness was identified in the Company's internal controls over financial reporting:

The Company failed to maintain an effective control environment with respect to its internal controls over financial reporting. Specifically:

- Management failed to adequately demonstrate through its directives, actions, and behavior the importance of integrity and ethical values to support the functioning of internal controls over financial reporting of Bezeq.
- The Board of Directors of Bezeq failed to adequately exercise its oversight responsibility regarding independence from management with respect to a Special Board of Directors' Subcommittee.
- Management and the Board of Directors failed to provide adequate oversight for financial reporting and the design, implementation, and conduct of internal controls related to Bezeq's regulatory environment.

These control deficiencies resulted in no material misstatement to the consolidated financial statements. However, these control deficiencies create a reasonable possibility that a material misstatement to the consolidated financial statements will not be prevented or detected on a timely basis, and therefore we concluded that the deficiencies represent material weaknesses in the Company's internal control over financial reporting.

The material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2017 consolidated financial statements, and this report does not affect our report on those consolidated financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated statements of financial position of the Company as of December 31, 2017 and 2016, 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, 2017, and the related notes (collectively referred to as the "consolidated financial statements"), and our report dated May 15, 2018 expressed a qualified opinion on those consolidated financial statements due to our inability to obtain sufficient appropriate audit evidence as to the effect, if any, of the investigation proceedings described above on the Company's consolidated financial statements.

*Disclaimer on Additional Information in Management's Report*

We do not express an opinion or any other form of assurance on management's statements, included in the content within "Remediation" of Management's Annual Report on Internal Control Over Financial Reporting, referring to corrective actions taken after December 31, 2017, relative to the aforementioned material weakness in internal control over financial reporting.

*Basis for Disclaimer of Opinion*

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting under Item 15 - Control and Procedures. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Somekh Chaikin

Somekh Chaikin

Certified Public Accountants (Isr.)

Member Firm of KPMG International

Tel Aviv, Israel

May 15, 2018

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Internet Gold - Golden Lines Ltd.

**Consolidated Statements of Financial Position as of****(In millions)**

|   |      | December 31 |              | Convenience<br>translation<br>into<br>U.S. dollars<br>(Note 2D) |
|---|------|-------------|--------------|---|
|   | Note | 2016<br>NIS | *2017<br>NIS | 2017<br>US\$  |
| Current assets                                |      |             |              |   |
| Cash and cash equivalents                     | 5    | 810         | 2,408        | 695   |
| Investments                                   | 6    | 1,240       | 769          | 222   |
| Trade receivables, net                        | 7    | 2,000       | 1,915        | 552   |
| Other receivables                             | 7    | 217         | <b>270</b>   | <b>78</b>   |
| Related party                                 |      | -           | <b>43</b>    | <b>12</b>   |
| Inventory                                     |      | 106         | 125          | 36  |
| Total current assets                          |      | 4,373       | 5,530        | 1,595   |
| Non-current assets                            |      |             |              |   |
| Trade and other receivables                   | 7    | 644         | 493          | 142   |
| Property, plant and equipment                 | 8    | 7,072       | 6,940        | 2,002   |
| Intangible assets                             | 9    | 6,534       | 5,840        | 1,684   |
| Deferred expenses and non-current investments | 10   | 465         | 558          | 161   |
| Broadcast rights                              | 11   | 432         | 454          | 131   |
| Deferred tax assets                           | 19   | 1,007       | 1,019        | 294   |
| Total non-current assets                      |      | 16,154      | 15,304       | 4,414   |
| Total assets                                  |      | 20,527      | 20,834       | 6,009   |

The accompanying notes are an integral part of these consolidated financial statements.

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Internet Gold - Golden Lines Ltd.

**Consolidated Statements of Financial Position as of (cont'd)****(In millions)**

|   |      | December 31 |              | Convenience<br>translation<br>into<br>U.S. dollars<br>(Note 2D)<br>2017 |
|---|------|-------------|--------------|---|
|   | Note | 2016<br>NIS | *2017<br>NIS | US\$  |
| <b>Current liabilities</b>                  |      |             |              |   |
| Bank loans and credit and debentures        | 13   | 2,181       | 1,955        | 564   |
| Trade and other payables                    | 14   | 1,661       | 1,735        | 500   |
| Related party                               | 12B  | 32          | -            | -   |
| Current tax liabilities                     | 19   | 138         | 160          | 46  |
| Provisions                                  | 15   | 80          | 94           | 27  |
| Employee benefits                           | 18   | 315         | 280          | 81  |
| Total current liabilities                   |      | 4,407       | 4,224        | 1,218   |
| <b>Non-current liabilities</b>              |      |             |              |   |
| Bank loans and debentures                   | 13   | 12,241      | 13,149       | 3,794   |
| Employee benefits                           | 18   | 258         | 272          | 78  |
| Other liabilities                           |      | 244         | 234          | 67  |
| Provisions                                  | 15   | 47          | 40           | 12  |
| Deferred tax liabilities                    | 19   | 593         | 459          | 132   |
| Total non-current liabilities               |      | 13,383      | 14,154       | 4,083   |
| Total liabilities                           |      | 17,790      | 18,378       | 5,301   |
| <b>Equity</b>                               |      |             |              |   |
| Attributable to shareholders of the Company | 23   | 194         | 177          | 51  |
| Non-controlling interests                   |      | 2,543       | 2,279        | 657   |
| Total Equity                                |      | 2,737       | 2,456        | 708   |
| Total liabilities and equity                |      | 20,527      | 20,834       | 6,009   |

Date of approval of the financial statements: May 15, 2018

/s/ Doron Turgeman /s/ Itzik Tadmor  
CEO Principal Financial Officer

\* For information regarding early adoption of IFRS 15, Revenue from Contracts with Customers, see Note 3a.

The accompanying notes are an integral part of these consolidated financial statements.

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Internet Gold - Golden Lines Ltd.

**Consolidated Statements of Income for The Year Ended December 31****(In millions, except per share data)**

|  |      | 2015   | 2016   | *2017 | Convenience<br>translation<br>into<br>U.S. dollars<br>(Note 2D)<br>2017 |
|--|------|--------|--------|-------|---|
|  | Note | NIS    | NIS    | NIS   | US\$  |
| Revenues   | 24   | 9,985  | 10,084 | 9,789 | 2,823   |
| Costs and expenses                                   |      |        |        |       |   |
| Depreciation and amortization                        |      | 2,131  | 2,161  | 2,117 | 611   |
| Salaries   | 25   | 1,960  | 2,017  | 2,008 | 579   |
| General and operating expenses                       | 26   | 3,878  | 4,024  | 3,911 | 1,128   |
| Other operating expenses (income), net               | 27   | 3      | 21     | 149   | 43  |
|  |      | 7,972  | 8,223  | 8,185 | 2,361   |
| Operating profit                                     |      | 2,013  | 1,861  | 1,604 | 462   |
| Financing (income) expenses                          | 28   |        |        |       |   |
| Finance expenses                                     |      | 759    | 1,108  | 652   | 188   |
| Finance income                                       |      | (164 ) | (133 ) | (75 ) | (22 )   |
| Financing expense, net                               |      | 595    | 975    | 577   | 166   |
| Profit after financing expenses, net                 |      | 1,418  | 886    | 1,027 | 296   |
| Share of loss (income) in equity-accounted investees | 12   | (12 )  | 5      | 5     | 1   |
| Profit before income tax                             |      | 1,430  | 881    | 1,022 | 295   |
| Income tax expenses                                  | 19   | 347    | 442    | 347   | 100   |

|                                |       |          |         |         |
|--------------------------------|-------|----------|---------|---------|
| Net profit for the year        | 1,083 | 439      | 675     | 195     |
| Profit (loss) attributable to: |       |          |         |         |
| Shareholders of the Company    | 87    | (202 )   | (15 )   | (4 )    |
| Non-controlling interests      | 996   | 641      | 690     | 199     |
| Net profit for the year        | 1,083 | 439      | 675     | 195     |
| Earnings (loss) per share      | 29    |          |         |         |
| Basic                          | 4.54  | (10.52 ) | (0.82 ) | (0.24 ) |
| Diluted                        | 4.47  | (10.52 ) | (0.82 ) | (0.24 ) |

\* For information regarding early adoption of IFRS 15, Revenue from Contracts with Customers, see Note 3a.

The accompanying notes are an integral part of these consolidated financial statements.

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Internet Gold - Golden Lines Ltd.

**Consolidated Statements of Comprehensive Income for the year ended December 31****(In millions)**

|  | 2015  | 2016  | *2017        | Convenience<br>translation<br>into<br>U.S. dollars<br>(Note 2D)<br>2017 |
|--|-------|-------|--------------|---|
|  | NIS   | NIS   | NIS          | US\$  |
| Net profit for the year                          | 1,083 | 439   | <b>675</b>   | <b>195</b>  |
| Items of comprehensive profit (loss), net of tax | 7     | (15 ) | <b>(8 )</b>  | <b>(2 )</b>   |
| Total comprehensive profit for the year          | 1,090 | 424   | <b>667</b>   | <b>193</b>  |
| Attributable to:                                 |       |       |              |   |
| Shareholders of the Company                      | 89    | (206) | <b>(17 )</b> | <b>(5 )</b>   |
| Non-controlling interest                         | 1,001 | 630   | <b>684</b>   | <b>198</b>  |
| Total comprehensive profit for the year          | 1,090 | 424   | <b>667</b>   | <b>193</b>  |

\* For information regarding early adoption of IFRS 15, Revenue from Contracts with Customers, see Note 3a.

The accompanying notes are an integral part of these consolidated financial statements.

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Internet Gold - Golden Lines Ltd.

**Consolidated Statements of Changes in Equity****(In millions except share data)**

|   | Attributable to shareholders of the Company   |                                    |                           |                          |                               |        | Total | Non-controlling interest | Total equity |
|---|---|------------------------------------|---------------------------|--------------------------|-------------------------------|--------|-------|--------------------------|--------------|
|   | Share capital<br>Number of<br><b>Shares</b> <sup>(1)</sup><br>NIS 0.01<br>par value | Share<br>Amount<br>premiums<br>NIS | Treasury<br>shares<br>NIS | Other<br>reserves<br>NIS | Accumulated<br>deficit<br>NIS | NIS    |       |                          |              |
| Balance as at January 1,<br>2015          | 19,203,186  | *                                  | 658                       | (169 )                   | (59 )                         | (613 ) | (183) | 2,949                    | 2,766        |
| Changes during 2015:                      |   |                                    |                           |                          |                               |        |       |                          |              |
| Exercise of options in<br>subsidiary      | -   | -                                  | -                         | -                        | 1                             | -      | 1     | 18                       | 19           |
| Dividends to non-controlling<br>interests | -   | -                                  | -                         | -                        | -                             | -      | -     | (1,274 )                 | (1,274)      |
| Other comprehensive profit,<br>net of tax | -   | -                                  | -                         | -                        | 2                             | -      | 2     | 5                        | 7            |
| Net profit for the year                   | -   | -                                  | -                         | -                        | -                             | 87     | 87    | 996                      | 1,083        |
| Comprehensive profit for the<br>year      | -   | -                                  | -                         | -                        | 2                             | 87     | 89    | 1,001                    | 1,090        |
| Balance as at December 31,<br>2015        | 19,203,186  | *                                  | 658                       | (169 )                   | (56 )                         | (526 ) | (93 ) | 2,694                    | 2,601        |

(\*) Represent an amount less than NIS 1.

(1) Net of treasury shares.

The accompanying notes are an integral part of these consolidated financial statements.

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Internet Gold - Golden Lines Ltd.

**Consolidated Statements of Changes in Equity (cont'd)****(In millions except share data)**

|  | Attributable to shareholders of the Company   |                            |                  |                    |                   |                        |                      | Non-controlling interest | Total equity |
|--|---|----------------------------|------------------|--------------------|-------------------|------------------------|----------------------|--------------------------|--------------|
|  | Share capital<br>Number of<br><b>Shares</b> <sup>(1)</sup><br>NIS 0.01<br>par value | Share<br>Amount<br>premium | Share<br>premium | Treasury<br>shares | Other<br>reserves | Accumulated<br>deficit | Accumulated<br>Total |                          |              |
|  | NIS   | NIS                        | NIS              | NIS                | NIS               | NIS                    | NIS                  | NIS                      | NIS          |
| Balance as at January 1, 2016                          | 19,203,186  | *                          | 658              | (169 )             | (56 )             | (526 )                 | (93 )                | 2,694                    | 2,601        |
| Changes during 2016:                                   |   |                            |                  |                    |                   |                        |                      |                          |              |
| Exercise of options in subsidiary                      | -   | -                          | -                | -                  | 1                 | -                      | 1                    | 4                        | 5            |
| Transactions with non-controlling interest, net of tax | -   | -                          | -                | -                  | -                 | 492                    | 492                  | 402                      | 894          |
| Dividends to non-controlling interests                 | -   | -                          | -                | -                  | -                 | -                      | -                    | (1,187 )                 | (1,187)      |
| Other comprehensive profit (loss), net of tax          | -   | -                          | -                | -                  | 3                 | (7 )                   | (4 )                 | (11 )                    | (15 )        |
| Net profit (loss) for the year                         | -   | -                          | -                | -                  | -                 | (202 )                 | (202)                | 641                      | 439          |
| Comprehensive profit (loss) for the year               | -   | -                          | -                | -                  | 3                 | (209 )                 | (206)                | 630                      | 424          |
| Balance as at December 31, 2016                        | 19,203,186  | *                          | 658              | (169 )             | (52 )             | (243 )                 | 194                  | 2,543                    | 2,737        |

(\*) Represent an amount less than NIS 1.

(1) Net of treasury shares.



The accompanying notes are an integral part of these consolidated financial statements.

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Internet Gold - Golden Lines Ltd.

**Consolidated Statements of Changes in Equity (cont'd)****(In millions except share data)**

|   | Attributable to shareholders of the Company |                 |                |                     |          |         | Non-controlling interest | Total equity | Convenience translation into US\$ (Note 2D) |        |
|---|---|-----------------|----------------|---------------------|----------|---------|--------------------------|--------------|---|--------|
|   | Share capital                               | Treasury shares | Other reserves | Accumulated deficit | Total    |         |                          |              |   |        |
|   | Number of Shares <sup>(1)</sup>             | Amount          | premiums       | shares              | reserves | deficit | Total                    |              |   |        |
|   | NIS 0.01 par value                          | NIS             | NIS            | NIS                 | NIS      | NIS     | NIS                      | NIS          | US\$  |        |
| Balance as at January 1, 2017                 | 19,203,186                                  | *               | 658            | (169 )              | (52 )    | (243 )  | 194                      | 2,543        | 2,737                                       | 789    |
| Changes during 2017:                          |   |                 |                |                     |          |         |                          |              |   |        |
| Dividends to non-controlling interests        | -   | -               | -              | -                   | -        | -       | -                        | (948 )       | (948 )                                      | (274 ) |
| Other comprehensive profit (loss), net of tax | -   | -               | -              | -                   | 1        | (3 )    | (2 )                     | (6 )         | (8 )  | (2 )   |
| Net profit (loss) for the year                | -   | -               | -              | -                   | -        | (15 )   | (15 )                    | 690          | 675   | 195    |
| Comprehensive profit (loss) for the year      | -   | -               | -              | -                   | 1        | (18 )   | (17 )                    | 684          | 667   | 193    |
| Balance as at December 31, 2017               | 19,203,186                                  | *               | 658            | (169 )              | (51 )    | (261 )  | 177                      | 2,279        | 2,456                                       | 708    |

(\*) Represent an amount less than NIS 1.

(1) Net of treasury shares.

The accompanying notes are an integral part of these consolidated financial statements.

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Internet Gold - Golden Lines Ltd.

**Consolidated Statements of Cash Flows for the Year Ended December 31****(In millions)**

|   | 2015   | 2016   | *2017         | Convenience<br>translation<br>into<br>U.S. dollars<br>(Note 2D) |
|---|--------|--------|---------------|---|
|   | NIS    | NIS    | NIS           | 2017<br>US\$  |
| Cash flows from operating activities                    |        |        |               |   |
| Net profit for the year                                 | 1,083  | 439    | 675           | 195   |
| Adjustments:  |        |        |               |   |
| Depreciation and amortization                           | 2,131  | 2,161  | 2,117         | 611   |
| Profit from gaining control over DBS                    | (12 )  | -      | -             | -   |
| Share of loss (profit) of equity accounted investees    |        |        | <b>5</b>      | <b>1</b>  |
| Loss from impairment of goodwill                        | (12 )  | 5-     |               |   |
|   |        |        | <b>129</b>    | <b>37</b>   |
| Finance expenses, net                                   | 626    | 1,025  | 584           | 168   |
| Capital gain, net                                       | (136 ) | (86 )  | (27 )         | (8 )  |
| Income tax expenses                                     | 347    | 442    | 347           | 100   |
| Change in inventory                                     | (20 )  | (20 )  | (35 )         | (10 )   |
| Change in trade and other receivables                   | 323    | 110    | 194           | 56  |
| Change in trade and other payables                      | (271 ) | (24 )  | 16            | 5   |
| Changes in provisions                                   | 18     | (19 )  | 15            | 4   |
| Changes in employee benefits                            | 110    | (65 )  | (33 )         | (10 )   |
| Change in other liabilities                             | (9 )   | 23     | (34 )         | (10 )   |
| Net income tax paid, net                                | (534 ) | (534 ) | (473 )        | (136 )  |
| Net cash provided by operating activities               | 3,644  | 3,457  | 3,480         | 1,003   |
| Cash flows from investing activities                    |        |        |               |   |
| Investment in intangible assets and deferred expenses   | (311 ) | (223 ) | <b>(399 )</b> | <b>(115 )</b>   |
| Proceeds from the sale of property, plant and equipment | 151    | 138    | 98            | 28  |

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|   |         |         |               |               |
|---|---------|---------|---------------|---------------|
| Tax payments due to owners loans                    | -       | (461 )  | -             | -             |
| Change in investments, net                          | 1,638   | 528     | 457           | 132           |
| Purchase of property, plant and equipment           | (1,324) | (1,193) | (1,131)       | (326 )        |
| Deposits from (to) restricted cash                  | (90 )   | 155     | -             | -             |
| Cash from gaining control over investee             | 299     | -       | -             | -             |
| Other   | 18      | 20      | 9             | 3             |
| Net cash provided by (used in) investing activities | 381     | (1,036) | <b>(966 )</b> | <b>(278 )</b> |

The accompanying notes are an integral part of these consolidated financial statements.

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Internet Gold - Golden Lines Ltd.

**Consolidated Statements of Cash Flows for the Year Ended December 31 (cont'd)****(In millions)**

|   | 2015    | 2016    | *2017        | Convenience<br>translation<br>into<br>U.S. dollars<br>(Note 2D)<br>2017 |
|---|---------|---------|--------------|---|
|   | NIS     | NIS     | NIS          | US\$  |
| Cash flows from financing activities                      |         |         |              |   |
| Proceeds from issuance of debentures and loans received   | 1,010   | 4,184   | 2,635        | 760   |
| Repayment of debentures and loans                         | (2,358) | (5,000) | (1,942)      | (560)   |
| Interest paid   | (826)   | (967)   | (583)        | (168)   |
| Dividends to non-controlling interests                    | (1,274) | (1,187) | (948)        | (274)   |
| Transactions with non-controlling interests               | -       | 1,034   | -            | -   |
| Payments to Eurocom DBS                                   | (680)   | (256)   | (61)         | (17)  |
| Other   | (10)    | (38)    | (17)         | (5)   |
| Net cash used in financing activities                     | (4,138) | (2,230) | (916)        | (264)   |
| Net increase (decrease) in cash and cash equivalents      | (113)   | 191     | <b>1,598</b> | <b>461</b>  |
| Cash and cash equivalents as at the beginning of the year | 732     | 619     | <b>810</b>   | <b>234</b>  |
| Cash and cash equivalents as at the end of the year       | 619     | 810     | <b>2,408</b> | <b>695</b>  |

\* For information regarding early adoption of IFRS 15, Revenue from Contracts with Customers, see Note 3a.

The accompanying notes are an integral part of these consolidated financial statements.



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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(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, 2017, 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, B Communications sold 115,500,000 shares of Bezeq (4.18% of the outstanding shares of Bezeq) for NIS 8.5 per share or NIS 978, net of transaction costs. B Communications retained a 26.34% ownership interest in Bezeq, following the closing of the transaction. For more information relating to B Communications’ 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.

On June 20, 2017, the Israel Securities Authority began an open investigation (“the Investigation”), which included searches at the offices of Bezeq and of DBS and seizure of documents.



As part of the investigation, the Chairman of Bezeq's Board of Directors (when the investigation was initiated) was questioned, as well as Bezeq's CEO, the CEO and CFO of DBS, and to the best of Bezeq's knowledge, other senior officers and officers in the Group.

On November 6, 2017, the Israel Securities Authority ("the ISA") issued a press release regarding the conclusion of the Investigation and the transfer of the Investigation file to the Tel Aviv District Attorney (Taxation and Economics). In accordance with the notice, the Israel Securities Authority ISA concluded that there is prima facie evidence establishing the involvement of the main suspects in the case, in offenses of: (1) fraudulently receiving funds in connection with the entitlement of Bezeq's controlling shareholder to a receive contingent consideration of NIS 170 as part of the transaction for Bezeq's purchase of DBS shares from Bezeq's controlling shareholder, which consideration was based on certain targets to be met by DBS; (2) leaking the material of the independent committee of Bezeq's Board of Directors that examined interested party transactions (the transaction for the acquisition of DBS shares by Bezeq and the transaction between DBS and Space Communications Ltd. for the purchase by DBS of satellite segments from Space Communications Ltd.) to Bezeq's controlling shareholder and associates; (3) and promoting Bezeq's interests in the Ministry of Communications in violation of the Penal Law and the Israel Securities Law. The notice further stated that the Investigation file was transferred to the District Attorney's Office and that the District Attorney's Office is authorized to decide on how to continue to proceed with this matter. It should be noted that in this context, on November 20, 2017, Bezeq and DBS received a "letter of notice to the suspect" indicating that the investigation file relating to Bezeq and DBS as suspects was transferred to the Attorney General for review.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 1 - Reporting Entity (cont'd)**

On February 18, 2018, the ISA and the Israel Police issued a joint press release stating that in view of the evidence the ISA found in its investigation, which raised suspicions of additional offenses, a new joint investigation was opened on that date by investigators of the ISA and the Unit for Combating Economic Crime at Lahav 433. Pursuant to such investigation, a number of suspects were arrested, including senior officers of the Bezeq Group (including a former director and controlling shareholder in Bezeq and Bezeq's CEO), and were subsequently released under restrictive conditions.

To the best of Bezeq's knowledge, and based on the Court's rulings, the officers are suspected, together with others, of offenses of fraud, administrative offenses, obstruction of justice, bribery, offenses under the Israel Securities Law, deception and breach of trust in a company, and also some offenses under the Prohibition on Money Laundering Law, 2000.

Subsequent to the opening of the investigation, a number of legal proceedings were commenced against Bezeq, officers of Bezeq, and companies of the group of controlling shareholders in Bezeq, including motions for certification of class action and motions for discovery of documents before submitting a motion for certification of a derivative claim. For further information, see Note 20.

Bezeq does not have full information about the investigations described in this section, or the content, the materials or the evidence in the possession of the legal authorities. In addition, in view of the provisions of Israeli law and the concern of obstructing investigation proceedings, Bezeq at present is prevented from, and is avoiding, the examination of all matters that were raised in the investigations. This restricts Bezeq's activity, including in all matters relating to audits and assessments required for publishing Bezeq's reports. Accordingly, Bezeq is unable to assess the effects of the investigations, their findings and their results on Bezeq and its officers, on the internal control of Bezeq, on the financial statements and on the estimates, if any, used in the preparation of these financial statements.

## **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 to be issued by the Company's Board of Directors on May 15, 2018.

### **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.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 2 - Basis of Preparation (cont'd)**

**B. Definitions (cont'd)**

(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 12- Investees.

(6) DBS: DBS Satellite Services (1998) Ltd.

(7) Eurocom Communications: Eurocom Communications Ltd.

(8) Subsidiaries: Companies whose financial statements are fully consolidated, directly or indirectly, with the financial statements of the Company.

(9) Associates: Companies in which the Group's investment is included, directly or indirectly, in the consolidated financial statements on the equity basis.

(10) Investees: Subsidiaries or associates.

(11) Related party: As defined in IAS 24 (2009), Related Party Disclosures.

(12)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, 2017, have been presented in dollars, translated at the representative rate of exchange as at December 31, 2017 (NIS 3.467 = 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.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 2 - Basis of Preparation (cont'd)**

**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.
- \* Equity-accounted investments.
- \* Deferred tax assets and liabilities.
- \* Provisions.
- \* Assets and 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.

**F. Operating cycle**

The Group's operating cycle is up to one year. As a result, current assets and current liabilities include items the realization of which is intended and anticipated to take place within one year from the date of the financial statements.

**G. Use of estimates and judgments**

Use of estimates and judgments

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

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.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 2 - Basis of Preparation (cont'd)****G. Use of estimates and judgments (cont'd)**

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:

| Subject  | Main assumptions  | Possible implications   | Reference                           |
|--|---|---|-------------------------------------|
| Useful life and expected operation of fixed assets, intangible assets, broadcasting rights, and subscriber acquisition asset | Assumptions of the useful life of groups of fixed assets, intangible assets and additional assets   | Change in the value of fixed assets, intangible assets, additional assets, and depreciation and amortization expenses | Note 8, Note 9, Note 10 and Note 11 |
| Measurement of recoverable amounts of cash-generating units that include goodwill  | Assumption of expected cash flows from cash-generating units  | Recognition of impairment loss  | Note 9                              |
| Deferred taxes   | Assumption of anticipated future realization of the tax benefit in the future, including assumptions for the utilization of carryforward losses in DBS, and the assumption that it is more likely than not that the cancellation of the structural separation between Bezeq and DBS will be approved. | Recognition or reversal of deferred tax asset in profit or loss   | Note 19                             |
| Uncertain tax positions  | The extent of the certainty that the Group's tax positions will be accepted and the risk of it incurring any additional tax and interest expenses. This is based  | Recognition or reversal of income tax expenses  | Note 19                             |



on an analysis of a number of matters including interpretations of tax laws and the Group's experience

|  |  |   |                             |
|--|--|---|-----------------------------|
| Measurement of liabilities and the fair value of the excess of advance payments for contingent consideration in a business combination | The assumptions regarding the amount expected to be recovered for Bezeq from the excess of the advance payments, and taking into consideration the solvency of Eurocom DBS   | Change in the value of the liability for contingent consideration for a business combination, change in the fair value of the excess of the advance payments for contingent consideration and recognition in the statement of income for this change, respectively. | Note 12                     |
| Provisions and contingent liabilities  | Assessment of the likelihood of claims against Group companies and measuring potential liabilities attributable to claims  | Reversal or creation of a provision for a claim and recognition of income/expenses respectively   | Note 15 and Note 20 Note 18 |
| Post-employment employee benefits  | Actuarial assumptions such as discount rate, future salary increases and churn rate  | Increase or decrease in the post-employment defined benefit obligation  |                             |
| The existence of effective control over Bezeq  | The practical ability to appoint most of the members of the board of directors of Bezeq, as a result of the control permit in Bezeq, the composition and distribution of the holdings of the other shareholders of Bezeq and the restrictions on these shareholders under the Telecommunications Law | Consolidation of Bezeq's reports or treatment of Bezeq using the equity method.   | Note 3                      |

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 2 - Basis of Preparation (cont'd)**

**H. 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.

**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.

In this Note, where the Group has chosen accounting alternatives permitted in accounting standards and/or in accounting policy where there is no explicit provision in accounting standards, such disclosure is presented in bold. This does not attribute greater importance compared to other accounting policies that are not presented in bold.

**A. Initial application of new standards**

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

IFRS 15 presents a new model for recognizing revenue from contracts with customers, which includes five steps for analyzing transactions so as to determine when to recognize revenue and in what amount:

1. Identifying the contract with the customer.
2. Identifying separate performance obligations in the contract.
3. Determining the transaction price.
4. Allocating the transaction price to separate performance obligations.
5. Recognizing revenue when the performance obligations are satisfied.

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

Application of the model did not have a material effect on the measurement of the Group's revenue in 2017, compared to the provisions of the previous standard.

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

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**A. Initial application of new standards (cont'd)**

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

An asset for obtaining a contract is amortized in accordance with the expected useful life of the subscribers and in accordance with the average churn rate of subscribers based on the type of subscriber and service received (mainly over 1-4 years).

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

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

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

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

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

The tables below summarize the effects on the consolidated statement of financial position as at December 31, 2017 and on the consolidated statements of income and cash flows for 2017, assuming that the Group's previous policy regarding subscriber acquisition costs continued during that period.

Effect on the consolidated statement of financial position of the Group as at December 31, 2017:

|  | <b>In accordance<br/>with the<br/>previous<br/>policy</b> | Change | In<br>accordance<br>with<br>IFRS15 |
|--|---|--------|------------------------------------|
|  | NIS   | NIS    | NIS                                |
| Net subscriber acquisition asset (stated as deferred expenses and non-current investments) | 4   | 111    | 115                                |
| Equity attributable to shareholders of the Company   | 163   | 14     | 177                                |
| Non-controlling interests  | 2,209   | 70     | 2,279                              |
| Total equity   | 2,372   | 84     | 2,456                              |

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****A. Initial application of new standards (cont'd)**

Effect on the consolidated statement of the Group income for 2017:

|   | Year ended December 31, 2017                  |               |                                  |
|---|---|---------------|----------------------------------|
|   | <b>In accordance with the previous policy</b> |               | <b>In accordance with IFRS15</b> |
|   | <b>NIS</b>                                    | <b>Change</b> | <b>NIS</b>                       |
| General and operating expenses                            | 4,042   | (131 )        | 3,911                            |
| Salaries  | 2,042   | (34 )         | 2,008                            |
| Depreciation and amortization expenses                    | 2,063   | 54            | 2,117                            |
| Operating profit  | 1,493   | 111           | 1,604                            |
| Profit after financing expenses                           | 916   | 111           | 1,027                            |
| Profit before income tax                                  | 911   | 111           | 1,022                            |
| Income tax  | 320   | 27            | 347                              |
| Net profit for the period                                 | 591   | 84            | 675                              |
| Profit (loss) attributable to shareholders of the Company | (29 )   | 14            | (15 )                            |
| Profit attributable to non-controlling interests          | 620   | 70            | 690                              |
| Earnings per share (Basic and Diluted)                    | (1.56 )                                       | 0.74          | (0.82 )                          |

Effect on the statement of the Group consolidated cash flows for 2017:

Year ended December 31, 2017

**In accordance  
with****the** Change In accordance  
**previous** with IFRS15**policy**

|                                       | NIS    | NIS    | NIS    |
|---------------------------------------|--------|--------|--------|
| Net cash from operating activities    | 3,315  | 165    | 3,480  |
| Net cash used in investing activities | (801 ) | (165 ) | (966 ) |

As from January 1, 2017, the Group applies the amendment to IAS 12, Income Taxes: Recognition of Deferred Tax Assets for Unrealized Losses. The Amendment clarifies that for purposes of recognizing a deferred tax asset, the effect of reversal of deductible temporary differences should be excluded when assessing future taxable profit. Moreover, the Amendment provides that probable future profits may include profits from the recovery of assets at more than their carrying value, if there is sufficient supporting evidence. Application of the amendment did not have an effect on the Group's financial statements.

**B. Non- controlling interests**

On January 1, 2016, the Group changed its accounting policy with respect to transactions with non-controlling interests, while retaining control. According to the new accounting policy, the difference between the consideration paid or received for change in non-controlling interests is recognized in retained earnings. The Group believes that this presentation provides more relevant information about its distributable earnings. This change in accounting policy was applied retrospectively and did not have any impact on earnings per share.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**B. Non- controlling interests (cont'd)**

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 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.

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.

**C. Consolidation of the financial statements and investments in associates**

(1) Business combinations

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.

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 C. the acquiree's equity instruments. In addition, the consideration transferred includes the fair value of any contingent consideration. Subsequent to the acquisition date, the Group recognizes changes in fair value of contingent consideration classified as a financial liability in profit or loss **under financing expenses**.

In step acquisitions, the difference between the fair value at the acquisition date of the Group's pre-existing equity D. rights in the acquiree and the carrying amount at that date is recognized in the statement of income under other operating income or expenses.

Costs associated with the acquisition that were incurred by the Group in the business combination such as advisory, E. legal, valuation and other professional or consulting fees were recognized as expenses in the period the services are received.

## (2)Subsidiaries

Subsidiaries are entities controlled by the Company. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date of loss of control.

Control exists when the Group is exposed, or has rights, to variable returns from its involvement with the acquiree and it has the ability to affect those returns through its power over the acquiree. Substantive rights held by the Group and others are taking into account when assessing control.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**C. Consolidation of the financial statements and investments in associates (cont'd)**

(3) 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.

**D. 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.

**E. 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 financial assets at the date the Group becomes a party to contractual provisions of the instrument, meaning the date that the Group undertakes to buy or sell the asset.

Financial assets are derecognized when the contractual rights of the Group to the cash flows from the asset expire, or the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

Regular way sales of financial assets are recognized on the trade date, meaning on the date the Group undertook to sell the asset.

## (2) Classification of financial assets and the accounting treatment in each group

The Group classifies its financial assets as follows:

### Cash and cash equivalents

Cash consists of cash balances available for immediate use and call deposits. Cash equivalents consists of 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. These financial assets are measured at fair value and changes therein are recognized in the statement of income.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**E. Financial instruments (cont'd)**

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.

(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 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)Derivative financial instruments including hedge accounting

a. Hedge accounting

The Group holds derivative financial instruments to hedge cash flows against risks to future changes in the CPI.

Forward contracts are measured at fair value. Changes in the fair value of a 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.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**E. Financial instruments (cont'd)**

b. Economic hedges

The Group holds other derivative financial instruments to hedge cash flows against foreign currency risks. Hedge accounting is not applied for these instruments. The derivative instruments are recognized at fair value; changes in fair value are recognized in profit and loss as incurred.

(7) 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.

## **F. Broadcast rights**

**Broadcasting rights are stated at cost, net of rights exercised.** The costs of the broadcasting rights acquired for the broadcasting of content include the amounts paid to the rights provider, plus direct costs for adjusting the rights to the broadcast. Broadcast rights are amortized in accordance with the actual broadcasts of the total number of expected broadcasts based on the management's estimate or broadcasts permitted under the agreement (the part that is unamortized at the end of the agreement term is amortized in full upon its termination), or on a straight-line basis in accordance with the term of the rights agreement or the economic life, whichever is shorter. **The net adjustment of the broadcasting rights is presented as an adjustment of earnings as part of the ongoing operations in the statements of cash flows.**

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**G. 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 estimated costs of dismantling and removing the items and restoring the site on which they are located when the Group has an obligation to vacate and restore the site. The cost of purchased software that is integral to the functionality of the related equipment is recognized as part of the cost of the equipment.

Spare parts, servicing equipment and stand-by equipment are classified as property, plant and equipment when they meet the definition of property, plant and equipment 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.



Gain or loss from the disposal of an item of property, plant and equipment is determined by comparing the proceeds from disposal of the asset with its carrying amount. **Gain or loss from the sale of fixed assets is recognized under 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.

(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.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**G. Property, plant and equipment (cont'd)**

The estimated useful lives for the current period are as follows:

|  | Useful life             |
|--|-------------------------|
| Fixed line and international network equipment (switches, transmission, power) | 4-12                    |
| Network  | 12-33                   |
| Subscriber equipment and installations   | 4-8                     |
| Equipment and infrastructure for multichannel television                       | 3-15                    |
| Vehicles   | 6-7                     |
| Office and general equipment   | 5-10                    |
| Electronic equipment, computers and internal communication systems             | 3-7                     |
| Cellular network   | 4-10                    |
| Passive radio equipment at cellular network sites                              | up to December 31, 2037 |
| Buildings  | 25                      |
| Seabed cable   | 4-25 (mainly 25)        |

Depreciation methods, useful lives and residual values are reviewed at least at each reporting year and adjusted as required.

**H. Intangible assets**

(1) Goodwill and brand names

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.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**H. Intangible assets (cont'd)**

(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 method over the term of the allocation of frequencies, which started from the use of the frequencies. The 4G frequencies (LTE) and 3.5G frequencies (UMTS/HSEA) are amortized until August 22, 2028.

(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.**

(6) Subsequent expenditures

Subsequent expenditures are recognized as intangible assets only when they increase the future economic benefits embodied in the specific asset to which they relate. 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 names (excluding brands acquired in the 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 names 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:

| <b>Type of asset</b>                     | <b>Amortization period</b>  |
|--|---|
| Frequency usage rights                   | Over the term of the license until 2028   |
| 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  |

Amortization methods and useful lives are reviewed at least once a year and adjusted if appropriate.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**I. Leased assets**

Leases, including leases of land from the Israel Land Administration, where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. **Subsequent to initial recognition, the assets are measured at cost less accumulated amortization and impairment losses.**

Other leases are classified as operating leases and the leased assets are not recognized in the Group's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

At inception or upon reassessment of an arrangement, the Group determines whether such an arrangement is or contains a lease. An arrangement is a lease or contains a lease if the following two criteria are met:

- A. The fulfillment of the arrangement is dependent on the use of a specific asset or assets.
- 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.

### **J. Right of use of capacities**

Transactions for acquiring an infeasible 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.

### **K. Inventory**

The cost of inventories includes the cost of purchase and cost incurred in bringing the inventories to their present location and condition.

Inventories are measured at the lower of cost or net realizable value. **The Group elected to base the cost of inventories on the moving average principle.**

The inventories include terminal equipment and accessories intended for sale and service, as well as spare parts used for repairs in the repair service provided to its customers.

Slow-moving inventory of terminal equipment, accessories and spare parts are stated net of the provision for impairment.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**L. 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. Other financial assets are assessed for impairment collectively in groups that share similar credit risk characteristics, taking into account past experience. The financial statements include specific provisions and Group provisions for doubtful debts, which properly reflect, in the estimation of the management, the loss inherent in debts for which collection is in doubt.

(2) 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 (for which future cash flows were not adjusted).

Determining cash-generating units

For the purpose of impairment testing, the assets are grouped together into the smallest group of assets that generates cash from continuing use that are largely independent of other assets or groups of assets (“cash-generating unit”).

Allocation of goodwill to cash-generating units

For purposes of goodwill impairment testing, cash-generating units to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes, but in any event is not larger than an operating segment. Goodwill acquired in a business combination is allocated to cash-generating units that are expected to generate benefits from the synergies of the combination.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**L. Impairment (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. See Note 9.

**M. 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.

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.**

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**M. Employee benefits (cont'd)**

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. **Any actuarial changes arising from a change in the discount rate are recognized in the financing expenses item, while the other differences are recognized in salary expenses.**

(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.

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.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**N. 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 describes 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.

**O. Revenues**

As from January 1, 2017, the Group has early adopted IFRS 15, Revenue from Contracts with Customers (“IFRS 15” or “the Standard”). As set out in Note 3A, the application of IFRS 15 did not have a material effect on the measurement of the Group’s revenue in 2017, compared to the provisions in the previous standard, and the main effect of application of IFRS 15 in the Group is the accounting treatment of incremental costs of obtaining a contract with a customer.

IFRS 15 presents a new model for recognizing revenue from contracts with customers, which includes five steps for analyzing transactions so as to determine when to recognize revenue and in what amount:

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**O. Revenues (cont'd)**

(1) Identifying the contract

The Group accounts for a contract with a customer only when the following conditions are met:

- a. The parties to the contract have approved the contract (in writing, orally or according to other customary business practices) and they are committed to satisfying the obligations attributable to them.
- b. The Group can identify the rights of each party in relation to the goods or services that will be transferred.
- c. The Group can identify the payment terms for the goods or services that will be transferred.
- d. The contract has a commercial substance (i.e. the risk, timing and amount of the entity's future cash flows are expected to change as a result of the contract).
- e. It is probable that the consideration, to which the Group is entitled to in exchange for the goods or services transferred to the customer, will be collected.

(2) Identifying performance obligations

On the contract's inception date, the Group assesses the goods or services promised in the contract with the customer and identifies as a performance obligation any promise to transfer to the customer one of the following:

- a. Goods or services (or a bundle of goods or services) that are distinct; or
- b.



A series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer.

(3) Determining the transaction price

The transaction price is the amount of the consideration to which the Group expects to be entitled in exchange for the transfer of goods or services promised to the customer, other than amounts collected in favor of third parties. When determining the transaction price, the Group takes into account the effects of all the following: variable consideration, the existence of a significant financing component in the contract, non-cash consideration and consideration to be paid to the customer.

Existence of a significant financing component

In order to measure the transaction price, the Group adjusts the amount of the promised consideration in respect of the effects of the time value of money if the timing of the payments agreed between the parties provides to the customer or the Group a significant financing benefit. In these cases, the contract contains a significant financing component. When assessing whether a contract includes a significant financing component, the Group examines, among other things, the expected length of time between the date the Group transfers the promised goods or services to the customer and the date the customer pays for these goods or services, as well as the difference, if any, between the amount of the consideration promised and the cash selling price of the promised goods or services.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**O. Revenues (cont'd)**

When the contract contains a significant financing component, the Group recognizes the amount of the consideration using the discount rate that would be reflected in a separate financing transaction between it and the customer on the inception date of the contract. The financing component is recognized as interest income or expenses over the period, which are calculated according to the effective interest method. In cases where the difference between the time of receiving payment and the time of transferring the goods or services to the customer is one year or less, **the Group applies the practical expedient included in the standard and does not separate a significant financing component.**

(4) Existence of performance obligation

Revenue is recognized when the Group satisfies a performance obligation by transferring to the customer control over promised goods or services.

(5) Contract costs

Incremental costs of obtaining a contract with a customer such as sales fees to agents, are recognized as an asset when the Group is likely to recover these costs. Costs to obtain a contract that would have been incurred regardless of the contract are recognized as an expense as incurred, unless the customer can be billed for those costs.

Capitalized costs are amortized in the income statement on a systematic basis that is consistent with the average projected churn rate of subscribers based on the type of subscriber and the service received (mainly over 1-4 years).

Every reporting period the Group examines whether the carrying amount of the asset recognized as aforesaid exceeds the consideration the entity expects to receive in exchange for the goods or services to which the asset relates, less the costs directly attributable to the provision of these goods or services that were not recognized as expenses, and if necessary an impairment loss is recognized in profit or loss.

(6) Principal supplier or agent

When another party is involved in providing goods or services to the customer, the Group examines whether the nature of its promise is a performance obligation to provide the defined goods or services itself, which means the Group is a principal and therefore recognizes revenue in the gross amount of the consideration, or to arrange that another party provide the goods or services which means the Group is an agent and therefore recognizes revenue in the amount of the net commission.

The Group is a principal when it controls the promised goods or services before their transfer to the customer. Indicators that the Group controls the goods or services before their transfer to the customer include, inter alia, as follows: the Group is the primary obligor for fulfilling the promises in the contract; the Group has inventory risk before the goods or services are transferred to the customer; and the Group has discretion in setting the prices of the goods or services.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**P. Financing income and expense**

Finance income includes mainly accrued interest income using the effective interest method in respect of the sale of terminal equipment in installments, interest income from deposits and changes in the fair value of financial assets at fair value through profit or loss.

Finance expenses include mainly interest and linkage expenses on borrowings received and debentures issued and financing expenses for provisions arising from legal claims.

In the statements of cash flows, **interest received and dividends received are presented as part of cash flows from investing activities. The Group elected to present interest and linkage differences paid for loans and debentures under cash flows used for financing activities.**

**Q. Income tax expense**

Income tax expense consists of 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.

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.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

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**Note 3 - Significant Accounting Policies (cont'd)**

**Q. Income tax expense (cont'd)**

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.

Presentation of tax expenses in the statement of cash flows

Cash flows arising from taxes on income are classified in the statement of cash flows as cash flows from operating activities, unless they can be specifically identified with investing and financing activities.

**R. 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.

**S. 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.

## **T. New standards and interpretations not yet adopted**

### **(1) IFRS 9, Financial Instruments ("IFRS 9")**

IFRS 9 replaces the current guidance in IAS 39, Financial Instruments: Recognition and Measurement. The new Standard includes revised guidance on the classification and measurement of financial instruments, a new 'expected credit loss' model for calculating impairment for most financial assets, and new guidance and requirements with respect to hedge accounting.

IFRS 9 is effective for annual periods beginning on January 1, 2018, with early adoption being permitted. IFRS 9 will be applied retrospectively, except for a number of exemptions.

The Group has examined the effects of applying IFRS 9, and in its opinion the effect on the financial statements will be immaterial.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**T. New standards and interpretations not yet adopted (cont'd)**

**(2) IFRS 16, Leases (“IFRS 16”)**

IFRS 16 replaces IAS 17, Leases (“IAS 17”) and its related interpretations.

IFRS 16 must be applied for annual periods beginning on January 1, 2019, with early application being permitted. The Group has decided to early apply IFRS 16 as from January 1, 2018 using the cumulative effect approach.

The standard’s instructions rescind the existing requirement that lessees classify leases as operating or finance leases.

The standard presents a unified model for the accounting treatment of all leases according to which the lessee has to recognize a right-of-use asset and a lease liability in its financial statements. IFRS 16 includes two exceptions to the general model whereby a lessee may elect to not apply the requirements for recognizing a right-of-use asset and a liability with respect to short-term leases of up to one year and/or leases where the underlying asset has a low value. The Group has decided not to apply the expedient for short-term leases.

On the date of initial application, the Group will recognize a lease liability for the leases previously classified as operating leases in accordance with IAS 17. The liability will be measured at the present value of the remaining lease payments, discounted at the Group’s incremental interest rate on the date of initial application.



The Group elected to apply the expedient in the standard according to which at the transition date, a right-of-use asset for leases previously classified as operating leases in accordance with IAS 17, will be recognized in the amount equal to the lease liability.

In view of the above, adoption of IFRS 16 is not expected to have an effect on the retained earnings at the transition date.

The Group elected to adopt the Standard while applying the expedients that are permitted in the transitional provisions to the standard as follows:

- It was not re-examined whether the contract is a lease or contains a lease as at the application date of the Standard. Accordingly, the agreements that were previously accounted for as operating leases will be accounted for in
- a. accordance with the new Standard, and the agreements that were previously accounted for as service contracts will continue to be accounted for as such without change.
  - b. The use of one capitalization rate for a lease contracts portfolio with similar characteristics.
  - c. The use of an earlier estimate of an onerous contract under IAS 37 at the transition date as an alternative to assessing the impairment of right-of-use assets.
  - d. Exclusion of direct costs incurred in the lease as part of the asset at the transition date.
  - e. Use of hindsight in determining the lease period if the contract includes options to extend or cancel the lease.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**

**T. New standards and interpretations not yet adopted (cont'd)**

**(2) IFRS 16, Leases (“IFRS 16”) (cont'd)**

IFRS 16 is expected to affect the accounting treatment of real estate leasing agreements, cellular sites, vehicles and other Group assets.

The Group believes that at the initial implementation date of the standard, non-current assets are expected to increase by NIS 1.4 billion, current liabilities by NIS 0.4 billion, and non-current liabilities by NIS 1 billion.

Accordingly, as from the initial application date, instead of presenting the rental expenses for the leased assets under operating leases, the Group will recognize depreciation expenses for depreciation of the right-of-use assets that were recognized and will also recognize financing expenses for the lease liability.

Therefore, application of the standard is expected to result in a decrease in operating expenses in the amount of NIS 0.4 billion in 2018 and an increase in depreciation and amortization and in financing expenses in a similar amount. In addition, following application of the standard, there is expected to be an increase in cash flows from operating activities and a decrease in cash flows from financing activities in the amount of NIS 0.4 billion. Application of the standard is expected to have a negligible effect on the Group's net profit for 2018.

The effect of application of the standard on the financial results, statement of cash flows, and statement of financial position is based on the existing lease contracts as at January 1, 2018 and the Group's expectations regarding future agreements, and will depend on the actual scope of the lease agreements to which the Group will be a party as from application of the standard at inflation rates in 2018 and other economic variables. Actual results may differ from this estimate.

**(3) IFRIC 22, Foreign Currency Transactions and Advance Consideration**

The interpretation provides that the transaction date for the purpose of determining the exchange rate for recording a foreign currency transaction that includes advance consideration is the date of initial recognition of the non-monetary asset/liability from the prepayment. If there are multiple payments or receipts in advance, the Group will establish a transaction date for each payment or receipt.

IFRIC 22 will be applied for annual periods beginning on January 1, 2018. The Group believes that application of IFRIC 22 will not have a material effect on the financial statements.

**(4) IFRIC 23, Uncertainty Over Income Tax Treatments**

IFRIC 23 clarifies application of recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. IFRIC 23 will be effective for annual periods beginning on January 1, 2019, with early application being permitted. The Group believes that application of IFRIC 23 will not have a material effect on the financial statements.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 4 - Segment Reporting**

The Group operates in four 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 (see also Note 24). 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.

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 in the ordinary course of business.

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.

The Group's investment in DBS was accounted for using the equity method up to March 23, 2015. As from that 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.

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Internet Gold – Golden Lines Ltd.

**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             |                            |  |                             |        |             | Consolidated |
|---|--|----------------------------|--|-----------------------------|--------|-------------|--------------|
|   | Domestic<br>fixed-line<br>communications | Cellular<br>communications | International<br>communications<br>and<br>internet<br>services | Multi-channel<br>television | Others | Adjustments |              |
|   | NIS                                      | 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      |
| 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 equipment and intangible assets | 837 | 419 | 127 | 281 | 33 | (80 | ) | 1,617 |
|--|-----|-----|-----|-----|----|-----|---|-------|

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Internet Gold – Golden Lines Ltd.

**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, 2016             |                            |  |                             |        |          | Adjustments | Consolidated |
|---|--|----------------------------|--|-----------------------------|--------|----------|-------------|--------------|
|   | Domestic<br>fixed-line<br>communications | Cellular<br>communications | International<br>communications<br>and<br>internet<br>services | Multi-channel<br>television | Others |          |             |              |
|   | NIS                                      | NIS                        | NIS  | NIS                         | NIS    | NIS      | NIS         |              |
| Revenue from external entities                      | 4,063                                    | 2,587                      | 1,478  | 1,745                       | 198    | -        | 10,071      |              |
| Inter-segment revenues                              | 320                                      | 43                         | 70   | -                           | 20     | (440 )   | 13          |              |
| Total revenue                                       | 4,383                                    | 2,630                      | 1,548  | 1,745                       | 218    | (440 )   | 10,084      |              |
| Depreciation and amortization                       | 717                                      | 380                        | 137  | 296                         | 16     | 615      | 2,161       |              |
| Segment results-operating income                    | 2,076                                    | 32                         | 176  | 264                         | (34 )  | (653 )   | 1,861       |              |
| Finance income                                      | 30                                       | 52                         | 5  | 13                          | 4      | 29       | 133         |              |
| Finance expenses                                    | (475 )                                   | (6 )                       | (15 )  | (539 )                      | (2 )   | (71 )    | (1,108 )    |              |
| Total finance income (expense), net                 | (445 )                                   | 46                         | (10 )  | (526 )                      | 2      | (42 )    | (975 )      |              |
| Segment profit (loss) after finance expenses, net   | 1,631                                    | 78                         | 166  | (262 )                      | (32 )  | (695 )   | 886         |              |
| Share in profit (loss) of equity-accounted investee | -  | -                          | 1  | -                           | (5 )   | (1 )     | (5 )        |              |
| Segment profit (loss) before income tax             | 1,631                                    | 78                         | 167  | (262 )                      | (37 )  | (696 )   | 881         |              |
| Income tax  | 399                                      | 17                         | 42   | (330 )                      | -      | 314      | 442         |              |
| Segment results - net profit (loss)                 | 1,232                                    | 61                         | 125  | 68                          | (37 )  | (1,010 ) | 439         |              |



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Additional information:

|  |        |       |       |       |     |       |        |
|--|--------|-------|-------|-------|-----|-------|--------|
| Segment assets   | 7,111  | 3,294 | 1,177 | 2,026 | 193 | 3,642 | 17,443 |
| Goodwill   | -      | -     | 6     | -     | 10  | 3,050 | 3,066  |
| Investment in equity-accounted investee                            | -      | -     | 5     | -     | 1   | 12    | 18     |
| Segment liabilities  | 11,988 | 569   | 380   | 1,434 | 104 | 3,315 | 17,790 |
| Investments in property, plant and equipment and intangible assets | 828    | 277   | 126   | 227   | 13  | -     | 1,471  |

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Internet Gold – Golden Lines Ltd.

**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, 2017             |                            |  |                             |        |             | Consolidated |
|---|--|----------------------------|--|-----------------------------|--------|-------------|--------------|
|   | Domestic<br>fixed-line<br>communications | Cellular<br>communications | International<br>communications<br>and<br>internet<br>services | Multi-channel<br>television | Others | Adjustments |              |
|   | NIS                                      | NIS                        | NIS  | NIS                         | NIS    | NIS         | NIS          |
| Revenue from external entities                      | 3,953                                    | 2,500                      | 1,466  | 1,650                       | 220    | -           | 9,789        |
| Inter-segment revenues                              | 291                                      | 46                         | 71   | -                           | 17     | (425)       | -            |
| Total revenue                                       | 4,244                                    | 2,546                      | 1,537  | 1,650                       | 237    | (425)       | 9,789        |
| Depreciation and amortization                       | 728                                      | 383                        | 135  | 285                         | 20     | 566         | 2,117        |
| Segment results- operating income                   | 1,971                                    | 72                         | 174  | 163                         | (20)   | (756)       | 1,604        |
| Finance income                                      | 36                                       | 54                         | 4  | 10                          | 5      | (34)        | 75           |
| Finance expenses                                    | (439)                                    | (3)                        | (12)   | (81)                        | -      | (117)       | (652)        |
| Total finance income (expense), net                 | (403)                                    | 51                         | (8)  | (71)                        | 5      | (151)       | (577)        |
| Segment profit (loss) after finance expenses, net   | 1,568                                    | 123                        | 166  | 92                          | (15)   | (907)       | 1,027        |
| Share in profit (loss) of equity-accounted investee | -  | -                          | -  | -                           | (4)    | (1)         | (5)          |
| Segment profit (loss) before income tax             | 1,568                                    | 123                        | 166  | 92                          | (19)   | (908)       | 1,022        |
| Income tax  | 396                                      | 28                         | 39   | 336                         | 0      | (452)       | 347          |
| Segment results - net profit (loss)                 | 1,172                                    | 95                         | 127  | (244)                       | (19)   | (456)       | 675          |
| Additional information:                             |  |                            |  |                             |        |             |              |
| Segment assets                                      | 9,086                                    | 3,271                      | 1,199  | 1,502                       | 174    | 2,655       | 17,887       |
| Goodwill  | -  | -                          | 6  | -                           | 10     | 2,921       | 2,937        |
| Investment in equity-accounted investee             | -  | -                          | 5  | -                           | (6)    | 11          | 10           |

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|  |        |     |     |       |    |       |        |
|--|--------|-----|-----|-------|----|-------|--------|
| Segment liabilities  | 13,901 | 536 | 410 | 1,154 | 64 | 2,313 | 18,378 |
| Investments in property, plant and equipment and intangible assets | 851    | 331 | 169 | 237   | 19 | -     | 1,607  |

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**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, |        |        |
|--|-------------------------|--------|--------|
|  | 2015                    | 2016   | 2017   |
|  | NIS                     | NIS    | NIS    |
| Revenue  |                         |        |        |
| Revenue from reporting segments  | 10,649                  | 10,306 | 9,977  |
| Revenue from other segments  | 221                     | 218    | 237    |
| Elimination of revenue from inter-segment sales except for revenue from sales to an associate reporting as a segment | (445 )                  | (440 ) | (425 ) |
| Elimination of revenue for a segment classified as an associate  | (440 )                  | -      | -      |
| Consolidated revenue   | 9,985                   | 10,084 | 9,789  |
|  |                         |        |        |
|  | Year ended December 31, |        |        |
|  | 2015                    | 2016   | 2017   |
|  | NIS                     | NIS    | NIS    |
| Profit or loss   |                         |        |        |
| Operating income for reporting segments  | 2,795                   | 2,548  | 2,380  |
| Elimination of expenses from a segment classified as an associate  | (59 )                   | -      | -      |
| Financing expenses, net  | (595 )                  | (975 ) | (577 ) |
| Share in the losses (profit) of equity-accounted investees   | 12                      | (5 )   | (5 )   |
| Profit (loss) for operations classified in other Categories  | 44                      | (34 )  | (20 )  |
| Depreciation and amortization of intangible assets resulting from the Bezeq PPA adjustments                          | (545 )                  | (442 ) | (483 ) |
| Other adjustments  | (222 )                  | (211 ) | (273 ) |
| Consolidated profit before income tax  | 1,430                   | 881    | 1,022  |

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Internet Gold – Golden Lines Ltd.

**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)**

|  | December 31, |          |
|--|--------------|----------|
|  | 2016         | 2017     |
|  | NIS          | NIS      |
| Assets   |              |          |
| Assets from reporting segments                             | 13,619       | 15,069   |
| Assets attributable to operations in other categories      | 204          | 178      |
| Goodwill not attributable to segment assets                | 3,050        | 2,921    |
| Investment in an equity-accounted investee                 | 12           | 11       |
| Inter-segment assets                                       | 703          | 269      |
| Assets resulting from the Bezeq PPA, net                   | 2,119        | 1,678    |
| Assets attributable to a non-reportable segment            | 820          | 708      |
| Consolidated assets  | 20,527       | 20,834   |
|  |              |          |
|  | December 31, |          |
|  | 2016         | 2017     |
|  | NIS          | NIS      |
| Liabilities  |              |          |
| Liabilities from reporting segments                        | 14,371       | 16,001   |
| Liabilities attributable to operations in other categories | 104          | 64       |
| Inter-segment liabilities                                  | (730 )       | (1,360 ) |
| Liabilities resulted from the Bezeq PPA, net               | 491          | 386      |
| Liabilities attributable to a non-reportable segment       | 3,554        | 3,287    |
| Consolidated liabilities                                   | 17,790       | 18,378   |

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**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, 2016, and December 31, 2017, cash and cash equivalents include mainly bank deposits with a maturity of up to 90 days.

**Note 6 - Investments including Derivatives**

|                                   | December<br>31, |      |
|-----------------------------------|-----------------|------|
|                                   | *2016           | 2017 |
|                                   | NIS             | NIS  |
| Current investments               |                 |      |
| Financial assets held for trading | 685             | 494  |
| Bank deposits                     | 546             | 275  |
| Monetary funds and others         | 9               | -    |
|                                   | 1,240           | 769  |

The deposits are repayable until July 2018 and the other investments can be disposed of immediately.

\*Reclassified

**Note 7 - Trade and Other Receivables**

**A. Composition of trade and other receivables**



|  | December 31, |       |
|--|--------------|-------|
|  | 2016         | 2017  |
|  | NIS          | NIS   |
| Trade receivables, net*  |              |       |
| Outstanding debts  | 785          | 765   |
| Credit cards and checks receivable                                       | 450          | 428   |
| Unbilled receivables   | 241          | 235   |
| Current maturities of long-term receivables                              | 505          | 472   |
| Related parties  | 19           | 15    |
| Total trade receivables  | 2,000        | 1,915 |
| Other receivables and current tax assets                                 |              |       |
| Prepaid expenses   | 145          | 66    |
| Other receivables (mainly from real estate sales) and current tax assets | 72           | 204   |
| Total other receivables  | 217          | 270   |
| <b>Long-term trade and other receivables</b>                             |              |       |
| Trade receivables- open debts (1)  | 445          | 387   |
| Long term receivables (from real estate sales)                           | 199          | 106   |
|  | 644          | 493   |
|  | 2,861        | 2,678 |

\*The amount of trade receivables is stated net of the provision for doubtful debts

(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 2017 are 3.4% - 3.5% (in 2016: 3.3% - 3.5%).

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 7 - Trade and Other Receivables (cont'd)**

**B.Excepted payment dates for long-term trade and other receivables:**

|                     | December 31,<br>2017<br>NIS |
|---------------------|-----------------------------|
| 2019                | 345                         |
| 2020                | 142                         |
| 2021 and thereafter | 6                           |
|                     | 493                         |

**C. Change in provision for doubtful debts during the year**

|                          | December<br>31 |       |
|--------------------------|----------------|-------|
|                          | 2016           | 2017  |
|                          | NIS            | NIS   |
| Balance at January 1     | 173            | 111   |
| Impaired loss recognized | 25             | 20    |
| Lost debts               | (87 )          | (39 ) |
| Balance at December 31   | 111            | 92    |

**D Aging of trade receivables**

The aging of trade receivables at the reporting date was as follow:

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|                              | December 31, |            | December 31, |            |
|------------------------------|--------------|------------|--------------|------------|
|                              | 2016         |            | 2017         |            |
|                              | Gross        | Impairment | Gross        | Impairment |
|                              | NIS          | NIS        | NIS          | NIS        |
| Current                      | 2,282        | (8 )       | 2,153        | (6 )       |
| Past due up to one year      | 183          | (46 )      | 165          | (37 )      |
| Past due one to two years    | 50           | (31 )      | 44           | (27 )      |
| Past due more than two years | 41           | (26 )      | 32           | (22 )      |
|                              | 2,556        | (111 )     | 2,394        | (92 )      |

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 8 - Property, Plant and Equipment**

|                                    | Land<br>and<br>buildings<br>NIS | Switching<br>Transmission,<br>power,<br>Cellular,<br>And satellite<br>equipment<br>NIS | Network<br>equipment<br>NIS | Multi-<br>channel<br>equipment<br>and<br>infrastructure<br>NIS | Subscriber<br>equipment<br>NIS | Office<br>equipment,<br>computers<br>and<br>vehicles<br>NIS | Total<br>NIS |
|------------------------------------|---------------------------------|--|-----------------------------|--|--------------------------------|---|--------------|
| <b>Cost</b>                        |                                 |  |                             |  |                                |   |              |
| Balance as at<br>January 1, 2016   | 1,061                           | 5,000  | 5,505                       | 867  | 1,203                          | 941   | 14,577       |
| Additions                          | 27                              | 457  | 247                         | 180  | 265                            | 73  | 1,249        |
| Disposals                          | (37 )                           | -  | (12 )                       | (11 )  | (4 )                           | (11 )   | (75 )        |
| Balance as at December 31,<br>2016 | 1,051                           | 5,457  | 5,740                       | 1,036  | 1,464                          | 1,003   | 15,751       |
| Balance as at<br>January 1, 2017   | 1,051                           | 5,457  | 5,740                       | 1,036  | 1,464                          | 1,003   | 15,751       |
| Additions                          | 34                              | 408  | 228                         | 165  | 278                            | 75  | 1,188        |
| Disposals                          | (81 )                           | -  | -                           | (1 )   | (4 )                           | (2 )  | (88 )        |
| Balance as at December 31,<br>2017 | 1,004                           | 5,865  | 5,968                       | 1,200  | 1,738                          | 1,076   | 16,851       |
| <b>Depreciation and impairment</b> |                                 |  |                             |  |                                |   |              |
| <b>Losses</b>                      |                                 |  |                             |  |                                |   |              |
| Balance as at<br>January 1, 2016   | 350                             | 2,951  | 2,486                       | 143  | 770                            | 664   | 7,364        |
| Depreciation for the year          | 64                              | 521  | 250                         | 236  | 183                            | 83  | 1,337        |
| Disposals                          | (12 )                           | -  | -                           | (10 )  | -                              | -   | (22 )        |
| Balance as at December 31,<br>2016 | 402                             | 3,472  | 2,736                       | 369  | 953                            | 747   | 8,679        |

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|                                 |     |       |       |     |       |     |       |
|---------------------------------|-----|-------|-------|-----|-------|-----|-------|
| Balance as at January 1, 2017   | 402 | 3,472 | 2,736 | 369 | 953   | 747 | 8,679 |
| Depreciation for the year       | 53  | 481   | 204   | 222 | 187   | 85  | 1,232 |
| Balance as at December 31, 2017 | 455 | 3,953 | 2,940 | 591 | 1,140 | 832 | 9,911 |
| <b>Carrying amounts</b>         |     |       |       |     |       |     |       |
| As at January 1, 2016           | 711 | 2,049 | 3,019 | 724 | 433   | 277 | 7,213 |
| As at December 31, 2016         | 649 | 1,985 | 3,004 | 667 | 511   | 256 | 7,072 |
| As at December 31, 2017         | 549 | 1,912 | 3,028 | 609 | 598   | 244 | 6,940 |

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(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 quarter. The residual value is NIS 188 as at December 31, 2017 and NIS 154 as at December 31, 2016.

B. Property, plant and equipment in the Bezeq Group is derecognized at the end of each year upon reaching full depreciation, except for land, buildings, vehicles, copper cables and specific components for Pelephone's UMTS network, which are derecognized upon their sale. In 2017, the Bezeq Group derecognized fully depreciated property at a cost of NIS 496 (in 2016, NIS 894).

C. Bezeq Group companies review the useful life of the property, plant and equipment through their 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.

D. 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.

E. In 2013, Bezeq started to install a fiber optic network that will reach the subscriber's home. In 2017, deployment of fibers reached the state required for operation when a decision is made on the technology to be used, and Bezeq began to amortize the network. Commercial operation of the network is expected in the future.

F. At the reporting date, there are commitments to purchase property, plant and equipment in the amount of NIS 136 (in 2016: NIS 139).

G.

In accordance with the Telecommunications Order (Telecommunications and Broadcasts) (Determination of Essential Service Provided by Bezeq The Israel Telecommunication Corp. Ltd.), 1997, approval from the Prime Minister and Minister of Communications is required to confer rights in some of Bezeq's assets (including switches, cable network, transmission network, and information and databases).

**H.** For information about pledges see Note 22.

**I.** For information about pledges on loans and borrowings, see Note 13.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 9 - Intangible Assets**

|  | Goodwill | Computer<br>software<br>and<br>licenses | Right of<br>use<br>in cellular<br>frequencies | Customer<br>relationships<br>and<br>brand<br>names | Others | Total  |
|--|----------|---|---|--|--------|--------|
|  | NIS      | NIS                                     | NIS   | NIS  | NIS    | NIS    |
| <b>Cost</b>  |          |   |   |  |        |        |
| Balance as at January 1, 2016                          | 3,066    | 1,592                                   | 480   | 7,479  | 269    | 12,886 |
| Acquisitions or additions from independent development | -        | 187                                     | -   | -  | 11     | 198    |
| Disposals  | -        | -                                       | -   | -  | (11 )  | (11 )  |
| Balance as at December 31, 2016                        | 3,066    | 1,779                                   | 480   | 7,479  | 269    | 13,073 |
| Balance as at January 1, 2017                          | 3,066    | 1,779                                   | 480   | 7,479  | 269    | 13,073 |
| Acquisitions or additions from independent development | -        | 227                                     | -   | -  | -      | 227    |
| Disposals  | -        | -                                       | -   | -  | (48 )  | (48 )  |
| Balance as at December 31, 2017                        | 3,066    | 2,006                                   | 480   | 7,479  | 221    | 13,252 |
| <b>Amortization and impairment losses</b>              |          |   |   |  |        |        |
| Balance as at January 1, 2016                          | -        | 1,009                                   | 205   | 4,339  | 215    | 5,768  |
| Amortization for the year                              | -        | 229                                     | 37  | 487  | 24     | 777    |
| Disposals  | -        | -                                       | -   | -  | (6 )   | (6 )   |
| Balance as at December 31, 2016                        | -        | 1,238                                   | 242   | 4,826  | 233    | 6,539  |
| Balance as at January 1, 2017                          | -        | 1,238                                   | 242   | 4,826  | 233    | 6,539  |
| Amortization for the year                              | -        | 218                                     | 29  | 530  | 9      | 786    |



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|                                 |       |       |     |       |       |       |
|---------------------------------|-------|-------|-----|-------|-------|-------|
| Disposals                       | -     | -     | -   | -     | (42 ) | (42 ) |
| Impairment losses               | 129   | -     | -   | -     | -     | 129   |
| Balance as at December 31, 2017 | 129   | 1,456 | 271 | 5,356 | 200   | 7,412 |
| Carrying amounts                |       |       |     |       |       |       |
| As at January 1, 2016           | 3,066 | 583   | 275 | 3,140 | 54    | 7,118 |
| As at December 31, 2016         | 3,066 | 541   | 238 | 2,653 | 36    | 6,534 |
| As at December 31, 2017         | 2,937 | 550   | 209 | 2,123 | 21    | 5,840 |

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Internet Gold – Golden Lines Ltd.

**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:

|  | December 31 |       |
|--|-------------|-------|
|  | 2016        | 2017  |
|  | NIS         | NIS   |
| Domestic fixed-line communications                 | 1,548       | 1,548 |
| Cellular telephone                                 | 1,205       | 1,163 |
| Multi-channel television (DBS)                     | 120         | 33    |
| International communications and internet services | 181         | 181   |
| others   | 12          | 12    |
| Total  | 3,066       | 2,937 |

**Goodwill impairment testing**

For the purpose of impairment testing, goodwill is allocated to the Group's cash generating units ("CGU") which represent the lowest level within the Group 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 carrying amount of the relevant CGU. The annual impairment test date is December 31.

The recoverable amount of each CGU was calculated as its value in use which was based on the Discounted Cash Flow method under the Income Approach.

Domestic fixed-line communications (Bezeq Fixed Line) -

The value in use for Bezeq Group of a domestic fixed line cash-generating unit was calculated using the future discounted cash flow (DCF) method, based on the expected cash flow for the next five years. The expected cash flow is based on results of the domestic fixed-line communications segment in recent years, taking into account the commercial effect of opening up the wholesale internet market and the expected reform in connection with wholesale telephony services. Main assumptions underlying the forecast: An erosion in the number of subscribers, and monthly average revenue per user in the telephony segment, an increase in the number of subscribers and in monthly average revenue per user in the internet services segment, stability in the other services provided by the fixed-line segment, and the development of new revenue channels. 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 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 nominal capital price taken into account was 7.5% (after tax). In addition, a permanent growth rate of 1% was assumed. The valuation was prepared by an external appraiser. Based on this valuation, the Group was not required to record amortization for impairment of a fixed line domestic communications cash-generating unit.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 9 - Intangible Assets (cont'd)**

Cellular telephone (Pelephone) -

The value in use for Bezeq Group of a cellular cash-generating unit was calculated using the future discounted cash flow (DCF) method, based on the expected cash flow for the next five years. The expected cash flow is based on Pelephone's results in recent years, such that future growth and market shares are affected by directions in the cellular market, such as price competition, regulation and the operation scope of the new cellular operators. The revenue forecast is based on assumptions regarding the number of users, average revenue per user, and sales of terminal equipment. The main assumption underlying the forecast is the recovery in Pelephone's business activity in 2019, due to the expected stabilization of the market and the start of competitive balance.

The operating, sales, marketing and investment expenses were adjusted for Pelephone's volume of operations. The nominal capital price taken into account was 10% (after tax). In addition, a permanent nominal growth rate of 2.5% was assumed.

The valuation was prepared by an external appraiser. Based on the above valuation, the carrying amount of the cellular telephone CGU is NIS 137 million higher than its recoverable amount of NIS 5,561 million. Consequently, an impairment loss of NIS 42 million attributable to shareholders was recognized. Due to the impairment of the CGU, the recoverable amount is the same as the carrying amount. The impairment loss was attributed in full to goodwill and was included under other income and expenses in the statement of income.

The circumstances that led to the recognition of an impairment loss are the lower revenues resulted from a lower ARPU forecast as a result of the price competition in the cellular market. The forecast also assumes a lower decrease

in the expenses of the cellular telephone CGU, as a result of efficiency measures taken by management, however, it does not fully compensate for the expected decrease in the CGU's revenues.

Multi-channel television (DBS) -

The value in use for Bezeq Group of a multichannel television cash-generating unit was calculated using the discounted cash flow (DCF) method, based on cash flow forecasts from the operation for the next five years. The cash flow forecast is based on assessments regarding the development of the multi-channel television market in general and the operations of DBS in this market in particular. The valuation includes assumptions regarding the intensity of competition in the market, price levels and the regulatory environment. A key assumption of the forecast is that in the medium term, the intensity of competition in the market will decrease in a manner that will affect the churn rate of subscribers and price levels. The operating, sales, marketing and investment expenses were adjusted to the volume of DBS' operations. The nominal capital price used was 8.5% (after tax). In addition, a permanent growth rate of 1% was assumed.

The valuation was prepared by an external appraiser. Based on the above valuation, the carrying amount of the multi-channel television sector is NIS 87 million higher than the recoverable amount of NIS 1,346 million. Consequently, an impairment loss of NIS 87 million was recognized. Due to the impairment of the cash-generating unit, the recoverable amount is the same as the carrying amount. The impairment loss was attributed in full to goodwill and was included under other income and expenses in the statement of income.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 9 - Intangible Assets (cont'd)**

The events and circumstances that led to recognition of the impairment loss are the expectation that DBS's revenues will continue to decline significantly in the short term, despite the positive contribution of the Sting TV service and due to the loss of satellite subscribers and the decrease in ARPU. The forecast assumes a decrease in the expenses of DBS, as a result of efficiency measures in most of its activities, however, this is not expected to fully compensate for the expected decrease in revenue. These, combined with relatively high capital investment throughout the forecast period, generated negative cash flows in the short term and improved DBS's cash production capacity in the mid-term as the intensity of competition in the market decreases.

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 ("ARPU"). The main assumption underlying the forecast is a decrease in ARPU 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 a decrease in retail users which will partially be offset by an increase in wholesale users. In addition, revenues of the International communications business are also expected to decrease as a result of increased use of cellular phones and other communication solutions.

In addition, the revenue forecast is based on assumptions of an increase in wholesale revenues along with an increase in revenues from value added services.

The operating, sales, marketing and investment expenses were adjusted for the volume of operations of Bezeq International. The price of nominal capital used is 10% (after tax). In addition, it was assumed that the permanent growth will be 2%. 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 CGU.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 10 -Deferred Expenses and Non-Current Investments**

|   | December<br>31 |      |
|---|----------------|------|
|   | 2016           | 2017 |
|   | NIS            | NIS  |
| Deferred expenses (A)                                       | 337            | 314  |
| Customer acquisition asset, net                             | -              | 115  |
| Deposit used as collateral against hedging transactions (B) | 58             | 67   |
| Bank deposit for loans to Company employees (C)             | 47             | 51   |
| Investments in equity-accounted investees                   | 18             | 11   |
| Other investments   | 5              | -    |
|   | 465            | 558  |

Transactions for acquiring an indefeasible right of use (IRU) of seabed cable capacities are accounted for as service A.transactions. Under the contract, Bezeq International has the right of use for capacities until 2022 with an option for an extension until 2027. The amount of the prepaid expense is amortized on a straight line until 2027.

B. A deposit used as collateral for hedging transactions is payable in two increments in December 2019 and December 2020.

C. A bank deposit for loans to the Bezeq Group employees without a repayment date.

**Note 11 -Broadcast Rights, Net of Rights Exercised**



December  
31  
2016 2017  
NIS NIS

|                       |       |       |
|-----------------------|-------|-------|
| Cost                  | 800   | 797   |
| Less rights exercised | (368) | (343) |
| Total                 | 432   | 454   |

As at December 31, 2017, DBS has agreements for the acquisition of broadcast rights. In 2017, acquisition of these broadcast rights amounted to NIS 248.

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Internet Gold – Golden Lines Ltd.

**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

|  | Principal<br>location<br>of the<br>company's<br><b>activity</b> | Ownership<br><b>interest</b> |   |
|--|---|------------------------------|---|
| B Communications Ltd.  | Israel  | 64.78                        | % |
| Subsidiaries of B Communications Ltd.                                      |   |                              |   |
| B Communications (SP1) Ltd. and B Communications (SP2) Ltd. <sup>(1)</sup> | Israel  | 100                          | % |
| Bezeq - The Israel Telecommunication Corp. Limited                         | Israel  | 26.34                        | % |
| Subsidiaries of Bezeq - The Israel Telecommunication Corp. Limited.        |   |                              |   |
| 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 Corporation Ltd.**

Bezeq is controlled by SP2 which holds 25.82% of Bezeq's outstanding shares. An additional 0.52% of Bezeq outstanding shares are held by B Communications directly. 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. DBS Satellite Services (1998) Ltd.**

DBS Satellite Services (1998) Ltd. ("DBS") is a wholly-owned subsidiary of Bezeq. DBS provides multi-channel television services.

**f. 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.

**g. Walla! Communications Ltd.**

Walla! is wholly owned by Bezeq. Walla! provides internet, management and media services for a range of populations.

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Internet Gold – Golden Lines Ltd.

**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)**

3. Dividend paid by Bezeq to non-controlling interests during 2017 was in the amount of NIS 948 (in 2016: NIS 1,062).

4. Bezeq's Dividend Distribution Policy

On August 4, 2009, the Board of Directors of Bezeq approved a dividend distribution policy in which Bezeq will distribute a dividend to its shareholders amounting to 100% of the semi-annual profit (after tax) (profit for the period attributable to the shareholders of Bezeq), in accordance with the consolidated financial statements of Bezeq.

On March 6, 2018, the Board of Directors of Bezeq resolved to revise the dividend distribution policy, such that Bezeq will distribute a dividend to its shareholders, on a semi-annual basis, of 70% of the semi-annual net profit in accordance with the consolidated financial statements of Bezeq, as from the next distribution scheduled for May 2018. 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 Bezeq's ability to meet its existing and anticipated liabilities, taking into consideration the projected cash flow, Bezeq's requirements and liabilities, the cash balance, its plans and position and subject to the approval of the general meeting of Bezeq's shareholders regarding any specific distribution, as set out in the articles of association of Bezeq.

In accordance with the March 6, 2018 decision of Bezeq's Board of Directors, capital gains from the sale of the Sakia property ("the Profits of Sakia") (See Note 21G), to the extent that they are recognized in 2018, will not be distributed in 2018, unless the entire consideration for the transaction is received in cash during 2018. Bezeq's Board of Directors

may decide to distribute a dividend for the Profits of Sakia at a later date in accordance with the circumstances and subject to the Law.

In accordance with Bezeq's revised policy for distribution of a dividend, on March 28, 2018, the Board of Directors of Bezeq resolved to recommend to the general meeting of Bezeq's shareholders the distribution of a cash dividend to its shareholders in the amount of NIS 368. The dividend was approved by Bezeq's shareholders on April 26, 2018 and was paid on May 10, 2018.

In 2016 and 2017, Bezeq declared and paid the following dividends in cash:

|   | 2016  | 2017  |
|---|-------|-------|
|   | NIS   | NIS   |
| Distribution of a regular dividend (see section B4 above) |       |       |
| 2017 (NIS 0.47 per share)                                 | -     | 1,286 |
| 2016 (NIS 0.52 per share)                                 | 1,441 | -     |

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Internet Gold – Golden Lines Ltd.

**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.**

As at March 25, 2015, Bezeq held 49.78% of the share capital of DBS and it held options to acquire 8.6% of DBS's shares, which Bezeq was unable to exercise until that date. Eurocom DBS Ltd. held the balance of DBS shares. On March 25, 2015, Bezeq exercised the options for no consideration and on June 24, 2016, Bezeq completed a<sup>1</sup> transaction ("the Acquisition Transaction") for the acquisition of the entire holdings of Eurocom DBS in DBS, which at that date represented 50.22% of the issued share capital of DBS (41.62% fully diluted) and all the shareholder loans provided by Eurocom to DBS.

On completion of the Acquisition Transaction, DBS became a wholly owned subsidiary (100%) of Bezeq.

Bezeq consolidates the financial statements of DBS as from March 25, 2015. The statements of income for the first quarter of 2015 include the operating results of DBS based on the equity method.

Under the terms of the Acquisition Transaction, Bezeq paid cash consideration of NIS 680, and agreed to pay two additional contingent payments, as follows: one additional payment of up to NIS 200, which was to be paid in accordance with the amount of the carry-forward losses of DBS used for tax purposes ("the First Contingent Consideration"); and another additional payment of up to NIS 170, which was to be paid in accordance with the business results of DBS in the 2015-2017 period ("the Second Contingent Consideration").

In September 2016, Bezeq paid Eurocom DBS NIS 188 (plus interest differences of NIS 10) for the First Contingent Consideration, under the Assessment Agreement and taxation decision of the Tax Authority as set out in Note 19. The

consideration paid was for the losses of DBS as at December 31, 2013. Following the decision regarding the additional and final losses as at December 31, 2014, the additional amount due to Eurocom DBS was calculated and paid out, and the unpaid amount will continue to bear interest in accordance with the acquisition agreement up to the payment date. As at December 31, 2017, the balance of the amount owed to Eurocom for the First Contingent Consideration was NIS 6.

The liability for the Second Contingent Consideration was adjusted as at December 31, 2016, and amounted to NIS 84. Bezeq updated the estimated Second Contingent Consideration in 2017 and as at December 31, 2017, the liability amounts to NIS 14.

On account of the Second Conditional Consideration, two payments of NIS 57 were paid in nominal terms, one in 2016 and the second in 2017.

As a result of the aforesaid, the advance payments received by Eurocom DBS from Bezeq as at December 31, 2017 amounted to NIS 94 (after offsetting a liability of NIS 6 for the first contingent consideration). In accordance with the agreement between the parties, if the final amount is less than the amount of advance payments, Eurocom DBS will return the difference to Bezeq immediately after the final settlement, which is expected to be shortly after the signing of Bezeq's financial statements for 2017 (or on the merger date as described in section B.2 below, whichever is earlier). The repayment bears annual interest at a rate of 4%. As at December 31, 2017, interest of NIS 10 was accrued for the excess of the advance payments.

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Internet Gold – Golden Lines Ltd.

**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”)**

Bezeq estimated the fair value of the amount expected to be recovered from the excess of the advance payments, and taking into consideration the solvency of Eurocom DBS, the value of the debt was estimated at NIS 43 as at December 31, 2017.

The revised fair value of the excess of the advance payments and the second contingent liability in the amount of NIS 14 in 2017 was recognized as a decrease in financing expenses in the statement of income.

Following the announcement of the Director of the Ministry of Communications on December 21, 2016, regarding “Cancellation of the structural separation obligation in Bezeq Group”, on December 25, 2016, Bezeq and DBS signed a merger agreement (“the Merger Agreement”), which, subject to the preconditions set out in the agreement, at the completion date of the merger, and effective retroactively from the effective date for the merger (December 31, 2016), all activities of DBS will be merged with and into Bezeq, for no consideration, in accordance with the provisions of section 323 of the Companies Law and the provisions of section 103B and section 103C of the Income Tax Ordinance (as described in Note 19), DBS will cease to exist as a separate legal entity, will be wound up without liquidation and the Registrar of Companies will delete it from the Register. Completion of the merger is subject to the fulfilment of the preconditions in the merger agreement. As of the approval date of the financial statements, the preconditions had not been fulfilled. Bezeq continues to advance the merger with DBS.

3. Following the conversion of the shareholders loans and capital investment in 2016, the equity of DBS as at December 31, 2017 and December 31, 2016 amounted to NIS 348 and NIS 592, respectively. As at December 31, 2017, its working capital deficit amounted to NIS 535. The management of DBS believes that the financial resources at its disposal, which include the deficit in working capital, repayment of loans from Bezeq, and the



conversion of DBS debentures to capital by Bezeq (as set out in Note 13) will be sufficient for the operations of DBS for the coming year.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)****C. 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,  |                 |               |                                      |
|---------------|--|-----------------------------------|------------------------------------|--------------------------------|---|---------------------------------|--|-----------------|---------------|--------------------------------------|
|               | <b>Rate of<br/>direct<br/>ownership<br/>interests<br/>held by<br/>non-<br/>controlling<br/>interests<br/>%</b> | <b>Current<br/>assets<br/>NIS</b> | <b>Non-<br/>current<br/>assets</b> | <b>Current<br/>liabilities</b> | <b>Non-<br/>current<br/>liabilities</b> | <b>Total<br/>net<br/>assets</b> | <b>Carrying<br/>amount of<br/>non-<br/>controlling<br/>interests</b> | <b>Revenues</b> | <b>Profit</b> | <b>Other<br/>comprehe<br/>income</b> |
| <u>2017</u>   |  |                                   |                                    |                                |   |                                 |  |                 |               |                                      |
| Bcom<br>Group | 35.22  | 5,334                             | 15,305                             | 4,111                          | 13,442                                  | 3,086                           | 2,279  | 9,789           | 741           | (8)                                  |
| <u>2016</u>   |  |                                   |                                    |                                |   |                                 |  |                 |               |                                      |
| Bcom<br>Group | 35.22  | 3,991                             | 16,154                             | 4,256                          | 12,588                                  | 3,301                           | 2,543  | 10,084          | 439           | (15)                                 |

2015

|               |       |       |        |       |        |       |       |       |       |   |
|---------------|-------|-------|--------|-------|--------|-------|-------|-------|-------|---|
| Bcom<br>Group | 33.29 | 4,730 | 17,392 | 5,199 | 13,532 | 3,391 | 2,694 | 9,985 | 1,136 | 7 |
|---------------|-------|-------|--------|-------|--------|-------|-------|-------|-------|---|

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)**

**D. 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.

The Company is 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 under the Concentration Law. Accordingly, if either the Company or B Communications 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, 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.

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 to 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 voting position in Bezeq.

The Company is currently examining several alternatives for the implementation of the Concentration Law, including, but not limited to, the possibility of raising private debt that will substitute for the debentures issued to the public, while delisting the Company's shares from the TASE; merger between B Communications and the Company, etc. There is no certainty that any of the alternatives will be implemented.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)**

**E.B Communications' control over Bezeq**

B Communications has 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 above 5% without regulatory approval, 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 nominate the majority of the board of directors of Bezeq.

**F. Transactions with non-controlling interests**

(1) 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.

**Note 13 - Debentures, Bank Loans and Credit**

**A. Composition**

| December 31 |      |
|-------------|------|
| 2016        | 2017 |
| NIS         | NIS  |

|                                  |        |        |
|----------------------------------|--------|--------|
| Current liabilities              |        |        |
| Current maturities of debentures | 1,342  | 1,263  |
| Current maturities of bank loans | 839    | 692    |
|                                  | 2,181  | 1,955  |
| Non-current liabilities          |        |        |
| Debentures                       | 9,157  | 8,748  |
| Bank loans                       | 3,084  | 4,401  |
|                                  | 12,241 | 13,149 |
|                                  | 14,422 | 15,104 |

**B. Debt terms and repayment schedule**

|  | December 31,<br>2016 |                           | December 31,<br>2017 |                           |               | Nominal<br>interest |
|--|----------------------|---------------------------|----------------------|---------------------------|---------------|---------------------|
|  | Par<br>value<br>NIS  | Carrying<br>amount<br>NIS | Par<br>value<br>NIS  | Carrying<br>amount<br>NIS | Currency rate |                     |
| Loans from banks and others:               |                      |                           |                      |                           |               |                     |
| Unlinked - Variable interest               | 978                  | 978                       | 675                  | 675                       | NIS           | P-0.33 to P+0.2     |
| Unlinked - Fixed interest                  | 2,931                | 2,945                     | 4,398                | 4,418                     | NIS           | 2.40 to 6.85        |
|  | 3,909                | 3,923                     | 5,073                | 5,093                     |               |                     |
| Debentures:                                |                      |                           |                      |                           |               |                     |
| Linked to the Israeli CPI - fixed interest | 4,925                | 5,234                     | 4,695                | <b>4,900</b>              | NIS           | 2.20 to 8.40        |
| Unlinked - variable interest               | 734                  | 734                       | 734                  | 732                       | NIS           | Makam + 1.4         |
| Unlinked - fixed interest                  | 4,505                | 4,531                     | 4,347                | 4,379                     | NIS           | 3.60 to 6.65        |
|  | 10,164               | 10,499                    | 9,776                | 10,011                    |               |                     |
| Total interest-bearing liabilities         | 14,073               | 14,422                    | 14,849               | 15,104                    |               |                     |

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Bank Loans and Credit (cont'd)**

**B. Debt terms and repayment schedule (cont'd)**

(1) Issuance of Series C Debentures

On September 28, 2010, the Company issued Series C Debentures at a par value. The Series C Debentures were listed on the TASE.

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.

As of December 31, 2017, the par value of the outstanding Series C Debentures was NIS 41.

As at December 31, 2017, and the approval date of the financial statements, the Company was in compliance with the financial covenants of the debentures.



(2) Issuance of Series D Debentures and replacement of debentures

On March 3, 2014 the Company issued Series D Debentures at a par value. The Series D Debentures were listed on the TASE.

The 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 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.

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. The Series D Debentures contain certain limitation on distribution of dividends by the Company.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Bank Loans and Credit (cont'd)**

**B. Debt terms and repayment schedule (cont'd)**

In October 2017 the Company completed two private placements of NIS 227 par value of Series D Debentures to certain institutional investors in Israel in exchange for NIS 205 par value of the Company's outstanding Series C Debentures, reflecting an exchange ratio of 1:1.11 (NIS 1.11 principal amount of Series D Debentures for NIS 1 principal amount of Series C Debentures).

As of December 31, 2017, the par value of the outstanding Series D Debentures was NIS 757.

As at December 31, 2017, and the approval date of the financial statements, the Company was in compliance with the financial covenants of the debentures.

The Company and its Israeli legal advisors' belief that the publication of the Company's annual financial statements with the accompanying Auditors' Report with a "qualified opinion" does not constitute an event of default under the Company's outstanding debentures. Nevertheless, it is not possible to predict with certainty that a debenture holder may claim otherwise. The Company believes that it has qualitative legal and economic arguments against a claim of breach by any holder of debentures. There is also a possibility of changing the nature and location of the listing of the Company's securities from the United States to elsewhere in a manner that may resolve such possible claim, if raised. A default under the Debentures could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

B Communications debentures

On September 21, 2010, B Communications issued, NIS 400 of Series B Debentures, at par value, to the public in (3) 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 April 1, 2016, B Communications completed a 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, 2017 par value of the outstanding Series B Debentures was NIS 452.

The Series B Debentures are denominated in NIS, 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). The Series B Debentures principal is payable in four equal installments on March 31 of each year starting from 2016. The 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 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 holds the controlling interest in B Communications.

As at December 31, 2017, and the approval date of the financial statements, B Communications was in compliance with the financial covenants of the Series B debentures.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Bank Loans and Credit (cont'd)**

**B. Debt terms and repayment schedule (cont'd)**

On February 19, 2014, B Communications issued \$800 of 7 Senior Secured Notes (“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 were senior obligations of B (4) Communications and were guaranteed by its two wholly-owned subsidiaries, SP1 and SP2, on a senior secured basis (“the Guarantees”). The Notes and the Guarantees were 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 were admitted for trading on the institutional trading system of the Tel Aviv Stock Exchange for by 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 funds maintained by SP2 had to 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.

On August 10, 2014 B Communications’ Board of Directors approved the buyback of up to \$50 of the Notes. On January 20, 2016, B Communications completed its \$50 repurchase program and its Board of Directors approved the extension and increase of the program by an additional \$50. During 2015 and 2016, B Communications purchased \$65 par value of the Notes.

On May 26, 2016 B Communications announced that its wholly-owned subsidiary, B Communications (SP4) LP, had invited holders of the Notes to submit tenders to purchase their Notes for cash within a purchase price range of \$1.00 to \$1.07 per \$1.00 nominal amount of the Notes. The aggregate par value of the Notes tendered and purchased was approximately \$18.6.

The total loss incurred from the repurchase of the Notes during 2015 and 2016 amounted to NIS 33.

In September 2016, the Notes were fully repaid following the issuance of Series C Debentures, as detailed below in Note 13B(6).

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Bank Loans and Credit (cont'd)**

**B. Debt terms and repayment schedule (cont'd)**

On September 18, 2016, B Communications issued, at par value, NIS 1.9 billion of Series C Debentures to the public in Israel. The principal of the Series C Debentures will be payable in four equal instalments payable on November 30 of each of the years 2020 through 2023 and one instalment payable on November 30, 2024. Each of (5) the first four instalments will be equal to 7.5% of the principal amount of the aggregate amount of the Series C Debentures issued and the last instalment will equal to 70% of such principal amount. The annual coupon of the Series C Debentures is 3.6% and will be denominated in NIS. The interest on the outstanding principal of the Series C Debentures is payable in semi-annual payments on May 31 and November 30 of each year.

The net proceeds from the offering together with cash and cash equivalents of B Communications were used to fully redeem the outstanding Notes and to deposit the upcoming interest payment due in May 2017 into a trustee account solely for the benefit of the holders of the Series C Debentures.

On January 16, 2017, B Communications completed a private placement of NIS 118 par value of its Series C Debentures to Israeli institutional investors for consideration of NIS 118.

As at December 31, 2017, the par value of the outstanding Series C Debentures was NIS 2.0 billion.

On January 23, 2018, the Company completed a private placement of NIS 240 par value of its Series C Debentures to Israeli institutional investors for an aggregate consideration of NIS 249.

Below are the main undertakings and covenants with respect to the Series C Debentures:

B Communications undertook to refrain from creating in favor of any third party a lien of any ranking whatsoever over its direct and/or indirect holdings of 691,361,036 shares of Bezeq, including any of the rights accompanying such shares (hereinafter, the “Undertaken Shares”) without the prior consent of the holders of the Series C Debentures by a special resolution (hereinafter, “Negative Lien Undertaking”).

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Bank Loans and Credit (cont'd)**

**B. Debt terms and repayment schedule (cont'd)**

B Communications further undertook to refrain from making any disposition of the Undertaken Shares without the prior consent of the holders of the Series C Debentures by a special resolution. Notwithstanding the foregoing, and subject to the provisions of applicable law and/or permit, B Communications may sell all or a portion of the Undertaken Shares to any third party, provided that in such instance, B Communications uses the net proceeds it receives from such sale, less the taxes, expenses and deductions entailed in the sale of such shares, to make full or partial early redemption, of the Series C Debentures (exclusively) in accordance with the provisions the indenture for the Series C Debentures .

B Communications undertook to refrain from assuming additional debt, with the exception of:

a. Financial debt in an amount (principal) which does not exceed NIS 400;

b. The financial debt is not secured by any collateral and does not have priority over Series C Debentures in creditor ranking upon insolvency.

c. The total par value of the Series C Debentures together with the total principal amount of the additional debt together with the (principal) amount of the new debt which B Communications intends to assume does not exceed an aggregate of NIS 2.3 billion.



As at December 31, 2017, and the approval date of the financial statements, B Communications was in compliance with the financial covenants of the Series C Debentures.

### **Control of Bezeq**

B Communications undertook to hold (directly and/or indirectly) at least 25% of Bezeq's issued and paid-up capital, unless a regulatory permit/approval is received to reduce such shareholding percentage.

### **Control in the Company**

Eurocom Communications, undertook to refrain from transferring control of B communications (directly or indirectly) to a party which has not been authorized in advance by the necessary regulatory entities, to the extent such approvals are required, at the relevant time.

### **Minimum equity**

B Communications undertook that its equity (capital attributed to B Communications' shareholders, without non-controlling interests) (hereinafter, the "Equity") according to its last consolidated financial statements published, shall not be less than NIS 650 for the duration of two or more consecutive calendar quarters. The indenture for the Series C Debentures includes a mechanism of adjustment of interest rate in the event of a drop below the Minimum Equity or in the event of a downgrade in the rating of the Series C Debentures.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Bank Loans and Credit (cont'd)**

**B. Debt terms and repayment schedule (cont'd)**

**Restriction on distribution**

B Communications undertook not to distribute a dividend to its shareholders and/or perform a buyback of its shares and/or any other distribution as defined in the Companies Law unless all the conditions provided in subsections (a) through (f) below are satisfied:

a. The distribution will not cause a downgrade in the rating of the Series C Debentures.

b. B Communications is not in violation of any of the covenants.

c. No grounds for immediate repayment exist at the time a resolution to make a distribution is adopted, and no such grounds exist as a result of such distribution.

d. B Communications' Equity post-distribution is not less than NIS 800.

e. Until full repayment of the principal of the Series C Debentures, B Communications shall not distribute a dividend exceeding 75% of the balance of B Communications' distributable surpluses (the surplus balance or surpluses accrued in the last two years, in accordance with the definitions provided in the Companies Law) in accordance with its consolidated financial statements. In addition, B Communications shall not make a distribution if it recorded an

aggregate net loss in the last four quarters preceding the distribution date, on the basis of its last financial statements and/or the quarterly financial report published prior to the distribution date.

Notwithstanding the foregoing, the restrictions set forth in this subsection shall not apply with respect to the balance of B Communications' profits/surpluses which are distributable in accordance with the provisions of the Companies f. Law, B Communications' financial statements as of June 30, 2016 (i.e. a total of NIS 416 which shall be excluded from the distribution restrictions under this subsection (f); for the avoidance of doubt, the restrictions provided in subsections (a) through (e) shall apply with respect to such distribution).

#### **Ratio of unconsolidated equity to total unconsolidated balance sheet**

Ratio of unconsolidated equity to total unconsolidated balance sheet: B Communications' equity shall not be less than 15% of the total balance sheet in accordance with B Communications' audited or reviewed (unconsolidated) financial statements (or, alternatively, the quarterly financial report figures, as elected by B Communications), as the case may be, for two or more consecutive calendar quarters.

B Communications and its Israeli legal advisors' belief that the publication of its annual financial statements with the accompanying Auditors' Report with a "qualified opinion" does not constitute an event of default under its outstanding debentures. Nevertheless, it is not possible to predict with certainty that a debenture holder may claim otherwise. B Communications believes that it has qualitative legal and economic arguments against a claim of breach by any holder of debentures. There is also a possibility of changing the nature and location of the listing of the its securities from the United States to elsewhere in a manner that may resolve such possible claim, if raised. A default under its Debentures could have a material adverse effect on its business, financial condition, results of operations and cash flows.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Bank Loans and Credit (cont'd)**

**B. Debt terms and repayment schedule (cont'd)**

(6) Below are details of the terms that Bezeq undertook for the loans that were received and the debentures that were issued:

For Bezeq's overall debt, 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.

In addition, 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 regarding 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 Bezeq's public debentures and bank loans in the amount of NIS 3.3 billion as at December 31, 2017, and for loans from financial institutions in the amount of NIS 2 billion as at December 31, 2017, 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 these lenders (subject to certain exceptions).

For Bezeq's public debentures and for loans from financial institutions amounting to NIS 1.7 billion, grounds were included for immediate repayment, if telecommunication ceases to be the Group's core activity.

d.

For Debentures (Series 9-10) and for loans from financial institutions in the amount of NIS 1 billion, grounds were included for the immediate repayment of the loans in the event of a change in control, following which the current controlling shareholders in Bezeq will cease to be controlling shareholders, with the exception of: (1) transfer of control to a transferee that received approval for control in Bezeq in accordance with the provisions of the Telecommunications Law and/or the Telecommunications Order; or (2) transfer of control in which the transferee holds control together with the current controlling shareholders in Bezeq, provided that the holding rate of the current controlling shareholders in Bezeq in the shares of Bezeq does not fall below 50.01% of the total shares of Bezeq held by the controlling shareholders together; or (3) a change in control to be approved by a meeting of the debenture holders/lenders.

e. For Bezeq's public debentures and for loans from financial institutions amounting to NIS 1.7 billion, Bezeq has undertaken to the lenders to take steps so that, to the extent under its control, the debentures will be rated by at least one rating agency, so as long as there are debentures of the relevant series in circulation or a balance in loans, as the case may be.

f. In addition, for Debentures (Series 9 and 10) and for loans from financial institutions in the amount of NIS 1 billion, grounds were included for immediate repayment of the debentures in the event of the recording of a going concern qualification 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/loans on time (as set out in section 35(I)1a1 of the Israel Securities Law).

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Bank Loans and Credit (cont'd)**

**B. Debt terms and repayment schedule (cont'd)**

As at December 31, 2017 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**

In May 2017, Bezeq issued Debentures (Series 6 and 10), to the holders of Debentures (Series B) of DBS, which are listed on the TACT-Institutional system of the TASE in return for the DBS debentures that they hold.

The offering was carried out in accordance with the Shelf Prospectus and the Shelf Offering Memorandum as follows: NIS 125 par value DBS Debentures were exchanged for NIS 125.75 par value Debentures (Series 6), of Bezeq and NIS 436.31 par value DBS Debentures were exchanged for NIS 481.68 par value Debentures (Series 10) of Bezeq.

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

In addition, in June 2017, Bezeq acquired NIS 17.40 par value DBS Debentures for NIS 20.

Accordingly, DBS has Debentures (Series B), with a balance of NIS 435 as at December 31, 2017 (of which Bezeq held NIS 419). Subsequent to the reporting date, Bezeq converted the balance of the DBS debentures it holds into capital and the balance of the debentures amounted to an immaterial amount of NIS 15 held by the public.

#### D. Movement in liabilities arising from financing activities

|   | Debentures<br>(including<br>accrued<br>interest)<br>NIS | Loans<br>(including<br>accrued<br>interest)<br>NIS | Total<br>NIS |
|---|---|--|--------------|
| <b>Balance as at January 1, 2017</b>  | 10,577  | 3,944  | 14,521       |
| <b>Changes due to cash flows from financing activities</b>                              |   |  |              |
| Consideration from the issue of debentures and receipt of loans, less transaction costs | 635   | 2,000  | 2,635        |
| Repayment of debentures and loans   | (1,107 )  | (835 )   | (1,942 )     |
| Interest paid   | (425 )  | (158 )   | (583 )       |
| <b>Net cash generated from (used in) finance activities</b>                             | (897 )  | 1,007  | 110          |
| Financing expenses recognized in the statement of income                                | 378   | 163  | 541          |
| <b>Balance as at December 31, 2017</b>  | 10,058  | 5,114  | 15,172       |

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(All amounts are in millions except where otherwise stated)

**Note 14 - Trade and Other Payables**

|   | December 31 |       |
|---|-------------|-------|
|   | *           | 2017  |
|   | 2016        | 2017  |
|   | NIS         | NIS   |
| Open accounts**   | 808         | 1,041 |
| Checks payable  | 92          | 21    |
| Trade payables  | 900         | 1,062 |
| Other payables  |             |       |
| Liabilities to employees and other liabilities for salaries | 353         | 355   |
| Institutions  | 98          | 89    |
| Accrued expenses  | 102         | -     |
| Accrued interest  | 99          | 66    |
| Deferred income   | 82          | 90    |
| Options and derivatives                                     | 10          | 54    |
| Other payables  | 17          | 19    |
| Total other payables  | 761         | 673   |
| Total Trade and Other Payables                              | 1,661       | 1,735 |

\*Reclassified

\*\* Of which, the carrying amount of trade payables that are related parties and interested parties as at December 31, 2017 amounts to NIS 31 (as at December 31, 2016 – NIS 21).



**Note 15 - Provisions**

|                                    | Customer<br>claims<br>NIS | Additional<br>legal<br>claims<br>NIS | Dismantling<br>and clearing<br>of cellular<br>and other<br>sites<br>NIS | Total<br>NIS |
|------------------------------------|---------------------------|--------------------------------------|---|--------------|
| Balance as at January 1, 2017      | 44                        | 30                                   | 53  | 127          |
| Provisions created in the period   | 20                        | 15                                   | 4   | 39           |
| Provisions used in the period      | (4 )                      | (7 )                                 | (1 )  | (12 )        |
| Provisions cancelled in the period | (1 )                      | (10 )                                | (9 )  | (20 )        |
| Balance as at December 31, 2017    | 59                        | 28                                   | 47  | 134          |
| Current                            | 59                        | 28                                   | 7   | 94           |
| Non-current                        | -                         | -                                    | 40  | 40           |

**Claims**

For details of legal claims, see Note 20.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(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 and B Communications' 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 in 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 to fluctuations in foreign currencies and the Israeli CPI.

### **C. Credit risk**

The Company's management monitors the Company's exposure to credit risks on a regular basis. B Communications' management monitors its exposure to credit risks on a regular basis. Bezeq's management monitors the Bezeq 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.

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**Notes to the Consolidated Financial Statements**

(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 Group 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

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\$.

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**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, 2017    |               | 2017         | 2018         | 2019-2021    | 2022<br>and<br>later |
|---|----------------------|---------------|--------------|--------------|--------------|----------------------|
|   | Carrying Contractual |               |              |              |              |                      |
|   | amount               | cash flow     |              |              |              |                      |
| NIS   | NIS                  | NIS           | NIS          | NIS          | NIS          |                      |
| <b>Non-derivative financial liabilities</b>             |                      |               |              |              |              |                      |
| Trade and other payables                                | 1,612                | 1,612         | 1,612        | -            | -            | -                    |
| Bank loans  | 5,093                | 5,813         | 855          | 776          | 2,388        | 1,794                |
| Debentures  | 10,011               | 11,390        | 1,511        | 1,505        | 4,349        | 4,025                |
| <b>Total</b>  | <b>16,716</b>        | <b>18,815</b> | <b>3,978</b> | <b>2,281</b> | <b>6,737</b> | <b>5,819</b>         |
| <b>Financial liabilities for derivative instruments</b> |                      |               |              |              |              |                      |
| Forward contracts on the CPI                            | 200                  | 200           | 41           | 47           | 112          | -                    |

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**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's exposure to linkage and foreign currency risk was as follows based on notional amounts:

|                                   | December 31, 2016 |                   |   |
|-----------------------------------|-------------------|-------------------|---|
|                                   | Israeli           |                   | Foreign<br>currency<br>linked<br>(mainly<br>U.S.<br>dollars)<br>NIS |
|                                   | Unlinked<br>NIS   | CPI-linked<br>NIS |   |
| Current assets                    |                   |                   |   |
| Cash and cash equivalents         | 778               | -                 | 32  |
| Trade receivables                 | 1,954             | 18                | 28  |
| Other receivables                 | 20                | 48                | -   |
| Investments including derivatives | 896               | 76                | 269   |
| Total current assets              | 3,648             | 142               | 329   |
| Non-current assets                |                   |                   |   |
| Trade and other receivables       | 429               | 215               | -   |
| Total non-current assets          | 429               | 215               | -   |
| Total assets                      | 4,077             | 357               | 329   |
| Current liabilities               |                   |                   |   |

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|   |          |          |     |
|---|----------|----------|-----|
| Debentures, loans and borrowings                      | 1,668    | 513      | -   |
| Trade and other payables                              | 1,340    | 77       | 203 |
| Total current liabilities                             | 3,008    | 590      | 203 |
| Non-current liabilities                               |          |          |     |
| Debentures and bank loans                             | 7,667    | 4,574    | -   |
| Other liabilities including derivatives               | -        | 176      | 9   |
| Total non-current liabilities                         | 7,667    | 4,750    | 9   |
| Total liabilities                                     | 10,675   | 5,340    | 212 |
| Total exposure in the statement of financial position | (6,598 ) | (4,983 ) | 117 |
| Forward transactions                                  | (2,456 ) | 2,184    | 272 |

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Internet Gold – Golden Lines Ltd.

**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**

|                                   | December 31, 2017 |                              |   |
|-----------------------------------|-------------------|------------------------------|---|
|                                   | Unlinked<br>NIS   | Israeli<br>CPI-linked<br>NIS | Foreign<br>currency<br>linked<br>(mainly<br>U.S. dollars) |
|                                   |                   |                              | NIS   |
| Current assets                    |                   |                              |   |
| Cash and cash equivalents         | 2,334             | -                            | 74  |
| Trade receivables                 | 1,862             | 36                           | 17  |
| Other receivables                 | <b>44</b>         | 154                          | -   |
| Related party                     | <b>43</b>         | -                            | -   |
| Investments including derivatives | 507               | 57                           | 205   |
| Total current assets              | 4,790             | 247                          | 296   |
| Non-current assets                |                   |                              |   |
| Trade and other receivables       | 423               | 121                          | 67  |
| Total non-current assets          | 423               | 121                          | 67  |
| Total assets                      | 5,213             | 368                          | 363   |
| Current liabilities               |                   |                              |   |
| Debentures, loans and borrowings  | 1,213             | 742                          | -   |
| Trade and other payables          | 1,346             | 70                           | 237   |
| Total current liabilities         | 2,559             | 812                          | 237   |
| Non-current liabilities           |                   |                              |   |

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|   |          |          |     |
|---|----------|----------|-----|
| Debentures and bank loans                             | 9,104    | 4,045    | -   |
| Other liabilities including derivatives               | -        | 159      | 10  |
| Total non-current liabilities                         | 9,104    | 4,204    | 10  |
| <br>  |          |          |     |
| Total liabilities                                     | 11,663   | 5,016    | 247 |
| <br>  |          |          |     |
| Total exposure in the statement of financial position | (6,450 ) | (4,648 ) | 116 |
| <br>  |          |          |     |
| Forward transactions                                  | (2,308 ) | 1,994    | 314 |

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**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)**

Information regarding the Israeli CPI and significant exchange rates:

|                       | Year ended     |             |             | December 31 |        |        |
|-----------------------|----------------|-------------|-------------|-------------|--------|--------|
|                       | December 31    | December 31 | December 31 | 2015        | 2016   | 2017   |
|                       | 2015           | 2016        | 2017        | 2015        | 2016   | 2017   |
| Rate of change        | Reporting date |             |             | spot rate   |        |        |
| %                     | %              | %           | NIS         | NIS         | NIS    | NIS    |
| 1 US dollar           | 0.3            | (1.5)       | (9.8)       | 3.902       | 3.845  | 3.467  |
| 1 euro                | (10.1)         | (4.8)       | 2.7         | 4.2468      | 4.044  | 4.153  |
| Israeli CPI in points | (0.9 )         | (0.3)       | 0.3         | 140.01      | 139.59 | 140.00 |

A change of 1% of the CPI as at December 31, 2016 and 2017 would have immaterial effect on total equity and net income. This analysis assumes that all other variables, in particular interest rates, remain constant. In addition, A change of 10% in the US\$ exchange rate as at December 31, 2016 and 2017 would have immaterial effect on total equity and net income.

**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 |          |
|---------------------------|-------------|----------|
|                           | 2016        | 2017     |
|                           | NIS         | NIS      |
| Fixed rate instruments    |             |          |
| Financial assets          | 2,503       | 2,164    |
| Financial liabilities     | (12,711)    | (13,697) |
|                           | (10,208)    | (11,533) |
| Variable rate instruments |             |          |
| Financial assets          | 99          | 47       |
| Financial liabilities     | (1,712 )    | (1,407 ) |
|                           | (1,613 )    | (1,360 ) |

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**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 total equity and net income by NIS 10 (2016 - NIS 12).

**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 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.

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| Hedge item                       | Repayment date                | Number of Transactions | Nominal Value<br>NIS | Fair value<br>NIS | Capital reserve<br>NIS |
|----------------------------------|-------------------------------|------------------------|----------------------|-------------------|------------------------|
| <b><u>December 31, 2016:</u></b> |                               |                        |                      |                   |                        |
| Debentures (Series 6)            | December 2018 - December 2022 | 9                      | 1,994                | (176 )            | 54                     |
|                                  |                               |                        | 1,994                | (176 )            | 54                     |
| <b><u>December 31, 2017:</u></b> |                               |                        |                      |                   |                        |
| Debentures (Series 6)            | December 2018 - December 2022 | 9                      | <b>1,994</b>         | <b>(200 )</b>     | <b>48</b>              |
|                                  |                               |                        | <b>1,994</b>         | <b>(200 )</b>     | <b>48</b>              |

DBS has forward transaction to reduce exposure to changes in the US\$ exchange rate. As at December 31, 2017, the net fair value of these transactions is a liability of NIS 12 (as at December 31, 2016, an asset of NIS 6).

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**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-marketable at the reporting date (Level 2).

|                                     | December 31,<br>2016 |               | December 31, 2017  |               | Fair<br>value<br>weighted<br>average<br>discount<br>rate |
|-------------------------------------|----------------------|---------------|--------------------|---------------|--|
|                                     | Carrying<br>amount   | Fair<br>value | Carrying<br>amount | Fair<br>value |  |
|                                     | NIS                  | NIS           | NIS                | NIS           | %  |
| Secured loans from banks and others |                      |               |                    |               |  |
| Unlinked                            | 2,947                | 3,089         | 4,436              | 4,693         | 2.63   |
| Debentures                          |                      |               |                    |               |  |
| Issued to the public (CPI-linked)   | 4,419                | 4,677         | 4,911              | 5,208         | 0.95   |

|   |        |        |        |        |      |
|---|--------|--------|--------|--------|------|
| Issued to institutional investors (US\$ linked) | 4,166  | 4,246  | 4,097  | 4,322  | 2.35 |
| Issued to institutional investors (unlinked)    | 830    | 879    | 15     | 17     | 2.44 |
| Issued to institutional investors (CPI-linked)  | 403    | 440    | 302    | 326    | 1.62 |
|   | 12,765 | 13,331 | 13,761 | 14,566 |      |

**(2) Financial instruments measured at fair value**

The table below analyses financial instruments carried at fair value, by valuation method.

|   | <b>December 31, 2016</b> |                |                | <b>Total</b> |
|---|--------------------------|----------------|----------------|--------------|
|   | <b>Level 1</b>           | <b>Level 2</b> | <b>Level 3</b> |              |
|   | <b>NIS</b>               | <b>NIS</b>     | <b>NIS</b>     | <b>NIS</b>   |
| Financial assets held for trading                   |                          |                |                |              |
| Monetary funds and ETFs                             | 31                       | -              | -              | 31           |
| Marketable securities                               | 655                      | -              | -              | 655          |
| Derivatives not used in hedging                     |                          |                |                |              |
| Forward contracts on CPI                            | -                        | (176)          | -              | (176)        |
| Contingent consideration for a business combination | -                        | -              | (84 )          | (84 )        |
|   | 686                      | (176)          | (84 )          | 426          |

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**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, 2017 |         |         | Total |
|---|-------------------|---------|---------|-------|
|   | Level 1           | Level 2 | Level 3 |       |
|   | NIS               | NIS     | NIS     | NIS   |
| Financial assets held for trading                   |                   |         |         |       |
| Monetary funds and ETFs                             | 14                | -       | -       | 14    |
| Marketable securities                               | 480               | -       | -       | 480   |
| Derivatives not used in hedging                     |                   |         |         |       |
| Forward contracts                                   | -                 | (212)   | -       | (212) |
| Contingent consideration for a business combination | -                 | -       | 43      | 43    |
|   | 494               | (212)   | 43      | 325   |

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,<br>2016  |                      | December 31,<br>2017  |                      |
|--|---|----------------------|---|----------------------|
|  | Maximum<br>additional<br>consideration<br>under<br>the<br>agreement | Fair<br>value<br>NIS | Maximum<br>additional<br>consideration<br>under<br>the<br>agreement | Fair<br>value<br>NIS |
| Additional consideration for the business results of DBS (second additional consideration) | 170   | 84                   | 170   | 43                   |

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(All amounts are in millions except where otherwise stated)

**Note 17 - Financial Instruments (cont'd)****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:

|  | December 31,<br>2016<br>NIS |  | 2017<br>NIS |
|--|-----------------------------|--|-------------|
| Trade and other<br>receivables, gross  | 119                         |  | 115         |
| Offset amounts   | (97 )                       |  | (99 )       |
| Trade and other<br>receivables<br>presented in the<br>statement of<br>financial position | 22                          |  | 16          |
| Trade payables,<br>gross   | 147                         |  | 143         |
| Offset amounts   | (97 )                       |  | (99 )       |
| Trade and other<br>payables presented<br>in the statement of<br>financial position       | 50                          |  | 44          |

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(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.

**A. Liabilities for employee benefits**

|  | December |       |
|--|----------|-------|
|  | 31,      |       |
|  | 2016     | 2017  |
|  | NIS      | NIS   |
| Current liabilities for:                             |          |       |
| Holiday  | 104      | 115   |
| Sick leave   | 122      | 142   |
| Early retirement                                     | 82       | 16    |
| Current maturities of pensioner benefits             | 7        | 7     |
| Total current liability for employee benefits        | 315      | 280   |
| Non-current liabilities for:                         |          |       |
| Liability for pensioner benefits                     | 118      | 120   |
| Severance compensation (net) (see composition below) | 51       | 57    |
| Early notice   | 19       | 23    |
| Pension  | 70       | 72    |
| Total non-current liabilities for employee benefits  | 258      | 272   |
| Total liabilities for employee benefits              | 573      | 552   |
| Composition of liabilities for severance pay:        |          |       |
| Liabilities for severance pay                        | 212      | 224   |
| Fair value of plan assets                            | (161)    | (167) |

**B. Defined contribution plans**

Liabilities for employee benefits at retirement age in respect of the period of their service with Bezeq and its (1) 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, |      |      |
| 2015         | 2016 | 2017 |
| NIS          | NIS  | NIS  |

|   |     |     |            |
|---|-----|-----|------------|
| Amount recognized as an expense for a defined contribution plan | 199 | 209 | <b>228</b> |
|---|-----|-----|------------|

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 (2) following an agreement among the Government of Israel, Bezeq, the General Federation of Laborers in Israel ("Histadrut") and the Makefet Fund.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 18 - Employee Benefits (cont'd)**

**B. Defined contribution plans (cont'd)**

Severance obligation to employees who will retire on terms entitling them to compensation is covered for the (3) 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 Bezeq 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.

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 (2) between the Civil Service Law and the standard policy of the Makefet Fund. 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.

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 (4) costs accumulates during the employment period. The Company's financial statements include the liabilities for expected costs in the post-employment period.

#### **D. 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 Bezeq 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.



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**Note 18 - Employee Benefits (cont'd)**

**E. Benefits for early retirement and termination**

According to the collective agreement of December 2006, among Bezeq, the employees' union and the Histadrut, and according to the amendment to the agreement of August 2015, Bezeq may, at its discretion, terminate the employment of 163 permanent employees in each of the years 2015-2021 (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, the expenses for voluntary redundancy are recognized in Bezeq's financial statements at the approval date of the plan.

In 2017, expenses of the early retirement plan amounted to NIS 23.

In addition, the Bezeq Group companies have collective agreements with the Histadrut New General Federation of Labor and the employees' committees. The agreements include mechanisms to integrate the employees' committees in decisions regarding the termination of permanent employees and the terms of severance.

**F. Actuarial assumptions**

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) The discount rate (nominal) is based on the yield on linked high-quality corporate debentures with maturity dates approximating those of the gross obligation.

The main discount rates are as follows:

|                        | December 31,<br>2016                   | December 31,<br>2017                   |
|------------------------|--|--|
|                        | Average<br>capitalization<br>rate<br>% | Average<br>capitalization<br>rate<br>% |
| Severance compensation | 4.2                                    | 3.3                                    |
| Retirement benefits    | 4.3                                    | 3.6                                    |

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 18 - Employee Benefits (cont'd)****F. Actuarial assumptions (cont'd)**

Assumptions regarding salary increments for calculation of the liabilities were made on the basis of the (4) management's assessments, distinguishing between the groups of employees. The main assumptions (in nominal terms) regarding salary increases are as follows:

|                               | <b>Salary increase assumptions</b>   |
|-------------------------------|--|
| 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 set out in the collective agreement at Pelephone                   |
| Bezeq International employees | An increase of 3.0%, as set out in the collective agreement at Bezeq International         |
| DBS employees                 | Rate of increase of 3.5%   |

Regarding Bezeq's employees, as well as the assumption of the age-dependent wage increase, an expected individual wage growth was assumed for 2019-2026, arising from the collective agreement that was signed in August 2015.

**(5) Sensitivity analysis for actuarial assumptions**

The following is an analysis of the possible effect of the changes in the principal actuarial assumptions on liabilities to employee benefits. The calculation is made for each assumption separately, assuming that the remaining assumptions

remain unchanged.

|  | Year ended December 31, |       |
|--|-------------------------|-------|
|  | 2016                    | 2017  |
|  | Years                   | Years |
| Discount rate - addition of 0.5%                   | (28 )                   | (29 ) |
| Rate of future salary increases - addition of 0.5% | 36                      | 40    |
| Rate of employees leaving - addition of 5.0%       | (10 )                   | (17 ) |

(6) Average weighted useful life of liabilities for the main severance benefits:

|                        | Year ended December 31, |       |
|------------------------|-------------------------|-------|
|                        | 2016                    | 2017  |
|                        | Years                   | Years |
| Severance compensation | 10.0                    | 10.4  |
| Retirement benefits    | 14.1                    | 14.7  |

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 19 - Income Tax**

**A. Corporate tax rate**

The corporate tax rate for 2015, 2016 and 2017 was 26.5%, 25% and 24%, respectively.

On January 4, 2016, the Knesset plenum passed the Law for the Amendment of the Income Tax Ordinance (Amendment 216), 2016, which includes a reduction in the corporate tax rate from 26.5% to 25% as from January 1, 2016. On December 22, 2016, the Knesset plenum passed the Economic Efficiency Law (Legislative Amendments for Achieving Budget Objectives in 2017 and 2018) – 2016, by which, among other things, the corporate tax rate was reduced from 25% to 24% in 2017 and to 23% as from January 1, 2018 and thereafter.

Deferred tax balances as at December 31, 2017 were calculated according to the new tax rates expected to apply on the date of reversal. The current taxes for the reported periods are calculated according to the actual tax rates as set out above

**B. Composition of income tax expenses (income)**

|                               | Year ended<br>December 31, |      |      |
|-------------------------------|----------------------------|------|------|
|                               | 2015                       | 2016 | 2017 |
|                               | NIS                        | NIS  | NIS  |
| Current tax expenses          |                            |      |      |
| Expenses for the current year | 567                        | 437  | 438  |

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|  |       |       |              |
|--|-------|-------|--------------|
| Adjustments for prior years  | -     | (28 ) | 54           |
| Total current tax expenses   | 567   | 409   | 492          |
| Deferred tax expenses (income)   |       |       |              |
| Adjustments for prior years according to an assessment agreement       | -     | -     | <b>(54 )</b> |
| Reversal of temporary differences according to an assessment agreement | -     | -     | <b>21</b>    |
| Creation and reversal of temporary differences                         | (220) | (33 ) | <b>(112)</b> |
| Total deferred tax expenses  | (220) | (33 ) | (145)        |
| Income tax expense   | 347   | 442   | 347          |

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 19 - Income Tax (cont'd)****C. Reconciliation between the theoretical tax on the pre-tax income and the tax expense**

|  | Year ended December |       |       |
|--|---------------------|-------|-------|
|  | 31                  |       |       |
|  | 2015                | 2016  | 2017  |
|  | NIS                 | NIS   | NIS   |
| Profit before income tax   | 1,430               | 881   | 1,022 |
| Statutory tax rate   | 26.5 %              | 25 %  | 24 %  |
| Income tax at the statutory tax rate   | 378                 | 220   | 245   |
| Changes in tax rate and others   | -                   | 67    | -     |
| Expenses not recognized for tax purposes                                       | (13 )               | 46    | 48    |
| Adjusted tax calculated for the  |                     |       |       |
| Company's share in equity- accounted investees                                 | (3 )                | 1     | -     |
| 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 | 97                  | 136   | 54    |
| Taxes in respect of previous years   | -                   | (28 ) | -     |
| Income tax expenses  | 347                 | 442   | 347   |

**D. Unrecognized deferred tax liabilities**

The calculation of deferred taxes does not take into account the taxes that would be applicable in the event 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, 2017, the Company has tax loss carry-forwards in the amount of NIS 165 and capital loss carry forwards in the amount of NIS 335. In addition, the Company's subsidiaries have tax loss carry-forwards in the amount of NIS 72 and capital loss carry-forwards in the amount of NIS 42.

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, 2017, deferred tax assets were not created on carry-forward losses and on carry-forwards capital losses of the Company as detailed above.

On January 14, 2016, The Company sold shares of B Communications (see note 12G2), as a result, the Company recognized deferred taxes due to the basis difference attributed to its investment in B Communications in the amount of NIS 11.



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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 19 - Income Tax (cont'd)****E. Unrecognized deferred tax assets and carry-forward tax loss (cont'd)**

On February 1, 2016, B Communications sold shares of Bezeq (see Note 1) and as a result, B Communications recognized deferred taxes due to the basis difference attributed to its investment in Bezeq in the amount of NIS 101 during 2015.

**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<br>for<br>DBS<br>NIS | Others* | Brand<br>Names<br>and<br>Customers<br>relationship<br>NIS | Total<br>NIS |
|---|--|-------------------------------|--|---------|---|--------------|
| Balance of deferred tax asset (liability) as at December 31, 2015 | (422 )   | 208                           | 1,419  | 195     | (839 )  | 561          |
| Recognized in profit or loss                                      | 74   | (26 )                         | (231 )   | (75 )   | 224   | (34 )        |
| Recognized in equity  | -  | (4 )                          | -  | (109 )  | -   | (113)        |

|  |        |       |       |    |        |     |
|--|--------|-------|-------|----|--------|-----|
| Balance of deferred tax assets (liability) as at December 31, 2016 | (348 ) | 178   | 1,188 | 11 | (615 ) | 414 |
| Balance of deferred tax asset (liability) as at December 31, 2016  | (348 ) | 178   | 1,188 | 11 | (615 ) | 414 |
| Recognized in profit or loss                                       | 25     | (13 ) | (22 ) | 28 | 127    | 145 |
| Recognized in equity   | -      | -     | -     | 1  | -      | 1   |
| Balance of deferred tax assets (liability) as at December 31, 2017 | (323 ) | 165   | 1,166 | 40 | (488 ) | 560 |

\*Reclassified

As at December 31, 2017, deferred taxes are presented in the statement of financial position as follows: under deferred tax assets NIS 1,019 (December 31, 2016: NIS 1,007) and under deferred tax liabilities NIS 459 (December 31, 2016: NIS 593).

A deferred tax asset for the carryforward tax losses of DBS appears in the financial statements of the Group in the amount of NIS 1,166. Recognition of the asset is based on the forecast of its future utilization in accordance with the expected merger, as set out in Note 19G, which will take place after receiving the regulatory approval for cancellation of the structural separation in Bezeq. The assumption of utilization of the tax asset in the merger is based on the assessment of Bezeq's management, which relies on ongoing discussions between Bezeq's management and the Ministry of Communications and on the work plan of the Ministry of Communications, that it is more likely than not that cancellation of the structural separation between Bezeq and DBS will be approved.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 19 - Income Tax (cont'd)**

**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 2014.

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 (3) 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.

On April 27, 2017, B Communications entered into a tax assessment agreement with the Israeli Tax Authority (the (4) “Agreement”) with respect to final tax assessments for the tax years 2010-2014. The Agreement covers all pending tax assessments and other tax matters with respect to such years. According to the Agreement, B Communications paid the Israeli Tax Authority NIS 25, including interest and CPI linkage differences.

(5) Bezeq has final tax assessments up to and including 2014.

On September 15, 2016, Bezeq and the Israel Tax Authority signed an assessment agreement (“the Assessment (6) Agreement”) ending the disputes involving the tax assessor’s claims regarding the financing income from the shareholder loans to DBS and about the rights and holdings in DBS acquired by Bezeq.

Concurrently, the Tax Authority granted approval for tax purposes for the merger of DBS with and into Bezeq, in accordance with Section 103(B) of the Income Tax Ordinance, whereby subsequent to the merger, the losses of DBS as at the merger date may be offset against the profits of the absorbing company, provided that in each tax year, it will not be permitted to offset an amount exceeding 12.5% (spread over eight years) of the total losses of the transferring company and the absorbing company, or 50% of the taxable income of the absorbing company in that tax year prior to offsetting the loss from previous years, whichever is lower.

The approval was granted in accordance with the applicable tax laws in effect at the time. Without derogating from the amount of the losses set out in the Assessment Agreement, if there is any change in the applicable tax laws, the Income Tax Authority will reconsider the taxation decision in accordance with the tax laws applicable at the merger date. The Approval is effective until December 31, 2019. The Income Tax Authority will extend the date of the Approval each year by an additional year, subject to the declaration of Bezeq and DBS that there has been no material change in their business affairs and subject to the terms of the taxation decision, and subject to the interpretation given to the tax laws, provided that such interpretation is published in writing. Any change in the tax laws that does not require a change in the Approval will not result in any such change.

The tax losses of DBS as at December 31, 2017 amount to NIS 5 billion.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 19 - Income Tax (cont'd)**

**G. Final tax assessments (con't)**

On December 26, 2017, Bezeq and the tax assessor signed a final assessment agreement for 2011-2014, which settles all the disputes that arose between the parties, including the non-recognition of financing expenses and timing differences in depreciation expenses. The net tax liability that was added as a result of the assessment agreement is NIS 70, for which a full provision is included in these financial statements. The assessment agreement regulates the claims of the tax assessor for 2015 and thereafter, regarding attribution of financing expenses to Bezeq's capital amortization in 2011-2013, as well as attribution of financing expenses to Bezeq's income from an intercompany dividend received or to be received from the subsidiaries, as from 2015 and thereafter, for the amounts of investments in Bezeq's financial statements as at the end of 2014 (for DBS, up to September 27, 2016).

(7) Pelephone has received final tax assessments up to and including 2014.

(8) Bezeq International has received final tax assessments up to and including 2012.

(9) DBS has received final tax assessments up to and including 2013.

(10) Walla has received final tax assessments up to and including 2011.

On November 12, 2017, as part of the assessment discussions of Walla, the tax assessor issued a best-judgment assessment for Walla for 2014. The tax assessor is demanding an additional payment of NIS 19. The main dispute between Walla and the tax assessor concerns Walla's tax liability following the sale of the holdings in the subsidiary

Coral Tell Ltd. Walla intends to file a reservation on the assessment. The management of Walla believes that the financial statements include appropriate provisions.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 20 - Contingent Liabilities**

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, 2017, due to claims filed against the Group companies on various matters and which are unlikely to be realized, amounts to NIS 6.4 billion. There is also an additional exposure of NIS 4 billion for claims for 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.

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Internet Gold – Golden Lines Ltd.

**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, 2017, classified into groups with similar characteristics.

| Claims group  | Nature of the claims  | Balance of provisions<br>NIS | Amount of additional exposure<br>NIS | Amount of exposure for claims for which the amount of exposure cannot be assessed<br>NIS |
|---|---|------------------------------|--------------------------------------|--|
| Customer claims   | Mainly motions for certification of class actions concerning contentions of unlawful collection of payment and deterioration in service provided by the Group companies.  | 59                           | 4,183                                | **2,148  |
| Claims by enterprises and companies                         | Claims alleging liability of the Group companies in respect of their activities and/or the investments made in various projects.  | 11                           | *2,005                               | ***1,808   |
| Claims of employees and former employees of Group companies | Mainly collective and individual claims filed by employees and former employees of the Group in respect of various payments and recognition of various salary components as components for calculation of payments to Group employees | 1                            | 4                                    | 1  |

|   |  |    |       |       |
|---|--|----|-------|-------|
| Claims by the State and authorities                         | Various claims by the State of Israel, government institutions and authorities (“the Authorities”). These are mainly procedures related to regulations relevant to the Group companies and financial disputes concerning monies paid by the Group companies to the Authorities (including property taxes). | 16 | 24    | -     |
| Supplier and communication provider claims                  | Legal claims for compensation for alleged damage as a result of the supply of the service and/or the product.  | -  | 148   | 4     |
| Claims for punitive damages, real estate and infrastructure | Claims for alleged physical damage or damage to property caused by Group companies and in relation to real estate and infrastructure. The additional amount of exposure for punitive damages does not include claims for which the insurance coverage is not disputed.                                     | -  | 66    | -     |
| Total legal claims against Bezeq Group companies            |  | 87 | 6,430 | 3,961 |

\* Including exposure in the amount of NIS 1.11 billion for a motion for certification as a class action against Bezeq, as well as against the subsidiary Walla, Yad 2 and an advertising company owned by Walla, which addresses with Bezeq’s 144B service. Subsequent to the date of the financial statements, the motion was dismissed.

\*\* Including exposure of NIS 2 billion for a motion for certification as a class action filed by a shareholder against Bezeq and officers in Bezeq, referring to alleged reporting omissions by Bezeq regarding the wholesale market and the reduction of interconnect fees, which the plaintiff estimates at NIS 1.1 billion or NIS 2 billion (depending on the method used to calculate the damage).

\*\*\* See Below table:

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 20 - Contingent Liabilities (cont'd)**

| Date      | Parties  | Instance   | Type of proceeding                   | Description  |
|-----------|--|--|--------------------------------------|--|
| June 2017 | Shareholders of Bezeq Against Bezeq, Chairman of Bezeq's Board of Directors, members of Bezeq's Board of Directors, B Communications, Internet Gold, and companies in the Eurocom Group (the first motion also against the CEO of Bezeq and the CEO and CFO of DBS). | At the Tel Aviv District Court (Economic Department) | Two motions to certify class actions | <p>The subject of the motions is the transaction from 2015 in which Bezeq acquired from Eurocom DBS Ltd (a company controlled by Bezeq's controlling shareholders) the balance of shares of DBS that it held.</p> <p>The first motion was filed in the name of anyone who acquired Bezeq shares between February 11, 2015 and June 19, 2017 (excluding the respondents and/or those acting on their behalf and/or connected with them). In the motion it is argued that the report concerning the transaction was misleading and/or deficient, and on account of which, due to the opening of a public investigation into the transaction by the ISA, the public has become aware of details concerning the transaction and its implementation, which led to a drop in Bezeq's share price in the days following the disclosure and analysis of the new information. The plaintiff argues that the respondents acted contrary to the provisions of the Securities Law, and contrary to the provisions of additional laws, and caused holders of Bezeq's securities heavy financial losses, amounting to millions of shekels if not more.</p> |

The second motion was filed in the name of three sub-classes - anyone who acquired (1) shares of Bezeq, (2) shares of our company, B Communications, and (3) shares of Internet Gold on the Tel Aviv Stock Exchange between May 21, 2015 and June 19, 2017. The plaintiff argues that the public that invested in these shares was seriously misled, which was uncovered following the opening of a public investigation into the transaction by the ISA on June 20, 2017, whereby the increase in the cash flow of DBS as reported in Bezeq's financial statements was artificially inflated, according to their claim, thereby misleading reasonable investors who based themselves on DBS cash flow data to estimate its worth, which led to over-valuation of the above companies. The plaintiff also claims additional damage caused to the groups of shareholders in B Communications and Internet Gold.

On October 25, 2017, a ruling was given ordering the striking out of another (third) class action certification motion filed in the same court in July 2017 concerning a transaction for the purchase of DBS shares and a transaction to continue the agreement between DBS and Spacecom, after the court ruled that the above motions should be preferred and after failing to find any added value in the other motion to advancing the class's interests or facilitating the hearing.

In accordance with a procedural arrangement approved earlier by the court, the plaintiffs agreed in the above motions to administer the motions jointly and they will file a consolidated motion.

On December 10, 2017, the court resolved to postpone the hearing in the case for 4 months after the Attorney General's attorney submitted his position whereby the hearing in this case should be delayed at this stage for 4 months, to enable the evidence in connection with the ISA investigation to be examined by the District Attorney's office, to allow the investigation to be completed to the extent that this is necessary, and so that the District Attorney's office can formulate its position.

On May 2, 2018 the Court granted the Attorney General's request and ordered the proceeding stayed for an additional four months. The Attorney General is required to update the Court by August 12, 2018.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 20 - Contingent Liabilities (cont'd)**

| Date   | Parties   | Instance                | Type of proceeding  | Description  |
|--|---|-------------------------|---|--|
| June-August 2017 and a motion from December 2017 | Bezeq shareholders against Bezeq and DBS (not including two motions that were filed only against Bezeq) | Tel Aviv District Court | Various motions to disclose documents prior to filing a motion to certify a derivative claim under Section 198A of the Companies Law filed further to the ISA investigation | In some of these motions (three in all), the court was moved to instruct Bezeq (and DBS, as applicable) to submit to the plaintiffs, documents and information in connection with the agreement for Bezeq's purchase of DBS, and specifically in connection with the Second Contingent Payment according to that agreement (payment of NIS 170 million which is contingent on DBS meeting free cash flow targets in the period 2015-2017). On October 24, 2017, the court resolved to strike out the three motions after accepting the plaintiff's request in the motion to certify a derivative action in the matter of an agreement for Bezeq to purchase DBS (see above), and this after concluding that these motions give rise to questions of fact and law that are essentially similar to the questions that arise in the Earlier Motion. In its decision, the court also noted that if the plaintiff in the Earlier Motion does not submit a motion to amend the motion for certification (such that it also applies to the matters included in the disclosure motions) or, alternatively, it files such a motion and its motion is dismissed, the plaintiffs in the foregoing three motions will have the right to initiate legal proceedings should they so determine.<br><br>In some of the motions, the court was moved to instruct Bezeq (and DBS, as applicable) to submit to the plaintiffs, certain documents in connection with an interested party transaction between DBS and |

Spacecom from 2013, as amended early in 2017. On December 10, 2017, the plaintiffs in three motions notified they were “joining forces” and cooperating with each other. A hearing on the question of which motions should be dismissed and which should remain was held on January 8, 2018 and a ruling on the matter has not yet been given. Further to ISA’s position that in view of the investigation the proceedings in these cases should be delayed, the court ordered the proceedings to be delayed until April 10, 2018.

In an additional motion, the court was moved to instruct Bezeq and DBS to submit to the plaintiffs, documents and information also in connection with the agreement for Bezeq’s purchase of DBS and in connection with the DBS - Spacecom Transaction. In this motion, the plaintiff wishes to explore the filing of a motion to certify a derivative claim against officers in Bezeq and DBS who were in breach of their fiduciary duty against Bezeq in these transactions, according to the plaintiff, where the relief requested is to return all the benefits they received for the positions they held in Bezeq or DBS (salary, bonuses, management fees, etc.). The court consolidated the preliminary hearing in this case with the preliminary hearing on the motions to disclose documents prior to filing the motion to certify a derivative claim, detailed above.

Motion from December 2017 - motion to order Bezeq to disclose various documents to the plaintiff with respect to advance payments on account of the second contingent payment in the DBS transaction, claiming that the decision to pay advances and to pay them without any collateral was flawed. On January 21, 2018, Bezeq filed an application for instructions and requesting the court to strike out one of the two motions, either this motion or the motion to certify a derivative claim since they deal with overlapping issues.

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**Notes to the Consolidated Financial Statements**

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**Note 20 - Contingent Liabilities (cont'd)**

On June 29, 2017, Plaintiff Lynne P. Maleeff commenced litigation on behalf of a purported class of all persons and entities who purchased or otherwise acquired B Communications' shares between March 18, 2015 and September 6, 2017. The original defendants were B Communications, Doron Turgeman (B Communications and our CEO), Itzik Tadmor (B Communications and our CFO) and Ehud Yahalom (B Communications and our former CFO). On December 8, 2017, lead plaintiffs filed an amended complaint adding ten new defendants: Shaul Elovitch, Or Elovitch, Ron Eilon, Stella Handler, David Mizrahi, Micky Neiman, Allon Raveh, Linor Yochehman, DBS and Eurocom Communications.

The amended complaint alleges a single cause of action against our company for violation of Section 10(b) of the Exchange Act and SEC Rule 10b-5 promulgated thereunder. The complaint alleges that B Communications made false and misleading statements and omissions in its SEC filings.

On February 20, 2018, B Communications moved to dismiss the litigation for failure to state a claim or, alternatively, to stay the litigation pending the outcome of criminal investigations in Israel. B Communications motion to dismiss asserts, among other things, that plaintiffs failed to allege that B Communications had the required knowledge or scienter about the purported wrongdoing by other defendants and that B Communications did not make any materially false statements. Plaintiffs filed their opposition to the motion to dismiss or stay on April 17, 2018. The court may schedule oral argument on B Communications motion to dismiss sometime in June or July, and it is possible that a decision will be issued before the end of October. While B Communications have solid arguments in its favor, it is impossible to predict how the court will rule on the motion to dismiss or stay. Similar class action lawsuits were filed in Israel, and are described in the table below.

Our company, B Communications and five members of B Communications Board of Directors were named as respondents in a motion to certify a claim as a derivative claim instituted in the Tel Aviv District Court (Economic



Affairs Division) on July 28, 2016. The plaintiff has alleged that NIS 113 out of the dividends distributed by B Communications in May 2016 was distributed unlawfully as such amount was not included in B Communications profit and loss report, and therefore does not qualify as a "surplus" that may be lawfully distributed as dividends under the Israeli Companies Law. A pretrial hearing was held in March 2017, in which the court allows B Communications to file an additional brief response and a supplementary expert opinion, in order to respond to the arguments. B Communications filed the additional responses on in June 2017. The court further held that the parties should consider the possibility of a constructive dialogue regarding the issues in dispute and instructed the parties to inform the court about the results of this dialogue, and whether they want to set a date for an evidence hearing or additional preliminary motions. The dialogue process failed, and accordingly, the court set dates for the evidence hearing (as part of the motion to certify) for January 6, 2019.

### **B. Subsequent customer claims**

Subsequent to the reporting date, claims amounting for NIS 571 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 1.2 billion came to an end.

In addition, subsequent to the date of the financial statements, a motion for certification of the claim as a derivative action was filed against Bezeq as a formal respondent, and against directors of Bezeq at the times relevant to the motion and against the controlling shareholders in Bezeq. The matter of the motion is Bezeq 's engagement in an assessment agreement with the Tax Authority, which was signed on September 15, 2016 (described in Note 19G), according to which the Company paid taxes in the amount of NIS 462 to the Tax Authority for financing income from loans to DBS. On the other hand, it was agreed, among other things, that the losses of DBS for the financing expenses for the shareholders' loans of Bezeq to DBS will be recognized in full for Bezeq after the merger between Bezeq and DBS.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 20 - Contingent Liabilities (cont'd)**

Bezeq and the CEO intend to study the notice of the Authority, to exercise the right to a hearing and to submit their arguments to the Commissioner. They are unable to assess at this stage the outcome of the proceeding.

**Note 21 - Agreements**

The Group companies have operating lease agreements for land, property cellular sites, real estate, and vehicles A. 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, 2017, are as follows:

| Year ended December 31 | Real estate<br>NIS | Vehicles<br>NIS | Total<br>NIS |
|------------------------|--------------------|-----------------|--------------|
| 2018                   | 222                | 88              | 310          |
| 2019                   | 213                | 74              | 287          |
| 2020                   | 165                | 48              | 213          |
| 2021                   | 86                 | -               | 86           |
| 2022                   | 50                 | -               | 50           |
| 2023 onwards           | 74                 | -               | 74           |
|                        | 810                | 210             | 1,020        |

In 2017, DBS signed an agreement with Spacecom Communications Ltd. (“Spacecom”), which is controlled by a controlling shareholder of the Company, with an amendment to the addendum to the existing agreement between B. the parties of November 4, 2013 for the receipt of satellite segments in Spacecom’s satellites (“the Agreement”), the principles of which are as follows:

The Agreement is valid until December 31, 2028 (the same term as of the 2013 Agreement), subject to the options for early termination set out below.

DBS will receive the following space segments: (A) Amos 3 satellite; (B) Amos 7 satellite, in which Spacecom holds the right to lease space segments; (C) Amos 8 satellite - a new satellite that is expected to serve DBS when it becomes operational.

In the contract period (subject to events of unavailability and until the end of the lifespan of Amos 3, which is expected in 2026), DBS is expected to use 12 space segments from two different satellites, according to the division in the agreement. The agreement also establishes the positioning of backup space segments in the contract period, under the terms and within the limitations in the agreement.

The overall nominal cost for the entire contract period is estimated at US\$ 263 and represents an average annual cost of US\$ 21.9, subject to discounts and reimbursements set out in the agreement.

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**Note 21 - Agreements (cont'd)**

The agreement stipulates the right to early termination without cause, subject to advance notice of 12 months and payment of the consideration in accordance with the prescribed mechanism. The agreement also stipulates the right to early termination due to a delay in the entry into force of the agreement for construction of Amos 8, and the right to early termination at the end of the lifespan of Amos 3 due to non-availability of Amos 8, without payment of compensation and under the conditions set out in the agreement.

In March 2018, Bezeq's audit committee and Board of Directors approved the agreement between DBS and Spacecom with the amendment to the 2017 agreement, whereby in the period from April 2018 up to September 2018 (and for an additional year, if the parties agree to this), instead of one of the space sections leased by DBS from Spacecom in the Amos 3 satellite, DBS will lease a section on the Amos 7 satellite. For this exchange, DBS is entitled to a monthly discount of US\$ 80 thousand in the interim period. As at the reporting date, the amendment has not yet been signed.

For information about the agreement with Spacecom, see Note 30 regarding the agreements with related parties.

C. In October 2016, the new agreement with Apple Distribution International ("Apple") came into effect for the acquisition and distribution of iPhones. In accordance with the agreement, Pelephone is required to purchase a minimum number of iPhones for an additional three years at the prices in effect at the manufacturer at the actual purchase date.

D. Pelephone has obligations as of December 31, 2017 amounting to NIS 147 (as at December 31, 2016, NIS 71) to acquire terminal equipment.

E. Pelephone utilizes Ericsson infrastructure equipment for its UMTS/HSPA and LTE networks. Pelephone has multi-annual agreements for maintenance, support and upgrade of software for the UMTS/HSPA network and an agreement for deployment of the 4G network (LTE) with Ericsson, and Pelephone believes that it could be dependent on Ericsson for network support and its expansion.

F. As at December 31, 2017, DBS has agreements for the acquisition of broadcast rights. In 2017, expenses for consumption of broadcast rights acquired by DBS amounted to NIS 342.

G. For information about agreements for the acquisition of broadcasting rights by DBS, see Note 11. For information about agreements for the purchase of fixed assets, see Note 9 above.

H. On January 21, 2018, Bezeq signed an agreement for the sale of a real estate asset in the Sakia complex for a total consideration of NIS 497, plus VAT, which may increase up to NIS 550, if the purchaser, in accordance with its right under the agreement, postpones the date of payment of up to two thirds of the consideration until December 31, 2022. Bezeq is expected to record a capital gain on the date on which the conditions for recognition of the sale of the asset are fulfilled in accordance with accounting principles. The final amount of the capital gain depends on the fees and levies that will apply to Bezeq for the sale of an asset.

I. For agreement to issue private debentures in 2018, see Note 13 below.

J. For information about transactions with related parties, see Note 30.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 22 - Securities, Pledges and Guarantees**

The Group's policy is to provide tender, performance and legal guarantees. In addition, the Company provides bank guarantees, where necessary, for banking obligations of subsidiaries.

The Bezeq Group companies have provided guarantees of NIS 152 in favor of the Ministry of Communications to

A. secure the terms of their licenses (of which an amount of NIS 37 is linked to the CPI and NIS 35 is linked to the US\$ exchange rate).

B. The Bezeq Group companies have provided bank guarantees of NIS 61 in favor of third parties.

C. In accordance with its cellular license, Pelephone is not permitted to sell, lease or pledge any of its assets used for the implementation of the license, without the consent of the Minister of Communications, except for:

A pledge on one of the license assets in favor of a bank operating lawfully in Israel, to receive bank credit,

1) 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.

D. For information about the conditions for loans and borrowings, see Note 13.

**Note 23 - Capital and Capital Reserves**

| Authorized       | Registered  |
|------------------|-------------|
| December 31      | and paid up |
| 2016 and         | December 31 |
| 2017             | 2016 and    |
|                  | 2017        |
| Number of shares |             |

|   |             |            |
|---|-------------|------------|
| Ordinary shares of NIS 0.1 par value each | 501,000,000 | 19,203,186 |
|---|-------------|------------|

As of December 31, 2017, 5,862,615 ordinary shares of the Company have been purchased pursuant to a share buyback program which was authorized by the Company's Board of Directors.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 24 - Revenues**

|  | Year ended December 31 |        |       |
|--|------------------------|--------|-------|
|  | 2015                   | 2016   | 2017  |
|  | NIS                    | NIS    | NIS   |
| Domestic fixed line communications                         |                        |        |       |
| Fixed line telephony                                       | *1,456                 | *1,352 | 1,255 |
| Internet – infrastructure                                  | *1,438                 | *1,461 | 1,488 |
| Transmission and data communication                        | *835                   | *835   | 775   |
| Cloud and digital services                                 | *184                   | *203   | 230   |
| Other services   | 212                    | 213    | 205   |
|  | 4,125                  | 4,064  | 3,953 |
| Cellular   |                        |        |       |
| Cellular services and terminal equipment                   | 1,948                  | 1,777  | 1,743 |
| Sale of terminal equipment                                 | 884                    | 811    | 757   |
|  | 2,832                  | 2,588  | 2,500 |
| International communications,<br>internet services and NEP | 1,487                  | 1,480  | 1,467 |
| Multi-channel television                                   | 1,333                  | 1,745  | 1,650 |
| Others   | 208                    | 207    | 219   |
|  | 9,985                  | 10,084 | 9,789 |

\*



Cloud and digital services were reclassified and presented separately to reflect the change in the mix of revenues in fixed-line domestic communications

**Note 25 - Salaries**

|   | Year ended December |       |       |
|---|---------------------|-------|-------|
|   | 31                  |       |       |
|   | 2015                | 2016  | 2017  |
|   | NIS                 | NIS   | NIS   |
| Salaries and incidentals:   |                     |       |       |
| Operating   | 1,871               | 1,922 | 1,931 |
| General and administrative  | 588                 | 624   | 648   |
| Total salaries and incidentals  | 2,459               | 2,546 | 2,579 |
| Less – salaries recognized in investments in property, plant and equipment and in intangible assets | 499                 | 529   | 571   |
|   | 1,960               | 2,017 | 2,008 |

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 26 - General and Operating Expenses\***

|  | Year ended December<br>31 |       |       |
|--|---------------------------|-------|-------|
|  | 2015                      | 2016  | 2017  |
|  | NIS                       | NIS   | NIS   |
| Terminal equipment and materials                                       | 880                       | 831   | 855   |
| Interconnectivity and payments to domestic and international operators | 909                       | 825   | 805   |
| Maintenance of buildings and sites                                     | 616                       | 605   | 584   |
| Marketing and general expenses   | 649                       | 709   | 615   |
| Services and maintenance by sub-contractors                            | 199                       | 261   | 260   |
| Vehicle maintenance expenses   | 167                       | 164   | 156   |
| Content services expenses  | 458                       | 629   | 636   |
|  | 3,878                     | 4,024 | 3,911 |

\*For information regarding early adoption of IFRS 15, Revenue from Contracts with Customers, see Note 3A.

\* Less expenses of NIS 65 recognized in 2017 for investments in property, plant and equipment and intangible assets (in 2016, NIS 64 and in 2015, NIS 63).

**Note 27 - Other Operating Expenses (Income), net**

|  | Year ended<br>December 31 |      |      |
|--|---------------------------|------|------|
|  | 2015                      | 2016 | 2017 |
|  | NIS                       | NIS  | NIS  |

|  |       |       |       |
|--|-------|-------|-------|
| Loss from impairment of goodwill                       | -     | -     | 129   |
| Provision for severance pay in early retirement        | 117   | 96    | 23    |
| Capital gain from sale of property plant and equipment | (136) | (86 ) | (27 ) |
| Others   | 22    | 11    | 24    |
|  | 3     | 21    | 149   |

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 28 - Financing Expenses (Income)**

|  | Year ended<br>December 31 |        |       |
|--|---------------------------|--------|-------|
|  | 2015                      | 2016   | 2017  |
|  | NIS                       | NIS    | NIS   |
| Interest and linkage differences from loans to an associate                            | (21 )                     | -      | -     |
| Linkage and exchange rate differences, net   | (7 )                      | (19 )  | -     |
| Income on bank deposits, investments and others  | (17 )                     | (20 )  | (8 )  |
| Change in fair value of financial assets measured at fair value through profit or loss | (27 )                     | (29 )  | (7 )  |
| Income in respect of credit in sales, net of discount commission                       | (52 )                     | (42 )  | (35 ) |
| Other financing income   | (40 )                     | (23 )  | (25 ) |
| Total financing income   | (164)                     | (133 ) | (75 ) |
| Interest expenses on financial liabilities   | 695                       | 924    | 503   |
| Linkage and exchange rate differences, net   | 61                        | 38     | 49    |
| Change in contingent consideration in a business combination                           | -                         | 55     | (14 ) |
| Change in fair value of financial assets measured at fair value through profit or loss | 13                        | 24     | 43    |
| Financing expenses for employee benefits, net  | 16                        | 15     | 35    |
| Reduction of the provision for assessor interest expenses                              | (76 )                     | -      | -     |
| Other financing expenses   | 50                        | 52     | 36    |
| Total financing expenses   | 759                       | 1,108  | 652   |
| Financing expenses, net  | 595                       | 975    | 577   |

**Note 29 - Earnings (Loss) per Share**

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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:

|   | Year ended<br>December 31 |       |       |
|---|---------------------------|-------|-------|
|   | 2015                      | 2016  | 2017  |
|   | NIS                       | NIS   | NIS   |
| Earnings (loss) attributable to ordinary Shareholders |                           |       |       |
| Basic earnings (loss) for the year                    | 87                        | (202) | (15 ) |
| Effect of diluted per share loss in a subsidiary      | (1)                       | -     | -     |
| Diluted earnings (loss) for the year                  | 86                        | (202) | (15 ) |

|  | Year ended December 31                                     |   |   |
|--|--|---|---|
|  | 2015   | 2016  | 2017  |
|  | Thousands<br>of<br>shares<br>of<br>NIS 0.1<br>par<br>value | Thousands of<br>shares of<br>NIS 0.1<br>par value | Thousands of<br>Shares of<br>NIS 0.1<br>par value |
| Weighted average number of ordinary shares (basic and diluted) | 19,203   | 19,203  | 19,203  |

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

Note 30 - 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, 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 and its subsidiaries and between other Eurocom Group companies, such as Eurocom Digital Communications, Eurocom Cellular Communications, SpaceCom, Gilat Satcom 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.

It should be noted that the transactions described below with interested and related parties do not include reference to Note 1 regarding the investigation of the ISA and the Israel Police.

**B. Balances with related parties**

|   | December<br>31,<br>2016 2017<br>NIS NIS |       |
|---|---|-------|
| Receivables - associates  | 10                                      | 8     |
| Liabilities to related parties, net *   | (12)                                    | (23 ) |
| Advanced payment (Liability) to Eurocom DBS (not including interest) for contingent consideration<br>(see note 12B) | (32)                                    | 99    |

(\*) The amounts are for the parent company, Eurocom, and their related parties.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

Note 30 - Transactions with Related Parties (cont'd)

**C. Transactions with related parties**

|   | Year ended December 31, |         |         |
|---|-------------------------|---------|---------|
|   | 2015                    | 2016    | 2017    |
|   | NIS                     | NIS     | NIS     |
| Revenues  |                         |         |         |
| From associates (including interest income in respect of shareholders' loans) * | 30                      | 7       | 8       |
| From related parties **   | 10                      | 13      | 23      |
| Expenses  |                         |         |         |
| To related parties * *  | 129                     | ****111 | 122     |
| To associates   | 3                       | 2       | 5       |
| Investments   |                         |         |         |
| Related parties **  | 76                      | 59      | 28      |
| Acquisition of DBS  | 913                     | ****55  | ***(70) |
| Revised fair value of the excess advance payments for acquisition of DBS        | -                       | -       | ***56   |

\* Revenues from associates in 2015 include mainly finance income from shareholders loans to DBS, prior to the acquisition of control in DBS.

\*\* The amounts are for the parent company, Eurocom and its related parties.

Adjustment of the liability for contingent consideration for a business combination with DBS and adjustment of \*\*\* the fair value estimate of the amount expected to be returned to Bezeq from the excess of the advance payments that it paid was recognized as financing income, net.

\*\*\*\* Reclassified



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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 30 - Transactions with Related Parties (cont'd)****D. Transactions listed in section 270(4) of the Companies Law**

| Approval date of<br>the general<br>meeting (after<br>approval of Bezeq's<br>audit committee<br>and Board of<br>Directors) | Nature of the transaction  | Amount of the transaction  |
|---|--|--|
| March 23, 2015  | Approval of Bezeq's acquisition agreement with Eurocom DBS Ltd. ("Eurocom DBS") whereby Bezeq will acquire the entire holdings of Eurocom DBS in DBS shares DBS and all the shareholder loans provided by Eurocom DBS to DBS (including acceptance of the terms established by the Antitrust Commissioner's in his approval of the merger on March 26, 2014, both by Bezeq and by DBS, and announcement of the exercise of Bezeq's option for the allotment of 6,221 DBS shares, at no cost, representing 8.6% of the share capital of DBS). | The total cost is comprised of: a) total cash of NIS 680; 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 US\$ 14.   |
| 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   | Annual scope of up to NIS 50 (for all the products).   |

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).

|                   |  |  |
|-------------------|--|--|
| June 30, 2016*    | Extension of the amended agreement with Eurocom Communications for ongoing management and consultation services for Bezeq. The agreement is for three years, valid until May 31, 2019, unless one of the parties submits three-month notice of termination of the agreement. | NIS 6.4 per year.  |
| November 27, 2014 | Bezeq's agreement to bring forward payments with Eurocom, according to which DBS may advance, at the supplier's request, payments that are due, or will be due, to Eurocom for orders of converters.   | Up to a total cost of US\$ 6. this approval was not used in the reporting year   |
| November 3, 2016  | Bezeq's agreement with Eurocom for the additional acquisition of up to 90 thousand VTECH N VDSL routers, valid until June 30, 2017.  | Approval for acquisition of up to US\$ 11.3 (not including VAT). In addition, in 2017, additional N standard VDSL routers were acquired, but in amounts that do not exceed the negligibility level as described above. |

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

Note 30 - Transactions with Related Parties (cont'd)

**D. Transactions listed in section 270(4) of the Companies Law (cont'd)**

Approval date of the  
general meeting  
(after approval of  
Bezeq's audit  
committee and Board  
of Directors)

Nature of the transaction

Amount of the transaction

April 3, 2017

Approval of Bezeq's vote at the general meeting of DBS in favor of the agreement between DBS and Spacecom with an amendment/addendum to the existing agreement between the parties dated November 4, 2013, for the lease of satellite segments in Spacecom's satellites ("the Agreement"), including in favor of implementation of the Agreement. The validity of the Agreement remains the same as the original agreement, namely, until the end of 2028.

A total nominal cost of up to US\$ 263 for the entire term of the Agreement (until December 31, 2028), reflecting an average annual cost of US\$ 21.9. It should be noted that the overall cost of the Agreement may be lower if surplus revenue sharing mechanisms are applied and/or the assumptions set out in the amendment to the Agreement.

July 5, 2017

The agreement between Bezeq International and Eurocom Digital for the purchase of up to 100,000 TECH VDSL routers

Approval of the acquisition in an amount of up to US\$ 3.2 (not including VAT)

Eurocom will also provide ongoing consultation services in diverse areas, in a monthly scope of at least 60 hours of \*consulting services, provided by Or Elovitch, Orna Elovitch-Peled, Amikam Shorer, Felix Cohen, Ami Bar-Lev, and any other party set out in the agreement.

For services provided by the Eurocom Communications as described above, Bezeq will pay the following consideration to Eurocom Communications: (A) directors' compensation, consisting of annual participation compensation and actual participation compensation based on a maximum amount for one meeting (as this term is defined in the Companies Regulations (Rules for Compensation and Expenses of an External Director), 2000), based on the relevant rating of Bezeq of the subsidiary/sub-subsidiary (as the case may be) at that date, for the participation of the directors serving on behalf of Bezeq's controlling shareholders, as part of their membership and their position as directors in Bezeq and/or its subsidiaries and the various committees, subject to adjustments in accordance with their number and presence at meetings; (B) NIS 3.5 per year for the service and activities of Shaul Elovitch as active chairman of the Board of Directors of Bezeq and its subsidiaries; and (C) NIS 432 thousand per year for ongoing consultation services.

In view of the restrictions imposed on the activities Shaul Elovitch and other directors who serve or who served in the reporting year on behalf of Eurocom Communications on the Board of Directors of t Bezeq and its subsidiaries, in connection with the investigation conducted by the ISA, the Board of Directors resolved on September 25, 2017, that the amount to be paid by Bezeq to Eurocom Communications for the services component of the Chairman of the Board of Directors, in accordance with the management agreement, for the period from June 20, 2017 to December 31, 2017, will be 50% of the amount set out in the agreement for this period. On January 29, 2018, the Board of Directors of Bezeq resolved that the payments under the agreement for the period as from June 20, 2017 will be withheld, and that for the period from January 1, 2018, Bezeq will start a review of changes to the management agreement, while withholding payments until a final decision on the matter is made. Due to the opening of another investigation by the ISA and the Israel Police (see Note 1), negotiations have not yet commenced, and Eurocom Communications does not provide the services of the chairman of the board and consulting services.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

Note 30 - Transactions with Related Parties (cont'd)

**E. Agreements with the Eurocom Group and B Communications**

The financial value of the transactions described above, which were carried out in 2017 were as follows:

|  | Amounts<br>included in<br>the<br>consolidated<br>financial<br>statements<br>NIS |
|--|---|
| Expenses   | 91  |
| Property plant and equipment   | 11  |
| Acquisition of Eurocom DBS holdings in DBS   | (70 )   |
| Adjustment of the fair value of excess advance payments for the acquisition of DBS | <b>56</b>   |

The Company both receives various services and products from, and provides various services and products to, related parties at market rates and in the ordinary course of business. Other than the transactions described below, none of these related party transactions are material to the Company or to the Company's related parties.

If a related party wishes to supply products or services to the Company, the Company 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 the Company's audit committee and the Company's board of directors (and in some

circumstances, The Company's shareholders). In addition, generally the Company 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 the Company's subsidiaries and affiliates engage in business activities with each other. Such business activities are primarily among Bezeq, other Bezeq Group companies and 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, the former chairman of the Company's board of directors, and his brother Yossef Elovitch, a director of the 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 four years, the Company has entered into transactions with Eurocom Communications and several of their affiliates, referred to as the Eurocom Group. The Company believes 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.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 30 - Transactions with Related Parties (cont'd)**

**E. Agreements with the Eurocom Group and B Communications (cont'd)**

In June 2017, our shareholders approved our entering into a Services Agreement with Eurocom Communications pursuant to which it will provide us with the services of its Legal Department in consideration of a monthly fee of NIS 15.5 thousand, plus an annual fixed amount of up to NIS 6 thousand in respect of various other expenses to be paid against receipts and documentation. Based on our prior experience, we estimated that the scope of the legal services provided to our company averaged approximately 48 hours per month on an annual basis. The legal services' portion of the Services Agreement was terminated on March 31, 2018.

In February 2018, our Board of Directors appointed Adv. Ami Barlev to serve as a director and as Acting Chairman of the Company's Board of Directors until the next annual shareholders' meeting.

In March 2018, Eurocom and the Company terminated the rest of the Services Agreement. The Company's Compensation Committee and Board of Directors have confirmed, among other things, that upon termination of the Services Agreement, Messrs. Felix Cohen, Yosef Elovitch and Ami Barlev will be entitled to compensation as directors pursuant to the "Fixed" statutory amount in accordance with the Companies Regulations (Rules Regarding Compensation and Expenses for an External Director) 5760-2000 for companies within the range of the Company's size. In addition, the directors will be entitled to receive reimbursement of expenses in accordance with the provisions of these Compensation Regulations, to receive coverage under the insurance policy that applies to all of the Company's directors and officers, and to receive indemnification letter as given to all of the Company's directors and officers. Mr. Barlev's compensation is effective starting February 7, 2018. The compensation of Messrs. Felix Cohen and Yosef Elovitch are effective starting April 1, 2018.



### **Certain Related Party Transactions**

The Company and B Communications lease the Company's principal offices from Eurocom Communications for an annual rent of NIS 110 thousand (approximately \$32 thousand) for both companies. Eurocom Digital provides us and B Communications with additional services, such as computing services for an annual fee of NIS 24 thousand (approximately \$7 thousand) for both companies. All of these expenses are divided one-third to the Company and two-thirds to B Communications.

In addition, the Company receives 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 the Company's related parties. If a related party wishes to supply products or services to the Company, the Company 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 the Company's Audit Committee and the Company's board of directors (and the Company's shareholders, if required). In addition, the Company will generally 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.

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Internet Gold – Golden Lines Ltd.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 30 - Transactions with Related Parties (cont'd)**

**E. Agreements with the Eurocom Group and B Communications (cont'd)**

**Registration Rights Agreement with Eurocom Communications**

In July 1999, the Company entered into a registration rights agreement with Euronet Communications (which was subsequently assigned to Eurocom Communications) and the Company's other existing shareholders granting them the right to register their ordinary shares under the U.S. Securities Act (the "Securities Act"). The registration rights include unlimited rights to request that their shares be included in any underwritten public offering of the Company's 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 the aggregate, that the Company register their shares. As of August 4, 2000, the holders of a majority of these shares are also entitled to request that the Company affect 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 to the Company.

Pursuant to the 1999 registration rights agreements with Eurocom Communications, on December 9, 2015, the Company filed on behalf of Eurocom Communications, a registration statement on Form F-3 relating to the resale, from time to time, by Eurocom Communications of up to 2,880,000 of the Company's ordinary shares. The registration statement became effective on December 14, 2015.

On January 30, 2017, the Company filed on behalf of Messrs. Shaul and Yossef Elovitch a registration statement on Form F-3 relating to the resale, from time to time, by Messrs. Shaul and Yossef Elovitch up to 925,000 of the Company's ordinary shares. The registration statement became effective on January 30, 2017.

**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, under which Eurocom Capital handles the execution of our financial investments pursuant to direct instructions from our chief executive officer. The execution services agreement was terminated on November 30, 2017. 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. The Company paid Eurocom Capital NIS 433 thousand, NIS 338 thousand and NIS 228 thousand (approximately \$66 thousand) for the years ended December 31, 2015, 2016 and 2017, respectively.

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 30 - Transactions with Related Parties (cont'd)**

**E. Agreements with the Eurocom Group and B Communications (cont'd)**

**Agreements with B Communications**

Registration Rights Agreement with B Communications

The Company and B Communications have entered into a registration rights agreement under which B Communications has granted us the right to demand registration under the Securities Act of the ordinary shares of B Communications that we hold. The Company is 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. B Communications is not required to effect more than one demand registration during any 12-month period or within 90 days of any other demand registration. The Company also has “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 the Company sell ordinary shares, unless such liability arose in reliance upon and in strict conformity with information that the Company furnished in writing. B Communications will pay all expenses incident to any demand registration, and the Company will pay the Company's respective portions of all underwriting discounts, commissions and fees attributable to the sale of the ordinary shares of B Communications.

### **Chief Executive Officer Employment Agreement**

The Company entered into an arrangement with B Communications according to which B Communications' employees provide services to both companies and B Communications will pay 2/3 and the Company will pay 1/3 of their compensation.

### **F. Key management personnel compensation (including directors)**

Key management personnel compensation comprised:

|                   | Year ended  |      |      |
|-------------------|-------------|------|------|
|                   | December 31 |      |      |
|                   | 2015        | 2016 | 2017 |
|                   | NIS         | NIS  | NIS  |
| Employee benefits | 2           | 4    | 3    |

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**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 31 -Subsequent Events**

On April 22, 2018, the Tel Aviv-Jaffa District Court issued a liquidation order for Eurocom Communications effective May 3, 2018. According to the order, the official receiver will be the temporary liquidator of Eurocom A. Communications until the appointment of a permanent liquidator, and attorneys Pinchas Rubin, Amnon Lorch and Uri Gaon were appointed as special managers. The liquidation order did not constitute a change of control under the Control Permit, but this may change in the future.

On April 26, 2018, Bezeq held its annual meeting of shareholders (the “Meeting”). In the Meeting, the following directors were elected to Bezeq’s Board: Shlomo Rodav, Doron Turgeman, Ami Barlev, Orly Guy, Ilan Biran, Dov B. Kotler, David Granot, Rami Nomkin, Idit Lusky (an external director) and Amnon Dik (an external director). Three additional external directors were not up for re-election are remain in office.

All the elected directors were either recommended by the Company or their election was supported by the Company.