August 22, 2018

"Bezeq" - The Israel Telecommunication Corporation Ltd.

Quarterly report for period ended June 30, 2018

Update to Chapter A (Description of Company Operations) of the Periodic Report for 2017

Directors' Report on the State of the Company's Affairs for the period ended June 30, 2018

Interim Financial Statements as at June 30, 2018

Quarterly report on the effectiveness of internal control over financial reporting and disclosure for the period ended June 30, 2018

Update to Chapter A (Description of Company Operations) of the Periodic Report for 2017

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

Update to Chapter A (Description of Company Operations) [1]
to the Periodic Report for 2017 ("Periodic Report")
of "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company")

1. General development of the Group's business

Section 1.1 - Group activities and business development

Section 1.1.2 - Control of the Company - Eurocom Communications

On proceedings relating to the liquidation of Eurocom Communications - on April 22, 2018, an order of liquidation was issued for Eurocom Communications (which entered into force on May 3, 2018), where in the framework of the liquidation decision the Court stipulated that its ruling does not derogate from the control permit regarding the Company. The decision concerning the liquidation of Eurocom Communications has no implications for the Company's debentures and loans. See also the update to Section 2.17.4.

As far as the Company is aware, Internet Gold-Golden Lines Ltd. ("Internet Gold"), which is controlled by Eurocom Communications and controls B Communications, the controlling shareholder of the Company, is reviewing the sale of its holdings in B Communications. In accordance with an announcement made by Internet Gold on June 26, 2018, in order to enable the existence of a proper procedure for examining for the sale of its holdings (all or part thereof) in B Communications and to maximize the consideration for the sale, the special administrators of Eurocom Communication acceded to Internet Gold's request that subject to court approval (which was received) and that the procedure for the sale are underway, the special administrators will not conduct a procedure to sell the shares of Internet Gold for three months and will not take action to sell the controlling interest in Internet Gold during this period. The decision was submitted as notice to the court further to a previous proceeding on this matter. As far as the Company is aware, Internet Gold has begun the process of selling its holdings in B Communications. On this matter, see also immediate reports published by the Company on June 17, 2018, June 18, 2018, and June 26, 2018, which are included in this report by way of reference.

Section 1.1.3 - Shareholders' requests and Section 1.1.4 - Organizational structure - Bezeq Group (Composition of the Company's Board of Directors)

On April 26, 2018, the Annual General Meeting of the Company's shareholders elected a new board of directors comprising 2 new external directors (in addition to three external directors already serving the Company), 2 independent directors and 6 directors who are not necessarily independent directors (including one director from among the employees), so that at the date of publication of this report 13 directors serve the Company[2]. Furthermore, on April 30, 2018, the Company's Board of Directors resolved to elect Mr. Shlomo Rodav as Chairman of the Board. For the up-to-date composition of the Company's Board of Directors, see the report on the Company's officeholders dated August 1, 2018, included in this report by way of reference.

Section 1.1.5 - Mergers and acquisitions

On a debt of Eurocom DBS to the Company for advances paid by the Company on account of the Second Contingent Payment and a motion on this matter filed by the Company for the liquidation of Eurocom DBS - on April 22, 2018, the court issued an order of liquidation for Eurocom DBS and the Company's attorneys were appointed the liquidator of Eurocom DBS.

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[1] The update is further to Regulation 39A of the Securities Regulations (Periodic and Immediate Reports), 1970, and includes material changes or innovations that have occurred in the corporation in any matter which must be described in the periodic report. The update relates to the Company's periodic report for the year 2017 and refers to the section numbers in Chapter A (Description of Company Operations) in the said periodic report.

[2] On April 18, 2018, in the Company's response to a request from Entropy Corporate Governance Consulting Ltd. in the name of various shareholders, the Company's Board of Directors made it clear that it intends to operate to reduce the number of directors, and this no later than the next annual general meeting of the Company's shareholders. On this matter, see the Company's Immediate Report dated April 18, 2018, included here by way of reference.

Section 1.1.6 - Investigations by the Securities Authority and Israel Police

On the absence of complete information for the Company regarding the investigations and their impact on the Company, see Note 1.2 to the Company's consolidated financial statements for the period ended June 30, 2018.

Section 1.4 - Dividend distribution

For information about a dividend distribution in the amount of NIS 368 million in respect of profits in the second half of 2017 that was approved by the general meeting of the Company's shareholders on April 26, 2018 and distributed on May 10, 2018, and a recommendation by the Company's Board of Directors on August 22, 2018, concerning a dividend distribution in the amount of NIS 318 million in respect of profits in the first half of 2018, see Note 9 to the Company's financial statements for the period ended June 30, 2018.

Outstanding, distributable profits at the date of the report - NIS 613 million (surpluses accumulated over the last two years, after subtracting previous distributions).

Section 1.5.4 - Highlights of the operating results and figures

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

	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Revenues (NIS million)	1,064	1,063	1,047	1,061	1,058	1,078
Operating profit (NIS million)	387	473	470	492	496	513
Depreciation and amortization (NIS million)	211	204	185	186	177	180
EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million)(1)	598	677	655	678	673	693
Net profit (NIS million)	202	263	260	276	317	319
Cash flow from current activities (NIS million)(1)	507	516	587	573	465	600
Payments for investments in property, plant & equipment, intangible assets and other investments (NIS million)	393*	205	226	170	219	210
Proceeds from the sale of property, plant & equipment and intangible assets (NIS million)	22	7	22	46	16	10
Free cash flow (NIS million) (2)	107*	285	383	449	262	400
Number of active subscriber lines at the end of the period (in thousands)(3)	1,865	1,889	1,916	1,942	1,961	1,986
Average monthly revenue per line (NIS) (ARPL)(4)	52	53	53	54	54	56
Number of outgoing use minutes (millions)	1,010	1,055	1,068	1,132	1,098	1,177
Number of incoming use minutes (millions)	1,153	1,191	1,205	1,266	1,220	1,281
Total number of internet lines at the end of the period (thousands) (7)	1,662	1,653	1,635	1,608	1,593	1,580
The number of which provided as wholesale internet lines at the end of the period (in thousands) (7)	600	574	532	484	444	414
Average monthly revenue per Internet subscriber (NIS) - retail	93	92	92	90	90	90
Average bundle speed per Internet subscriber - retail (Mbps)(5)	55.4	53.5	51.5	49.5	47.2	45.1
Telephony churn rate (6)	2.8%	3.0%	2.4%	2.3%	2.4%	2.7%

(1) EBITDA (Earnings before income taxes, depreciation and amortization) is a financial index that is not based on generally accepted accounting principles. The Company presents this index as an additional index for assessing its business results since this index is generally accepted in the Company's area of operations which counteracts aspects arising from the modified capital structure, various taxation aspects and methods, and the depreciation period for fixed and intangible assets. This index is not a substitute for indices which are based on GAAP and it is not used as a sole index for estimating the results of the Company's activities or cash flows. Additionally, the index presented in this report is unlikely to be calculated in the same way as corresponding indices in other companies. Commencing January 1, 2018, the Company has early adopted IFRS 16 - Leases. The effect of applying this standard to EBITDA and to the cash flow from current activities was an increase of NIS 23 million, and NIS 26 million, respectively, in Q1 2018 and an increase of NIS 23 million and NIS 29 million, respectively, in Q2 2018.

(2) Free cash flow is a financial index which is not based on GAAP. Free cash flow is defined as cash from current activities less cash for the purchase/sale of property, plant and equipment, and intangible assets, net and as of 2018, with the application of IFRS 16, as described in par. (1) above, payments for leases are also deducted. The Company presents free cash flow as an additional index for assessing its business results and cash flows because the Company believes that free cash flow is an important liquidity index that reflects cash resulting from ongoing operations after cash investments in infrastructure and other fixed and intangible assets.

(3) Inactive subscribers are subscribers whose Bezeq lines have been physically disconnected (except for a subscriber during (roughly) the first three months of the collection process).

(4) Excluding revenues from transmission services and data communication, internet services, services to communications operators and contractor and other works. Calculated according to average lines for the period.

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

(6) The number of telephony subscribers (gross) who left Bezeq Fixed Line during the period divided by the average number of registered telephony subscribers in the period.

(7) Number of active Internet lines including retail and wholesale lines. Retail - Internet lines provided directly by the Company. Wholesale - Internet lines provided through a wholesale service to other communications providers.

(*) Including permit fee payments in the amount of NIS 112 million (75% of the requirement) and land appreciation tax of NIS 80 million for the sale of the Sakia property (on this matter, see also the update to Section 2.7.4).

B. Pelephone

	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Revenue from services (NIS million)	438	431	437	461	449	435
Revenue from sale of terminal equipment (NIS million)	164	188	214	174	183	193
Total revenue (NIS million)	602	619	651	635	632	628
Operating profit (NIS million)	2	2	15	22	30	5
Depreciation and amortization (NIS million)	159	158	90	100	99	94
EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million)(1)	161	160	105	122	129	99
Net profit (NIS million)	7	9	21	24	34	16
Cash flow from current activities (NIS million)(1)	181	239	86	209	193	117
Payments for investments in property, plant & equipment, intangible assets and other investments, net (NIS million)	90	69	76	78	82	73
Free cash flow (NIS million) (1)	41	95	10	131	111	44
Number of subscribers at the end of the period (thousands) (2) (5)	2,601	2,546	2,525	2,475	2,410	2,430
Average monthly revenue per subscriber (NIS) (ARPU) (3)	57	57	58	63	61	60
Churn rate (4)	7.3%	8.0%	6.9%	7.1%	6.3%	7.9%

(1) On the definition of EBITDA (earnings before income taxes, depreciation and amortization) and free cash flow, see comments (1) and (2) in the Bezeq Fixed Line table. Commencing January 1, 2018, the Company has early adopted IFRS 16 - *Leases*. The effect of applying this standard to EBITDA and to the cash flow from current activities was an increase of NIS 62 million, and NIS 75 million, respectively, in Q1 2018 and an increase of NIS 63 million and NIS 50 million, respectively, in Q2 2018.

(2) Subscriber data includes Pelephone subscribers (without subscribers from other operators hosted on the Pelephone network) and does not include subscribers connected to Pelephone services for six months or more but who are inactive. An inactive subscriber is one who in the past six months has not received at least one call, has not made one call / sent one SMS, performed no surfing activity on his phone or has not paid for Pelephone services. It is noted that a customer may have more than one subscriber number ("line"). In Q2 2018, 55,000 subscribers were added to Pelephone's subscriber listings, of which 40,000 are post-paid subscribers and 15,000 are prepaid subscribers. On changing the definition of prepaid subscribers from Q3 2018, see the update to Section 3.4.

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

(4) The churn rate is calculated at the ratio of subscribers who disconnected from the company's services and subscribers who became inactive during the period, to the average number of active subscribers during the period. The churn rate in Q2 2017 does not include the effect of the disconnection of 83,000 CDMA subscribers when the network was closed down.

(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.

C. Bezeq International

	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Revenues (NIS million)	336	352	379	367	407	384
Operating profit (NIS million)	30	34	41	39	45	49
Depreciation and amortization (NIS million)	45	43	35	34	33	33
EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million)(1)	75	77	76	73	78	82
Net profit (NIS million)	20	24	31	27	33	36
Cash flow from current activities (NIS million)(1)	54	67	82	74	69	52
Payments for investments in property, plant & equipment, intangible assets and other investments, net (NIS million)(2)	44	31	35	29	46	29
Free cash flow (NIS million) (1)	1	27	47	45	23	23
Churn rate (3)	6.0%	6.0%	6.8%	6.3%	5.0%	5.3%

(1) On the definition of EBITDA (earnings before income taxes, depreciation and amortization) and cash flows, see comments (1) and (2) in the Bezeq Fixed Line table. Commencing January 1, 2018, the Company has early adopted IFRS 16 - *Leases*. The effect of applying this standard to EBITDA and to the cash flow from current activities in Q1 and Q2 2018 is an increase of NIS 9 million each, for each quarter.

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

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

D. DBS

	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Revenues (NIS million)	375	375	404	406	416	424
Operating profit (NIS million)	(17)	(1)	27	35	49	52
Depreciation and amortization (NIS million)	79	79	72	72	71	70
EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million)(1)	62	78	99	107	120	122
Net profit (loss) (NIS million)	(10)	1	11	(123)	(151)	19
Cash flow from current activities (NIS million)(1)	60	86	95	115	169	51
Payments for investments in property, plant & equipment, intangible assets and other investments, net (NIS million)	75	62	53	69	52	60
Free cash flow (NIS million) (1)	(23)	16	42	46	117	(9)
Number of subscribers (at the end of the period, in thousands) (2)	582	580	587	597	603	608
Average monthly revenue per subscriber (ARPU) (NIS)(3)	215	214	226	226	229	232
Churn rate (4)	4.7%	6.1%	5.9%	4.8%	3.8%	4.3%

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

(2) Commencing January 1, 2018, the Company has early adopted IFRS 16 - *Leases*. The effect of applying this standard to EBITDA and to the cash flow from current activities in Q1 and Q2 2018 is an increase of NIS 8 million each, in each quarter.

(3) Subscriber - a single household or small business customer. In the case of a business customer with multiple reception points or a large number of decoders (such as a hotel, kibbutz, or gym), the number of subscribers is calculated by dividing the total payment received from the business customer by the average revenue from a small business customer. The number of subscribers was corrected retrospectively due to an insignificant change in the counting of subscribers among large customers.

(4) 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.

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

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

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

Pursuant to a preliminary HQ work, which included an initial review of certain synergies between the Company's subsidiaries and as part of a review of Bezeq Group's strategy and the alternatives available to it in light of changes in the communications market, regulatory requirements, technology developments and customer preferences, on May 23, 2018, the Company's Board of Directors resolved to review certain issues aimed at focusing on the Group's future core operations, including synergies between the activities of the Company's subsidiaries, the sale of the subsidiaries Bezeq Online Ltd. and Walla!, enhancing the independence of the Company's wholesale activity and establishing an innovation unit which will work to position the Company at the center of the future communications world. All this without derogating from the Company's continuing activity to eliminate the structural separation between it and each of the subsidiaries, as specified in Section 1.7.2.1 (B) in the Description of Company Operations chapter in the 2017 periodic report. This entails a review of various topics where certain alternatives are now being examined with the ministry of Communications, and the existence or non-existence of regulatory certainty could affect the preferred alternatives. As a continuation of this, the Company's Board of Directors is moving ahead in the formulation of a new, comprehensive strategic plan for the Group, parts of which are contingent on various regulatory approvals, and the Group has already begun to implement parts of it.

In this context, on August 22, 2018, the Board of Directors approved a request to obtain approval in principle from the Minister of Communications, to advance a move to change the Group's legal structure. This will enable the Company to continue to operate in its current format as a public company providing fixed-line, domestic carrier telecommunications services, and in parallel to establish a fully owned registered partnership to which the assets, licenses and activity of the subsidiaries, DBS, Pelephone and Bezeq International will be transferred and which will be fully separate, structurally, from the Company. The purpose of the change is to adapt the structure of the subsidiaries to prevailing technological, economic and competitive conditions in the telecoms market for the purpose of advancing the communications market in Israel and to allow Bezeq group to maintain a proper economic raison d'être for the benefit of its employees and the investors in its shares. Subject to the approval of the tax authority, this change will also enable losses to be offset from the entire Group's profits. This request does not imply any change in the Company's position with respect to cancellation of the structural separation.

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

Section 1.7.3.3 - Wholesale service use of physical infrastructures - on April 16, 2018, the Ministry of Communications announced that after reviewing the comments of the Company and an ISP (Partner), the Ministry has formulated its decision and it instructed, *inter alia*, that the Company must allow the service providers, through parties with the relevant security authorization, to insert communications cables through the Company's telecom manhole which is located at the opening of the conduit leading to private land, and to perform any necessary works in the manhole for this purpose, all this without derogating from the service providers' responsibility to obtain the landowner's permission. However, on August 9, 2018, the Ministry of Communications published a hearing concerning a "service portfolio allowing service providers to make mutual use of each other's passive infrastructures". The purpose of this service portfolio is to regulate implementation of the obligation to allow the use of passive infrastructures belonging to one domestic carrier by another domestic carrier (including infrastructure owners). This service portfolio will replace the service portfolio for the use of physical infrastructures which will be revised to include the dark fiber and optical wave services only (which are not subject to the obligation of mutual use). The draft service portfolio contains revised instructions, including with respect to the design stages, execution of the works, use of infrastructures on private land and deployment to buildings. In this context, the instruction stipulating that the connecting points will be in the passive infrastructure facilities belonging to the infrastructure owner, and that in order to connect the infrastructure of one domestic carrier to the infrastructure of another domestic carrier, it will set up a passive infrastructure facility (such as a telecom manhole) near the infrastructure owner's passive infrastructure facility, is replaced by an instruction that the connecting points between the infrastructures will be inside the infrastructure owner's passive infrastructure facility or in a facility belonging to another domestic carrier, as it chooses, and that the other domestic carrier will be able to install its communications components inside the infrastructure owner's passive infrastructure facility for the purpose of connecting the two infrastructures. This irrespective of whether it refers to the last manhole before the building or to a passive infrastructure component belonging to the infrastructure owner on private land. The draft portfolio also states that the infrastructure owner will allow another domestic carrier to insert cables through its last manhole before the building and conduits to the building, as far as the communications cabinet in the building or to any other physical infrastructure facility. The draft also includes an instruction according to which when new underground infrastructure is set up, an infrastructure owner that is obligated to provide universal deployment will offer the other domestic carries to share its investments in advance, and it will not be obligated to provide right of use to another infrastructure owner who is obligated to provide universal deployment but refused to do so, for three years. Also on August 9, 2018, an annex to the service portfolios of the Company and Hot were introduced which stipulate that other domestic carriers, infrastructure owners and contracting companies whose employees meet certain security requirements will be able to carry out work on the passive infrastructure of other domestic carriers and infrastructure owners. The draft portfolio further stipulates that access to information for design purposes must be available both in designated information rooms and by remote access.

Section 1.7.3.4 - Use of the Company's physical infrastructure by infrastructure owners - see 1.7.3.3 above. Additionally, on August 13, 2018, a hearing and draft regulations were published on determining the maximum payments for mutual use by infrastructure owners of access service to passive infrastructure so that based on the recommendations of the Economics Department from July 30, 2018, the Minister is considering determining that the tariff will be the same as for the payments currently defined in the Use Regulations for a domestic carrier which is a special general license holder. Notably, a letter attached to the hearing dated August 9, 2018, concerning the service portfolio described in the update to Section 1.7.3.3 states that the Ministry is considering not setting a maximum or minimum payment for service to be provided by other domestic carriers for which no payment was defined.

Section 1.7.3.5 - Wholesale telephony service - On June 5, 2018, the Ministry of Communications informed the Company that it will not extend the temporary arrangement relating to telephony service in resale format and that accordingly, as of August 1, 2018, the Company must provide wholesale telephony service in the format defined in the BSA + Telephony service portfolio ("the Service Portfolio") and that the Company must provide this service both as a stand-alone service and as a supplementary service to the BSA service.

Upon receiving this notice, the Company stipulated that it does not expect to meet the deadline specified in the notice, further to its previous clarifications that the service format in the service portfolio cannot be implemented technologically and that it requires the replacement of a switch which is a prolonged, complex process, and that it intends to ask the Ministry to find a solution for this problem.

After discussions with the Ministry, the Company offered, commencing August 1, 2018, telephony call minutes service and associated wholesale services in the wholesale market on the basis of the service portfolio in a technology format which is similar to the resale arrangement and with wholesale market tariffs. In parallel, the Company began the process of replacing the switch.

The Company believes that the implementation of wholesale telephony will adversely affect its financial results. However, at this time the Company is unable to estimate the extent of the impact, which could be significant, given that it depends on different variables, including the volume of demand for the service, the price levels of substitute products currently available on the market (such as VoB), etc.

Further to the Ministry of Communication's announcement dated October 19, 2017, that it intends to apply financial sanctions to the Company, on August 8, 2018 the Company received a "Supplementary Supervisory Report to the Final Supervisory Report Concerning Non-implementation of the Wholesale Telephony Service" as well as an "Updated Notice of its intention to apply financial sanctions concerning implementation of the broadband reform" ("the Updated Notice") in which the Ministry of Communications announced its intention to apply financial sanctions to the Company of NIS 11,327,540 (a similar amount to that stated in the Notice described in Section 1.7.3.5 to the 2017 Periodic Report). The notice further states that the Ministry intends to take additional enforcement measures if the breach continues. The Company has the right to present its arguments against the intention to apply financial sanctions and against the amount, within 30 days of the date of delivery of the Updated Notice.

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

Section 1.7.4.4(A) - Hearing about call center waiting times - on May 21, 2018, the Company, Pelephone and Bezeq International received an amendment to their licenses which will enter into force by March 21, 2019. The amendment to the licenses prescribes, among other things, provisions concerning the obligation to route calls on certain matters to a professional human response, call waiting times as well as provisions concerning call center work hours, the recording and documenting of calls and reporting obligations. On July 25, 2018, an amendment to the Consumer Protection Law was published which will become applicable one year from its publication. According to the amendment, the Company, Bezeq International, Pelephone and DBS are required to route customers' calls to a professional, human response within six minutes when dealing with calls about malfunctions, clarifying bills and terminating contracts. The amendment prescribes an instruction whereby if the license or other legislation prescribe instructions relating to the call response time, the regulator may instruct that a business is entitled to deviate from the defined call response time of six minutes. The Company is studying the implications of the amendments that could lead to an increase in the costs of operating the Group companies' call centers, and it is preparing to implement them.

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

Section 2.6.5 – Other competing infrastructures

With respect to the obligation for universal deployment by IBC - on February 27, 2018, the Ministry of Communications published a hearing concerning: "Changes in the obligation for nationwide deployment applicable to IBC", according to which the Ministry is considering amending IBC's license and changing the deployment obligation applicable to it. The Company submitted its opposition and stated that the reasons given by the Ministry for the change are erroneous and in any event do not justify granting the far-reaching relief being considered by the Ministry, and that the decisions considered in the hearing have ramifications for the Company and the structure of the domestic carrier market, and it therefore requested an opportunity to present its arguments orally as well.

On August 8, 2018, the Minister of Communications decision on the hearing was received. This followed a decision made by the government on August 5, 2018, granting the Minister of Communications discretion to determine the scope of IBC's deployment obligation in its license. Pursuant to this decision of the Minister of Communications, regulations will be drawn up for the activity of a special, general license holder (infrastructure) as a type of special, general license and wholesale operator that provides its services exclusively to license holders (or permit holders), similar to the domestic carrier infrastructure license ("the New License"). These regulations will allow IBC to apply for such a license, and subject to IBC's compliance with the conditions, will facilitate limiting the deployment obligation applicable to IBC so that it gradually reaches at least 40% of households in Israel within 10 years and only after the "Cherry Picking" period (which will last three years), will the New License holder be required to provide accessibility for at least one household in the periphery for every household provided with access in the center of the country.

Furthermore, on August 8, 2018, Cellcom reported that it had signed a Memorandum of Understanding (MOU) to acquire 70% of IBC's share capital. On this, see also an Immediate Report of Cellcom dated August 8, 2018.

At this time, the Company is unable to assess the impact of the updates on it and on its business, given that it is dependent on different variables and factors.

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

In April 2018, the Company launched its new router - Be. This is an advanced router with an innovative design and cutting-edge capabilities including, among others, smart Wi Fi which provides quality, continuous browsing on home Internet, cyber protection and preparation for a smart home. The router and services are managed by a designated application.

Section 2.7.4 – Real estate

Section 2.7.4.4 (sale of real estate) - on the entering into an agreement by the Company for the sale of the Sakia property to Naimi Towers Ltd. - on May 21, 2018, the Company received a demand for permit fees from the Israel Land Authority with respect to a property improvement plan approved prior to signing the agreement, in which the Company was required to pay NIS 148 million plus VAT ("the Demand"). The Company filed an objection to the Demand on legal grounds and it also intends to submit an objection appraiser grounds. On August 5, 2018, the Company received from the Or Yehuda Local Planning Committee a demand for payment of a betterment levy of NIS 143.5 million for the sale of the Property ("Demand for Betterment Levy"). The Company is studying the Demand for the Betterment Levy, including the issue of its obligation to pay all or part of the levy, in terms of its contractual relationships with the Israel Land Authority. Notably, the amount of the permit fee to be determined at the end of the proceedings could also affect the amount of the betterment levy that the Company will be required to pay the planning committee. If in the final outcome the Company is required to pay the full amount of the Demand for the Betterment Levy and the full sum of the Demand, then the capital gain to be recorded in its financial statements is expected to be NIS 250 million. The Company estimates that the permit fees and the betterment levy it will be required to pay will be lower and possibly even substantially lower than the total amount of the demands.

The information contained in this section relating to the Company's estimates and the capital gain resulting from the sale of the property is forward-looking information as this term is defined in the Securities Law, and it is based, *inter alia*, on the foregoing and on the Company's estimates of the costs of the transaction, various expenses of the Company in connection with the property and regarding the Company's arguments pertaining to payment of the Demand, while at this stage the Company is not in possession of all the arguments of the Israel Land Authority on these matters. The information may not fully materialize insofar as the Company's aforementioned estimates materialize differently than expected.

Section 2.9.3 - Early retirement plans

On May 23, 2018, the Company's Board of Directors approved an early retirement plan in 2018 at a cost of NIS 80 million, following a previous decision of the Board of Directors in March 2018, which approved early retirement at a cost of NIS 10 million in respect of the first quarter of 2018 (hereinafter together "the Retirement Plan"). The Retirement Plan is for the early retirement of 75 employees in accordance with the terms of the collective agreement between the Company and the Labor Union and the Histadrut from December 2006, as last amended in August 2015. On this matter, see also Note 15.1 to the Company's consolidated financial statements for the period ended June 30, 2018.

Section 2.9.5 - Officers and senior management in the Company

On changes in the composition of the Company's Board of Directors, see the update to sections 1.1.3 and 1.1.4.

On May 21, 2018, the general meeting of the Company's shareholders approved an amendment to the Company's compensation policy whereby the annual premium for insuring Directors and Officers (D&O) of the Company will not exceed USD 1 million, with a deductible of up to USD 1 million. Additionally, on August 12, 2018, a special general meeting of the Company's shareholders was convened for September 17, 2018. The agenda for this meeting will include a further amendment to the Company's compensation policy whereby the possibility of compensating the chairman of the Company's Board of Directors through a management company will be added, and the possibility of providing compensation for directors who are not external directors and are not independent directors will be added up to the maximum amount of compensation payable to an expert external director, as defined in the Fourth Schedule to the Companies Regulations (Rules for the Compensation and Expenses of External Directors), 2000.

On the term of office of the Company's CEO - the date on which the CEO, Mrs. Stella Handler, will cease to serve as CEO will be August 31, 2018, and on September 1, 2018, Mr. David Mizrachi, will take up office as CEO.

Section 2.11 – Working capital

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

Section 2.13.6 - Credit rating

On April 26, 2018, S&P Global Rating Maalot Ltd. affirmed the Company's ilAA rating and downgraded the rating outlook to negative. Furthermore, on April 30, 2018, Midroog affirmed the current Aa2.il rating for the Company's debentures (Series 6, 7, 9 and 10) with a stable outlook. On these and on the aforementioned rating reports, see Immediate Reports of the Company dated April 26, 2018 (Maalot) and April 30, 2018 (Midroog), included here by way of reference.

Section 2.16.1 - Control of Company tariffs

On May 23, 2018, the Ministry of Communications announced an update of the Company's tariffs stipulated in the regulations, effective from June 1, 2018, based on the update formula set out in the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Payments for Telecommunications Services), 2007, so that the tariffs for the services provided by the Company which are stipulated in the regulations will be reduced by 11.88%, except for the fixed monthly payment for the telephone line, which will remain unchanged. According to the Ministry's announcement and in the Company's estimate, the implications of this tariff change are an annual decline of NIS 16 million in the Company's revenues.

Section 2.16.7 – Antitrust Laws

Section 2.16.7.8 - On notice from the Antitrust Authority that it is considering determining that the Company abused its position and imposing sanctions on the Company and its CEO - on August 5, 2018, an oral hearing took place at the Antitrust Authority prior to which the Company and its CEO submitted their position in writing. The position submitted to the hearing included arguments and evidence that there had been no fault in the Company's actions and it had not breached the Antitrust Law, and there is therefore no reason to apply any enforcement powers by virtue of the law (including sanctions) and that the determination being considered should not be published. In this context, the Company and CEO pointed out, among other things, factual errors that were included in the Antitrust Authority's notice with respect to the methods of inserting cables in the conduits.

Section 2.16.10 – Consumer legislation

On the Consumer Protection Authority's requirement to provide documents on the description of the Company's cyber service in various advertisements - on May 10, 2018 the Company received notice of an intention to impose financial sanctions of NIS 243,000. The Company has the right to submit its arguments requesting cancellation of the intention to impose these sanctions. On August 6, 2018, the Company submitted its arguments in a request to cancel the Antitrust Authority's intention of imposing the financial sanctions in which it argued that the content of the publications is correct and that the Consumer Protection Authority's conclusions were erroneous.

Section 2.17.4 - Management agreement

On July 26, 2018, the Company's Board of Directors decided that the provision of all components of the services under the management agreement was discontinued de facto on April 25, 2018, the date that the Board of Directors in its new composition was appointed by the annual general meeting of the Company's shareholders; the amount due to Eurocom Communications from the Company by virtue of the management agreement for the period between January 1, 2018 and April 25, 2018, based on actual performance, was NIS 800,000; the amount based on the above calculation will not be paid to Eurocom Communications in practice, but will be offset against the debt of Eurocom Communications to the Company, similar to the other payments under the management agreement that were offset in the past. Accordingly, the Company informed the special administrators of Eurocom Communications of this decision. In response, they rejected the information in the Company's statement and in particular dismissed the existence of any debt towards the Company, the amount of the Company's debt towards Eurocom Communications and that the Company has any grounds for offsetting amounts. The Company rejected these arguments.

Section 2.18 – Legal proceedings

In April 2018, a motion was filed against the Company in the Tel Aviv District Court to certify a claim as a class action. The motion alleges that the Company is in breach of the prohibition prescribed in the Communications Law on sending advertisements ("spam"), in part by means of text messages to customers who contact it, which include a link to Bezeq's website. The petitioners estimate the amount of the class action at NIS 85 million, consisting of monetary loss (estimate of the loss for time wasted in dealing with the spam messages) and non-monetary loss due to mental anguish, causing a nuisance and so forth. Notably, a similar motion for the same matter (but for a later period) and in the amount of NIS 52 million was filed in March 2015 in the same court ("the Previous Motion") and on January 9, 2018 it was certified as a class action. The Company filed a motion for leave to appeal the decision and it is scheduled for a court hearing, with a stay of implementation. The present motion for certification was filed in respect of text messages sent by the Company after the Previous Motion was filed. Concurrently with the filing of the present motion, the petitioners also filed a motion to consolidate the hearing on the current motion with that of the Previous Motion.

In June 2018, a motion to disclose and inspect documents under Section 198(a) of the Companies Law was filed in the Tel Aviv District Court (Economics Department). In this motion, the court was asked to instruct the Company, DBS, the indirect controlling shareholder in the Company, Mr. Shaul Elovitch, and his son Mr. Or Elovitch (hereinafter together: "Messrs. Elovitch"), to submit to the petitioner, as a shareholder in the Company, various documents for the purpose of examining the possibility of filing a motion to certify a derivative claim on behalf of Bezeq. According to the petitioner, the controlling shareholder of Bezeq, B Com, and Messrs. Elovitch breached their duties of loyalty and fairness towards the Company in that the sale of 115 million Bezeq shares on February 2, 2016 by B Com while B Com and Messrs. Elovitch used inside information about the Company, and at a value significantly higher than the real value of the shares. The petitioner argues that this sale produced unlawful profits for B Com in the amount of NIS 313 million. The alleged inside information is that the financial statements of

DBS and the Company supposedly did not reflect the Company's de facto financial position, but rather a "free cash flow" that was allegedly inflated in order to increase the consideration in the transaction in which the Company acquired the shares of Eurocom Communications Ltd. (a company indirectly controlled by Mr. Shaul Elovitch) in DBS ("Yes Transaction"). Notably, there is another motion pending against the Company to certify a derivative claim in connection with the Yes Transaction (see Section 2.18(b) in the chapter Description of Company Operations in the 2017 Financial Statements and an update to the motion in this section), which is stayed due to the ISA's investigation. The petitioner contends in this current motion that despite the fact that its motion is based in part on the same factual background, it is different from the existing proceedings in this matter. In view of the ISA investigation, at this stage the response to this motion must be submitted by October 28, 2018.

Subsection B - On a motion to certify a derivative claim in connection with the transaction to purchase all the holdings and owners' loans of Eurocom DBS in DBS - a process that was stayed until July 15, 2018 due to the investigation. The Israel Securities Authority filed a motion in the court to continue to stay the proceedings in view of the investigation and to submit a revised notice by November 11, 2018. The court instructed the parties to respond to the motion. No decision has yet been made on this matter.

Subsection I - On two motions to certify class actions in relation to the Company's B144 service - on July 19, 2018, the Supreme Court resolved to dismiss the appeal that was filed against the decision to dismiss, *in limine*, the first motion (motion in the amount of NIS 1.11 billion), in view of the fact that no guarantee was deposited.

Subsection J - On two motions to certify a class action in connection with the agreement to purchase DBS - further to the Attorney General's request to extend the stay of proceedings in view of the Investigation, on May 2, 2018 the court approved a further stay of proceedings of four months. On August 21, 2018, the Attorney General requested that the court should receive another update by December 31, 2018, with respect to the possibility of advancing the process. The court has not yet issued its ruling on this matter.

Subsection K - par. (b) - motions to disclose documents in connection with the DBS - Spacecom transaction - on April 15, 2018, the court resolved to consolidate the four motions that had been filed on this matter. Subsequently, on June 24, 2018, the plaintiffs filed a consolidated and amended motion. Notably, on August 16, 2018, the motion for permission to appeal the decision on consolidation that was filed by one of the applicants in which he asked to cancel the consolidation decision and instruct that the other motions should be struck out, was dismissed. Additionally, further to a request by the Securities Authority, the proceeding was stayed until August 12, 2018. On August 21, 2018, the Securities Authority requested that the court should receive a further update by December 31, 2018, with respect to the possibility of advancing the process. The court has not yet issued its ruling on this matter.

Subsection K - par. (c) - an additional motion to disclose documents in connection with the agreement for the purchase of DBS and in connection with the DBS - Spacecom transaction - pursuant to the court's decisions from April 15, 2018 and April 24, 2018, the motion was struck out in view of the similarity with other existing motions on the same matter (motion to certify a derivative claim from March 2015, described in Section 2.18 B in the Chapter on the Description of Company Operations in the 2017 Financials, and four motions that were consolidated as detailed above with respect to par. (b)).

Subsection K - par. (d) - on a motion to disclose documents with respect to advance payments on account of the Second Contingent Consideration in the YES transaction - on April 17, 2018, the motion was struck out with the petitioner's agreement in view of the similarity with another motion on the same matter (motion to certify a derivative claim from March 2015, detailed in Section 2.18 B in the chapter on Description of Company Operations in the 2017 Financials).

Subsection L - on a motion to certify a class action that was filed in the USA in the name of shareholders in B Communications, among others against officeholders (past and present) in the Company and DBS - in July 2018, the respondents filed motions to dismiss the motion and claim *in limine*.

Subsection M - on a motion to certify a derivative claim against directors and the controlling shareholders in the Company in connection with a tax assessment agreement - at the request of the ISA, the proceeding was stayed until August 20, 2018 due to the ISA investigation. On August 21, 2018, the Securities Authority requested that the court receive another update by December 31, 2018, with respect to the possibility of advancing the process. The court has not yet issued its ruling on this matter.

A new legal proceeding against an investee company which is not a key operating segment (Walla) - in May 2018 an action was filed in the court against Walla, together with a motion for its certification as a class action. The motion alleges that on its website, Walla publishes "advertising-related articles" without due disclosure of the fact that they contain marketing content, and that the publication of marketing content without proper disclosure, as alleged, is, among other things, a breach of the provisions of the

Consumer Protection Law, violation of the Rules of Journalism Ethics, a tort and unjust enrichment. The petitioner estimates that the value of the loss caused to the class members is NIS 60 million.

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

Section 3.1 - General information about the area of operations

Section 3.1.8.1 - in April 2018, Marathon 018 (Xfone) began to operate (thus increasing the number of cellular telephony operators to six), further increasing competition in this sector.

Section 3.4 - Trade receivables

As noted in the Periodic Report, Pelephone has prepaid subscribers where the volume of revenues from these subscribers is not material to the Company's total revenue. Pelephone resolved to update the definition of an active subscriber so that its subscriber listing will no longer include IOT subscribers, and to add a separate reference for prepaid subscribers so that a prepaid subscriber will be included in the list of active subscribers from the date on which the subscriber loaded his device, and it will be removed from the list of active subscribers if no outgoing calls were made for six months or more. The change will enter into force in Q3 2018. As a result, 426,000 prepaid subscribers are expected to be written off Pelephone’s list of active subscribers at the beginning of the third quarter. On the date of the change, this writing off of prepaid subscribers is expected to result in an increase of NIS 11 in ARPU.

Section 3.8.2 - Frequency usage rights, and Section 3.19.3 G - Pelephone’s risk factors - Frequency spectrums

On July 3, 2018, Pelephone received notice from the Ministry of Communications that the 850 MHz frequency allocation used by Pelephone will expire on September 9, 2022. Instead Pelephone will receive the same bandwidth on frequencies in the 900 MHz spectrum, no later than March 22, 2021. The Ministry explained its decision by the need to designate use of the first giga spectrum to the region in which the State of Israel is located. The notice further stipulates that the format and timetable for making the replacement will be formulated by a joint professional team with representatives from the Ministry of Communications, the Ministry of Finance Budget Division and where necessary, also representatives of the relevant companies, including Pelephone. Pelephone will wait for the format and timetable to be formulated and it will work to exercise its rights in accordance with the law, respectively.

Furthermore, on July 12, 2018, the Ministry of Communications granted a temporary allocation of two bandwidths, each of 5 MHz on the 700 Mhz spectrum, to Partner and Hot Mobile. According to the Ministry’s notice dated May 17, 2018, the purpose of these temporary allocations is to facilitate technological deployment for the supply of advanced services and to streamline the integration of the relevant technologies using this frequency. This temporary allocation will be cancelled in accordance with the results of the tender to allocate additional frequency spectrums to the cellular companies, which is due for publication at the end of this year. Pelephone decided, for reasons of its own, not to request a temporary allocation on this frequency spectrum at this time.

Section 3.9.5 - Announcement of a labor dispute

On June 6, 2018, Pelephone received notice from the New General Federation of Labor - Cellular, Internet and High-Tech Workers Union (“Histradrut”), of a labor dispute in accordance with the Settlement of Labor Disputes Law, 1957 and a strike/stoppage commencing on June 21, 2018 onwards. According to the notice, the matters in the dispute are the intention to make organizational and structural changes in Pelephone, including a merger and consolidation of activities etc. with the Company and/or its subsidiaries, a demand by the employees' representatives to provide details and data on the planned organizational and structural changes and to hold the necessary consultations, and a demand to conduct negotiations for the signing of a collective labor agreement for the regulation of the rights of Pelephone's employees, including the subject of a safety net, following the aforementioned organizational and structural changes. At this stage, the Company and/or Pelephone are unable to assess the implications deriving from this Notice.

Notably, on June 27, 2018, Pelephone received notice from the Histadrut that the additional notice concerning a labor dispute dated January 31, 2018 regarding organizational and structural changes and regarding an expansion of services and outsourcing, is cancelled in view of agreements that were reached, and that the announcement of other labor disputes in Pelephone remain in force.

Section 3.16 – Legal proceedings

In April 2018, an action was filed against Pelephone in the Tel Aviv District Court together with a motion for its certification as a class action. The main subject of the action is the allegation that Pelephone markets and sells 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. The petitioners do not explicitly state the amount of the action against the respondent, but estimate that the value of the loss caused to each class member by the inability to cancel the repair service before the end of the commitment period is hundreds of shekels each year for each class member.

Section 3.16.1 H - on a claim and motion for its certification as a class action which was filed against Pelephone in the Nazareth District Court, alleging that Pelephone 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 retroactively when they purchase a web-browsing package and after accumulating a debt for the surfing services. The plaintiff argues that Pelephone therefore practices unjust enrichment. On June 6, 2018, the court approved the plaintiff's abandonment of the motion for certification as a class action, struck out the motion, dismissed the plaintiffs' personal claim and instructed that the proceeding be closed without an order for legal costs.

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

Section 4.8 – Human resources

On a collective labor agreement dated January 12, 2016 between Bezeq International and the New Histadrut Labor Federation and the workers committee of Bezeq International - on May 15, 2018, the validity of the agreement was extended for an additional year, until December 31, 2019.

Further to reports in relation to announcements in January 2018 regarding labor disputes in the Company and Pelephone with respect to the possible transfer of control in the Company (Sections 2.9 and 3.9 in the Periodic Report for 2017), it is noted that on that date, Bezeq International received similar notice.

On May 31, 2018, Bezeq International received notice from the New General Federation of Labor ("Histradrut") - Cellular, Internet and Hitech Workers' Union, of a labor dispute in accordance with the Settlement of Labor Disputes Law, 1957 and a strike commencing on June 15, 2018. According to the notice, the matters in the dispute are the intention to make organizational and structural changes in Bezeq International, including a merger and consolidation of activities, etc. with the Company and/or the Company's subsidiaries, a demand by the employees' representatives to provide details and data on the planned organizational and structural changes and to hold the necessary consultations, and a demand to conduct negotiations for the signing of a collective labor agreement for regulation of the rights of Bezeq International's employees, including the subject of a safety net, following the aforementioned organizational and structural changes.

Section 4.13 – Legal proceedings

Subsection B - on a claim and motion for its recognition as a class action with respect to content filtering services - in April 2018, the court approved part of the action as a class action (the part relating to additional compensation of NIS 1,000 for each of the students using the website filtering software was struck out). Additionally, Bezeq International's service provider was removed from the proceeding.

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

Section 5.1.2 - Legislation, restrictions and special constraints in the segment of operations

Bill for the regulation of content providers - in July 2018, a Memorandum of the Communications (Telecommunications and Services) (Regulation of Content Providers) Law, (Amendment no. __), 2018, ("the Memorandum"), was published. According to the Memorandum, the purpose of and need for the Bill are changes in the format of regulations in the multi-channel television market and adapting it to technological developments so that they will apply to the providers of audio-visual content that transmit content to the Israeli public, from a certain volume of revenues, unrelated to the type of technology used for transmitting the content, while encouraging competition and reducing the regulatory burden. At this initial stage, DBS is unable to estimate the overall ramifications stemming from the Memorandum. It is stipulated that the legislative process is still in its early stages and there is no certainty that the Memorandum will develop into binding legislation in its proposed version or at all.

Section 5.8.2 - Terminal satellite equipment

In April 2018, Altech, the manufacturer of Zapper HD decoders and 4K PVR decoders which DBS purchases from Draco and OSI, announced its intention of discontinuing its decoder manufacturing activity in November 2018, and in May 2018 it announced that it will not supply some of the existing orders of decoders to Draco and OSI.

In July 2018, an agreement was signed between DBS, Altech, Draco and OSI (to which a corporation that indirectly controls Altech added a "backup" undertaking for the obligations of Altech) which includes, among other things, regulation of the transfer of intellectual property rights in connection with the Zapper HD decoders and 4K PVR decoders to DBS and substitute manufacturer/s as well as an additional undertaking by Altech in connection with the aforementioned decoder orders and the commencement of the manufacture of these decoders by the substitute manufacturer/s. The agreement also cancels the previous supply agreements for decoders of these models and includes a general and reciprocal waiver by the parties of arguments and claims in connection with the two aforementioned decoder models and their supply agreements.

Additionally, in July 2018, DBS signed two supply agreements between DBS, an alternative set-top box (STB) manufacturer (Skardin Industrial Corp. - "Skardin"), and OSI. Under these agreements, Skardin will manufacture and OSI will import, sell and supply to DBS, Zapper HD decoders and 4K PVR decoders as a substitute for Altech's production.

The deployment in this section concerning the expected discontinuation of Altech's manufacturing activity with respect to DBS's requirements until decoders can be obtained from a substitute manufacturer and with respect to the losses that DBS might sustain, if and to the extent that there is no continuous supply of the decoders, is forward-looking information according to its definition in the Securities Law, which is based, inter alia, on the information provided to DBS by Altech, Skardin, Draco and OSI, and on DBS's assessments with respect to its requirements and the feasibility of Skardin actually manufacturing the decoders, as well as with respect to the estimated timing of the sale and supply of these alternative decoders to DBS by Draco and OSI. Consequently, these estimates may not materialize, or may materialize differently than expected, in part depending on conditions relating to Altech (including its ability to meet its undertakings in connection with the assistance for the substitute manufacturer and transfer of the intellectual property), Skardin, Draco and OSI, and the conditions that could affect the materialization and timing of the chain of supply and manufacture of the decoders, as well as the needs of the market in which DBS operates.

Section 5.8.5 - Operating and encryption systems

In May 2018, Cisco informed DBS of the sale of its activity for serving multi-channel providers to a third party, where according to publications by Cisco, this transaction has been signed but not yet completed. DBS is reviewing the significance of this announcement, taking note of its agreements with Cisco and its relevant activity.

Section 5.10.2

On August 7, 2018, DBS signed a long-term agreement with the Sports Channel Ltd. ("Sports Channel") in which the Sports Channel will provide DBS with channels produced by it as well as other channels that it will produce in the future, including for broadcasting on OTT platforms.

The consideration to which the Sports Channel will be entitled is based mainly on a fixed monthly payment in accordance with the number of subscribers to DBS broadcasts.

Notably, DBS also has a long-term agreement with Charlton Ltd. ("Charlton") in which Charlton will provide DBS with the sports channels that it produces, including for broadcasting on OTT platforms. The consideration to which Charlton is entitled is fixed payment based on the number of subscribers to the channels, but will not be less than a defined amount.

Section 5.11 – Human resources

On August 1, 2018, the CEO of Pelephone, Mr. Ran Guron, took up office as the CEO of DBS (in addition to his position as the CEO of Pelephone), replacing Mr. Ron Eilon.

Section 5.11.3 - Benefits and the nature of employment agreements

In June 2018, the National Labor Federation declared a labor dispute. According to the Federation's announcement, the issues in dispute are the intention to make organizational and structural changes in DBS, including a merger and consolidation of operations with the Company or with its subsidiaries, a lack of good faith reflected by not providing information and actually implementing structural changes without conducting the required consultation and negotiations as required by law within the framework of the collective labor dialog.

Section 5.15.10 - Regulation of the transmission of video content via the Internet

On a memorandum relating to the application of regulations to the providers of audio-visual content in Israel, see the update to Section 5.1.2.

Section 5.16.2 - Space segment leasing agreement

Footnote 71 - in June 2018, Spacecom announced that the date for payment of the consideration under the agreement it engaged in for the manufacture of the Amos 8 satellite had been extended until September 25, 2018.

Section 5.16.4 - Space segment leasing agreement

In April 2018, a space segment leased by DBS was replaced following an amendment to the 2017 agreement.

In April 2018, Spacecom announced that it had received a letter from a government entity whereby "government entities intend to take action to launch and operate a communications satellite through Israel Aerospace Industries to a point in the sky at 4^0W (Israel's national air space), consistent with their requirements". Spacecom further noted that it is unable to estimate the feasibility and chances of launching this satellite. In July 2018, Spacecom announced that it is continuing to examine several options for building Amos 8, including possible cooperation with the Israeli government. Any delay in positioning the Amos 8 satellite will have repercussions for DBS with respect to the number of space segments available to it and in view of the fact that beyond the period in which it was agreed that the space segments would be leased from just one satellite, there will be an additional period.

Section 5.17 – Pending legal proceedings

Subsection A - motion to certify a class action relating to electricity consumption by the broadcasting equipment on apartment buildings that belongs to DBS - on July 31, 2018, the court approved conducting the action as a class action and it determined that there are ostensible grounds for representatives of the apartments in the buildings in which the representatives signed any forms in which there is no explicit agreement, to pay the cost of a monthly charge for communal electricity consumption by the broadcasting equipment.

Subsection C - allegation regarding discrimination of DBS customers - in its decision dated March 27, 2018, on motions to approve procedural arrangements, the court ruled that proceedings against all the communications companies, including the television companies and the motions against DBS, will be heard jointly and it established court proceedings for clarifying the motions for certification. Furthermore, and after the parties to the proceeding submitted their summaries to the court, on July 11, 2018, a hearing took place on all the motions for certification against all the communications companies, in which the court recommended that the plaintiffs should consider withdrawing from the motions for certification with compensation, and it ruled that to the extent that no recommendation is received by September 2018, the court will rule on the motions for certification.

Subsection D - claim concerning the automatic renewal of fixed-period transactions while charging customers unilaterally and without their consent - in May 2018, in accordance with a court ruling, the compromise settlement reached by the parties and the motion for its certification were published in the press and on the Internet. According to the main points of the settlement, DBS will open a designated channel for those entitled to the benefit for three months.

Subsection F - class action on the discontinuation of broadcasts of the Children's Channel - on April 11, 2018, the Council informed the applicant in response to her request that it rejects her arguments whereby there is a period in which no worthy alternative was provided for the discontinued Children's Channel. On May 28, 2018, the applicant's attorney filed an "agreed motion to strike out the motion for certification" and on that same day, the court issued its ruling in which it determined that the applicant must file a motion for abandonment in accordance with Section 16 of the Class Actions Law. Subsequently, on July 13, 2018, a court ruling was issued in which, if the applicant does not file a motion for abandonment by July 31, 2018, the court will consider setting a date for a hearing and charging the applicant costs. On August 19, 2018, the court issued its ruling in which the applicant failed to act in accordance with the court's decision of May 28, 2018, and a hearing was scheduled for December 31, 2018.

Subsection H - On a motion to certify a class action in connection with a transaction between the Company and Eurocom DBS Ltd. - see the update to Section 2.18 J.

Subsection I - on various motions to disclose documents prior to filing a motion for certification of a derivative claim under Section 198(a) of the Companies Law, which was filed subsequent to the ISA investigation, see the update to Section 2.18 K.

Subsection J - on a motion to certify a class action which was filed in the USA - see the update to Section 2.18 L.

August 22,2018	
Date	"Bezeq" The Israel Telecommunication Corporation Ltd.

Names and titles of signatories:
Shlomo Rodav, Chairman of the Board of Directors
Stella Handler, CEO

Chapter B -
Board of Directors' Report on the State of the Company's Affairs for the Period Ended June 30, 2018

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

We hereby present the Board of Directors' report on the state of affairs of "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company") and the consolidated Group companies (the Company and the consolidated companies, jointly - "the Group"), for the six months ended June 30, 2018 ("Six Months") and the three months then ended ("Quarter").

The Board of Directors' report includes a condensed review of its subject-matter, and was prepared assuming the Board of Directors' report of December 31, 2017 is also available to the reader.

For information concerning the Israel Securities Authority and the Israel Police's investigation, see Note 1.2 to the financial statements.

The auditors have drawn attention to the matter in their opinion of the financial statements.

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

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

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

The Group's results were as follows:

	1-6.2018	1-6.2017	Increase (decrease)		4-6.2018	4-6.2017	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%
Profit	455	708	(253)	(35.7)	195	358	(163)	(45.5)
EBITDA (operating profit before depreciation and amortization)	1,895	1,991	(96	(4.8)	908	997	(89)	(8.9)

Profit was down in the present Quarter, as compared to the same quarter last year, mainly due to a decrease in revenues across all Group segments, as well as an increase in other operating expenses, net in the Domestic Fixed-Line Communications segment.

EBITDA in the present Quarter was significantly affected by early adoption of IFRS 16 - Leases starting January 1, 2018 (see Note 3.1 to the financial statements).

1. The Board of Directors' explanations on the state of the Company's affairs, the results of its operations, equity, cash flows, and additional matters

1.1 Financial position

	June 30, 2018 NIS millions	June 30, 2017 NIS millions	Increase (decrease) NIS millions	%	Explanation
Cash and current investments	2,599	1,873	726	38.8	The increase was attributable to current investments in the Domestic Fixed-Line Communications segment, including through receipt of loans. For more information, see Section 1.4 - Cash Flows, below.
Current and non-current trade and other receivables	2,557	2,845	(288)	(10.1)	The decrease was mainly attributable to the Cellular Communications segment, due to a decrease in trade receivables following a decrease in revenues from installment-based handset sale and a decrease in other accounts receivable.
Eurocom D.B.S.	25	56	(31)	(55.4)	The Company has updated, as of March 31, 2018, the fair value of the amount expected to be repaid to the Company from overpayment of advances for the second contingent consideration for the purchase of DBS's shares and loans. This amount has been updated to NIS 25 million. See Note 4.2.1 to the financial statements.
Inventory	96	105	(9)	(8.6)	
Broadcasting rights	467	456	11	2.4	
Usage right assets	1,424	-	1,424	-	Following early adoption of IFRS 16 - Leases ("IFRS 16"), the Group has recognized a usage right asset for agreements in which the Group is the lessee. See Note 3.1 to the financial statements
Property, plant and equipment	6,811	6,868	(57)	(0.8)	
Intangible assets	2,687	2,943	(256)	(8.7)	The decrease was mainly due to depreciation of excess costs for intangible assets recorded upon assuming control of DBS, and impairment of DBS's goodwill to the amount of NIS 87 million in the fourth quarter of 2017.
Deferred tax assets	1,035	1,015	20	2.0	
Deferred costs and non-current investments	530	457	73	16.0	The increase was due to an increase in net subscriber acquisition asset balances.
Investment property	130	-	130	-	Payment of permit fees for the Sakia property (see Note 7 to the financial statements).
Total assets	18,361	16,618	1,743	10.5	

1.1. Financial Position (Contd.)

	June 30, 2018	June 30, 2017	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	
Debt to financial institutions and debenture holders	12,000	11,519	481	4.2	Receipt of loans in the Domestic Fixed-Line Communications segment, offset by loan and debenture repayments in the Domestic Fixed-Line Communications and Multi-Channel Television segments.
Liabilities for leases	1,451	-	1,451	-	Following early adoption of IFRS 16, the Group recognized liabilities for leases. See Note 3.1 to the financial statements.
Trade and other payables	1,583	1,608	(25)	(1.6)	
Employee benefits	636	577	59	10.2	The increase was mainly due to a NIS 90 million provision for an early retirement plan in 2018 in the Domestic Fixed-Line Communications segment, offset by payments for previous plans. See Note 15.1 to the financial statements.
Current tax liabilities	-	112	(112)	(100)	The decrease was due to an income tax payment under a final tax assessment agreement for 2011-2014, and an advance on a betterment tax payment following the sale of the Sakia property.
Other liabilities	434	477	(43)	(9.0)	
Total liabilities	16,104	14,293	1,811	12.7	
Total equity	2,257	2,325	(68)	(2.9)	Equity comprises 12.3% of the balance sheet total, as compared to 14.0% of the balance sheet total on June 30, 2017.

1.2 Results of operations

1.2.1 Highlights

	1-6.2018	1-6.2017	Increase (decrease)		4-6.2018	4-6.2017	Increase (decrease)		
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	Explanation
Revenues	4,694	4,916	(222)	(4.5)	2,333	2,463	(130)	(5.3)	The decrease was due to lower revenues in the Group's core segments, excluding the Domestic Fixed-Line Communications segment, where revenues remained stable.
General and operating expenses	1,679	1,932	(253)	(13.1)	838	973	(135)	(13.9)	The decrease was mainly due to early adoption of IFRS 16 - Leases, starting January 1, 2018, whereby rent expenses, associated with properties rented under operating leases, are recognized as assets. See Note 3.1 to the financial statements.
Salaries	1,013	998	15	1.5	503	494	9	1.8	The increase was mainly attributable to the Domestic Fixed-Line Communications segment.
Depreciation and amortization	1,062	852	210	24.6	537	424	113	26.7	The increase was mainly due to depreciation of usage right assets following the early adoption of IFRS 16. See Note 3.1 to the financial statements.
Other operating expenses (income), net	107	(5)	112	-	84	(1)	85	-	The change was attributable to the Domestic Fixed-Line Communications segment, mainly following recognition of expenses for employment termination by way of early retirement.
Operating profit	833	1,139	(306)	(26.9)	371	573	(202)	(35.3)	
Finance expenses, net	218	203	15	7.4	110	102	8	7.8	The increase in net finance expense was mainly attributable to the Domestic Fixed-Line Communications segment, and was offset by lower expenses in the Multi-Channel Television segment. Expenses were also affected by early adoption of IFRS 16.
Share in losses of investees	2	4	(2)	(50.0)	1	2	(1)	(50.0)	
Income tax	158	224	(66)	(29.5)	65	111	(46)	(41.4)	The decrease was due to a reduction in taxable income, and a reduction in the corporate tax rate from 24% to 23% starting 2018.
Profit for the period	455	708	(253)	(35.7)	195	358	(163)	(45.5)	

1.2.2 Operating segments

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

	1-6.2018		1-6.2017		4-6.2018		4-6.2017	
	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues
Revenues by operating segment								
Domestic Fixed-Line Communications	2,127	45.3	2,136	43.4	1,064	45.6	1,058	43.0
Cellular Communications	1,221	26.0	1,260	25.6	602	25.8	632	25.7
International Communications, Internet and NEP Services	688	14.7	791	16.1	336	14.4	407	16.5
Multi-Channel Television	750	16.0	840	17.1	375	16.1	416	16.9
Other and offsets	(92)	(2.0)	(111)	(2.3)	(44)	(1.9)	(50)	(2.0)
Total	4,694	100	4,916	100	2,333	100	2,463	100

	1-6.2018		1-6.2017		4-6.2018		4-6.2017	
	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues
Operating profit by segment								
Domestic Fixed-Line Communications	860	40.4	1,009	47.2	387	36.4	496	46.9
Cellular Communications	4	0.3	35	2.8	2	0.3	30	4.7
International Communications, Internet and NEP Services	64	9.3	94	11.9	30	8.9	45	11.1
Multi-Channel Television	(18)	(2.4)	101	12.0	(17)	(4.5)	49	11.8
Other and offsets	(77)	-	(100)	-	(31)	-	(47)	-
Consolidated operating profit/ percentage of Group revenues.	833	17.7	1,139	23.2	371	15.9	573	23.3

1.2.2 Operating segments (contd.)

B. Domestic Fixed-Line Communications Segment

	1-6.2018	1-6.2017	Increase (decrease)		4-6.2018	4-6.2017	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Fixed-line telephony	**593**	654	(61)	(9.3)	**291**	320	(29)	(9.1)	The decrease was due to lower average revenues per phone line and a decrease in the number of lines.
Internet - infrastructure	**799**	763	36	4.7	**403**	381	22	5.8	The increase was mainly due to growth in the number of internet subscribers through the wholesale service and higher ARPU (retail), offset by a decline in the number of retail internet subscribers.
Transmission, data communications and others	**607**	606	1	0.2	**304**	300	4	1.3	
Digital and cloud services	**128**	113	15	13.3	**66**	57	9	15.8	The increase was attributable, among other things to IP Centrex and cyber services.
Total revenues	**2,127**	2,136	(9)	(0.4)	**1,064**	1,058	6	0.6	
General and operating expenses	**285**	331	(46)	(13.9)	**145**	166	(21)	(12.7)	The decrease was mainly due to a decrease in vehicle leasing and building leasing expenses recognized as an asset following early adoption of IFRS 16.
Salaries	**460**	444	16	3.6	**232**	220	12	5.5	The increase was mainly due to salary raises pursuant to collective labor agreements, partially offset by employee retirement.
Depreciation and amortization	**415**	357	58	16.2	**211**	177	34	19.2	The increase was mainly due to depreciation of usage right assets following early adoption of IFRS 16, starting January 1, 2018.
Other operating expenses (income), net	**107**	(5)	112	-	**89**	(1)	90	-	The transition to net expenses was mainly due to NIS 90 million in expenses recognized for employment termination by way of early retirement, of which NIS 80 million were recognized in the present Quarter (see Note 15.1 to the financial statements), and a decrease in capital gains.
Operating profit	**860**	1,009	(149)	(14.8)	**387**	496	(109)	(22.0)	
Finance expenses, net	**240**	174	66	37.9	**119**	82	37	45.1	The increase in net financing expenses was mainly due to NIS 18 million in finance expenses recognized in the Six Months following a decrease in the fair value of the amount expected to be repaid to the Company from the overpayment of advances on the second contingent consideration for the acquisition of DBS's shares and loans (see Note 4.2.1 to the financial statements), as compared to a NIS 27 million reduction in expenses in the same quarter last year. Results were also affected by increased interest expenses on loans.
Taxes on income	**155**	199	(44)	(22.1)	**66**	97	(31)	(32.0)	The decrease was due to a reduction in taxable income, and a reduction in the corporate tax rate from 24% to 23% starting 2018.
Segment profit	**465**	636	(171)	(26.9)	**202**	317	(115)	(36.3)	

1.2.2 Operating segments (contd.)

C. Cellular Communications segment

	1-6.2018 NIS millions	1-6.2017 NIS millions	Increase (decrease) NIS millions	Increase (decrease) %	4-6.2018 NIS millions	4-6.2017 NIS millions	Increase (decrease) NIS millions	Increase (decrease) %	Explanation
Services	869	884	(15)	(1.7)	438	449	(11)	(2.4)	Subscriber growth stemmed the erosion in revenues seen in recent years. Increased revenue from subscriber growth was offset by lower ARPU, following existing subscribers' transition to cheaper plans offering greater bandwidth at current market prices.
Equipment sales	352	376	(24)	(6.4)	164	183	(19)	(10.4)	The decrease was mainly due to lower sales volumes. The decrease in the Six Months was also due to cancellation of the purchasing tax on imported cellular handsets, which lowered prices. This decrease was offset by an greater income per unit, following a change in the product mix.
Total revenues	1,221	1,260	(39)	(3.1)	602	632	(30)	(4.7)	
General and operating expenses	705	839	(134)	(16.0)	346	409	(63)	(15.4)	The decrease was mainly due to a reduction in leasing expenses following early adoption of IFRS 16, and a decrease in the cost of sales for handsets. The decrease was partially offset by increased call completion fees and estimate updates which resulted in lower expenses in the same quarter last year.
Salaries	195	193	2	1.0	95	94	1	1.1	
Depreciation and amortization	317	193	124	64.2	159	99	60	60.6	The increase in expenses was mainly due to an increase in expenses from depreciation of usage right assets following early adoption of IFRS 16 starting January 1, 2018, and an increase in expenses from depreciation of subscriber acquisition assets. On the other hand, there was a decrease in expenses from depreciation of property, plant and equipment and other assets.
Operating profit	4	35	(31)	(88.6)	2	30	(28)	(93.3)	
Finance income, net	17	28	(11)	(39.3)	6	14	(8)	(57.1)	The decrease in net finance income was mainly due to an increase in finance expenses recognized following early adoption of IFRS 16.
Income tax	5	13	(8)	(61.5)	1	10	(9)	(90.0)	
Segment profit	16	50	(34)	(68.0)	7	34	(27)	(79.4)	

1.2.2 Operating segments(contd.)

D. International Communications, Internet and NEP Services

	1-6.2018	1-6.2017	Increase (decrease)		4-6.2018	4-6.2017	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Revenues	688	791	(103)	(13.0)	336	407	(71)	(17.4)	The decrease was mainly due to a reduction in revenue from telecom solution sales to businesses and PBXs, and lower revenues from hubbing and international calls following increased adoption of substitute software products.
General and operating expenses	377	465	(88)	(18.9)	187	247	(60)	(24.3)	The decrease was mainly due to a reduction in the cost of sales for telecom solutions for businesses and PBXs, and lower hubbing and international call expenses, corresponding to revenues as aforesaid. Furthermore, leasing expenses were down, following adoption of IFRS 16.
Salaries	158	165	(7)	(4.2)	75	81	(6)	(7.4)	The decrease was due to the sale of outsourced operations during the period.
Depreciation and amortization	88	66	22	33.3	45	33	12	36.4	The increase was due to depreciation of usage right assets following adoption of IFRS 16 starting January 1, 2018, and an increase in depreciation of the subscriber acquisition asset.
Other finance expenses (income)	1	1	-	-	(1)	1	(2)	-	
Operating profit	64	94	(30)	(31.9)	30	45	(15)	(33.3)	
Finance expenses, net	7	3	4	-	4	1	3	-	The increase was due to adoption of IFRS 16, and changes in foreign currency rates.
Tax expenses	13	22	(9)	(40.9)	6	11	(5)	(45.5)	
Segment profit	44	69	(25)	(36.2)	20	33	(13)	(39.4)	

1.2.2 Operating segments (contd.)

E. Multi-Channel Television

	1-6.2018 NIS millions	1-6.2017 NIS millions	Increase (decrease) NIS millions	Increase (decrease) %	4-6.2018 NIS millions	4-6.2017 NIS millions	Increase (decrease) NIS millions	Increase (decrease) %	Explanation
Revenues	750	840	(90)	(10.7)	375	416	(41)	(9.9)	The decrease was mostly due to a decrease in the subscriber base and a decrease in ARPU. These were offset by revenue from content sales.
General and operating expenses	492	480	12	2.5	252	237	15	6.3	The increase was mainly due to an update to the provision for legal actions.
Salaries	118	118	-	-	61	59	2	3.4	
Depreciation and amortization	158	141	17	12.1	79	71	8	11.3	The increase was mainly due to depreciation of usage right assets following early adoption of IFRS 16.
Operating profit (loss)	(18)	101	(119)	-	(17)	49	(66)	-	
Finance expenses (income), net	(10)	59	(69)	-	(7)	32	(39)	-	The change was mostly due to a change in the fair value of financial assets, and a decrease in financing expenses on debentures following conversion of the Company's share in the debentures to equity.
Tax expenses	1	174	(173)	(99.4)	-	168	(168)	(100)	The decrease in tax expenses was due to depreciation of the tax asset in the same quarter last year, following a change in expected profitability as a result of changes in Management expectations concerning the scope and severity of competition in the television market.
Segment loss	(9)	(132)	123	(93.2)	(10)	(151)	141	(93.4)	

1.3 Cash flow

	1-6.2018	1-6.2017	Increase (decrease)		4-6.2018	4-6.2017	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Net cash from operating activities	1,715	1,701	14	0.8	806	875	(69)	(7.9)	Due to reclassification of payments on leases as financing activity following early adoption of IFRS 16 (see Note 3.1 to the financial statements), net cash from operating activities grew by NIS 207 million in the Six Months, and by NIS 89 million in the Quarter. The bulk of this increase was attributable to the Cellular Communications segment. The increase was offset by a decrease in net cash in the Multi-Channel Television segment following a decrease in cash profits, and in the Quarter - also due to changes in working capital and a decrease in net cash in the Six Months in the Domestic Fixed-Line Communications segment, which includes an increase in tax payments on final tax assessments. In the Quarter - cash flows were also affected by a decrease in net cash in the Cellular Communications segment due to changes in working capital and a decrease in net profits as well as an increase in net cash in the Domestic Fixed-Line Communications segment following changes in working capital.
Net cash from (used in) investing activities	(2,311)	(199)	(2,112)	-	(860)	174	(1,034)	-	The increase in net cash used in investing activities was due to net investment in bank and other deposits in the Domestic Fixed-Line Communications segment, while in the same quarter last year, only proceeds were recorded from redemption of bank deposits. Furthermore, in the present Quarter, permit betterment tax fees were paid on the sale of the Sakia complex, to a total amount of NIS 192 million (see Note 7 to the financial statements).
Net cash from (used in) financing activities	(662)	(296)	(366)	-	(849)	13	(862)	-	Net cash used in financing activities was up due to a decrease in cash flows from debenture issuance and receipt of loans, offset by a decrease in debenture and loan repayments in the Domestic Fixed-Line Communications segment. Furthermore, data for the present Quarter and Six Months include principal and interest payments on leases classified as financing activities and not as operating activities, as aforesaid. On the other hand, overall dividend payouts decreased as compared to the same period and quarter last year, and the six month period of last year also included payments to Eurocom DBS for the purchase of DBS's shares and loans.
Net increase (decrease) in cash	(1,258)	1,206	(2,464)	-	(903)	1,062	(1,965)	-	

1.3. Cash Flows (contd.)

Average volume in the reporting Period:

Long-term liabilities (including current maturities) to financial institutions and debenture holders:

NIS 12,043 million.

Supplier credit: NIS 985 million. Short-term credit to customers: NIS 1,848 million. Long-term credit to customers: NIS 377 million.

Working Capital

As of June 30, 2018, the Group had a working capital surplus of NIS 555 million, as compared to a working capital surplus of NIS 1,297 million on June 30, 2017.

According to its separate financial statements, the Company had a working capital surplus of NIS 490 million as of June 30, 2018, as compared to a working capital surplus of NIS 776 million on June 30, 2017.

The decrease in the Group's working capital surplus was mainly due to current maturities on liabilities for leases which were recognized starting January 1, 2018, following early adoption of IFRS 16 (see Note 3.1 to the financial statements). There was also an increase in current liabilities for debentures and loans, and a decrease in trade receivables and cash balances, offset by an increase in current investments.

2. Disclosure Concerning the Company's Financial Reporting

2.1 Disclosure on the early adoption of IFRS 16 - Leases

Following publication of IFRS 16 - Leases ("the Standard"), the Company reviewed the Standard's possible impact on its financial statements, including by consultation with its auditing accountants. This review was conducted across all Group companies. As a result, the Company decided on the early adoption of the Standard, starting from January 1, 2018.

For information concerning the Standard's guidelines, its application, and adjustments to the Group's financial statements following the Standard's first-time application, see Note 3.1 to the financial statements.

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

1. The Group studied the possible impact of the Standard on its financial statements. This process included a review of the Standard's provisions, a review of professional information issued by international accounting firms, and internal discussions with Group companies. In addition, consultations and professional meetings were held with the auditing accountants. These meetings included a thorough discussion of issues raised by the Standard's application, application of the transitional provisions, and a review of its impact on the Group's companies. Each company documented the relevant issues and their impact on the financial statements.
2. The Group has reviewed the necessary adjustments to the Group's information systems supporting the Standard's application. Following this review, specialized software was purchased which supports the accounting treatment required under the Standard, and adjustments were made to existing information systems.
3. The Group has studied the adaptation of its internal controls to the Standard, in order to achieve effective control over proper first-time application of the Standard, and the plausibility of significant judgments and estimates made in such application.

2.2 Due to legal actions brought against the Group, which cannot yet be assessed or for which the Group cannot yet estimate its exposure, the auditors drew attention to these actions in their opinion concerning the financial statements.

2.3 Disclosure of an extremely material valuation

The following table discloses an extremely material valuation pursuant to Regulation 8B to the Securities Regulations (Periodic and Immediate Reports), 1970: The valuation is attached to the financial statements.

	Pelephone
Subject of valuation	Pelephone's value in use, to test for impairment of goodwill attributed to Pelephone in the Company's financial statements pursuant to IAS 36.
Date of valuation	June 30, 2018; the valuation was signed on August 21, 2018.
Value prior to the valuation	NIS 2,164 million carrying amount of Pelephone's net operating assets* (NIS 1,027 million - goodwill).
Value set in the valuation	NIS 3,907 million. The Company concluded that there is no impairment requiring a write-down of goodwill recognized in the Company's books.
Assessor's identity and profile	Prometheus Financial Advisory Ltd. The study was conducted by a team headed by Eyal Shevach, who holds a bachelor's degree in electronic engineering from the Technion, and an MBA from Tel Aviv University. Mr. Shevach is an expert with extensive experience in valuation, financial statement analysis, preparing expert opinions, and performing various financial advisory studies for companies and businesses. The assessor has no dependence on the Company.
Valuation model	Discounted Cash Flow method (DCF).
Assumptions used in the valuation	Discount rate - 9.97% (post-tax). Permanent growth rate - 2.5%. Scrap value of total value set in valuation - 84%.

(*) Pelephone's net operating assets do not include trade receivable balances from installment-based handset sales presented at present value.

For more information, see Note 6 to the financial statements.

3. Details of debt certificate series

3.1 On April 26, 2018, S&P Global Ratings Maalot Ltd. affirmed the Company's ilAA rating and downgraded its rating forecast to negative due expectations for a continued increase in competition and in light of the volatility in the Company's executive suite (see immediate report, ref. no. 2018-01-033573). Furthermore, on April 30, 2018, Midroog Ltd. maintained its Aa2.il/Stable rating for the Company's Debentures (Series 6,7,9, and 10) (see immediate report, ref. no. 2018-01-034470).

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

3.2 See Note 15.4 to the financial statements concerning a commitment to issue Company Debentures (Series 9) in 2018.

4. Miscellaneous

For information concerning the liabilities balances of the reporting corporation and those companies consolidated in its financial statements as of June 30, 2018, see the Company's reporting form on the MAGNA system, dated August 23, 2018.

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

Shlomo Rodav	Stella Handler
Chairman of the Board	CEO

Signed: August 22, 2018

Part C:

Condensed Consolidated Interim Financial Statements as of June 30, 2018 (Unaudited)

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KPMG

Somekh Chaikin
KPMG Millennium Tower
17 Ha-Arbaa Street, PO Box 609
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800068403

Review Report to the Shareholders of

"Bezeq" -The Israel Telecommunication Corporation Ltd.

Introduction

We have reviewed the accompanying financial information of "Bezeq" -The Israel Telecommunication Corporation Ltd. and its subsidiaries (hereinafter – "the Group") comprising of the condensed consolidated interim statement of financial position as of June 30, 2018 and the related condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the six-month and three-month period then ended. The Board of Directors and Management are responsible for the preparation and presentation of this interim financial information in accordance with IAS 34 "Interim Financial Reporting", and are also responsible for the preparation of financial information for this interim period in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express a conclusion on this interim financial information based on our review.

We did not review the condensed interim financial information of a certain consolidated subsidiary whose assets constitute 1 % of the total consolidated assets as of June 30, 2018, and whose revenues constitute 1% of the total consolidated revenues for the six-month and three-month periods then ended. The condensed interim financial information of that company was reviewed by other auditors whose review report thereon was furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial information of that company, is based solely on the said review report of the other auditors.

Scope of Review

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

Conclusion

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

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

Emphasis of Matter

Without qualifying our abovementioned conclusion, we draw attention to Note 1.2 which refers to Notes 1.2.1 and 1.2.2 to the annual consolidated financial statements of 2017, regarding the Israel Securities Authority's (ISA) investigation of the suspicion of committing offenses under the Securities' Law and Penal Code, in respect to transactions related to the controlling shareholder, and the transfer of the investigation file to the District Attorney's Office, and regarding the opening of a joint investigation by the Securities Authority and the Unit for Combating Economic Crime at Lahav 433. As stated in the above note, at this stage, the Company is unable to assess the effects of the investigations, their findings and their effect on the Company and its officers, on the evaluation of the internal controls of the Company, and on the financial statements and on the estimates used in the preparation of these financial statements, if any.

Without qualifying our abovementioned conclusion, we draw attention to lawsuits filed against the Group which cannot yet be assessed or the exposure in respect thereof cannot yet be estimated, as set forth in Note 8.

Somekh Chaikin

Certified Public Accountants (Isr.)

August 22, 2018

Condensed Consolidated Interim Statements of Financial Position

		June 30, 2018*	June 30, 2017	December 31, 2017
		(Unaudited)	(Unaudited)	(Audited)
Assets	**Note**	**NIS million**	**NIS million**	**NIS million**
Cash and cash equivalents		**923**	1,854	2,181
Investments		**1,676**	19	289
Trade receivables		**1,822**	1,991	1,915
Other receivables		**288**	347	270
Inventory		**96**	105	125
Eurocom DBS Ltd., related party		**25**	56	43
Total current assets		**4,830**	4,372	4,823
Trade and other receivables		**447**	507	493
Broadcasting rights, net of rights exercised		**467**	456	454
Right-of-use assets	3.1	**1,424**	-	-
Fixed assets		**6,811**	6,868	6,798
Intangible assets		**2,687**	2,943	2,768
Deferred tax assets		**1,035**	1,015	1,019
Deferred expenses and non-current investments		**530**	457	494
Investment property	7	**130**	-	-
Total non-current assets		**13,531**	12,246	12,026

Total assets		**18,361**	16,618	16,849

Condensed Consolidated Interim Statements of Financial Position (Contd.)

		June 30, 2018*	June 30, 2017	December 31, 2017
		(Unaudited)	(Unaudited)	(Audited)
Liabilities and equity	**Note**	**NIS million**	**NIS million**	**NIS million**
Debentures, loans and borrowings		**1,796**	958	1,632
Current maturities of liabilities for leases	3.1	**417**	-	-
Trade and other payables		**1,583**	1,608	1,699
Employee benefits		**369**	318	280
Provisions		**110**	79	94
Current tax liabilities		**-**	112	152
Total current liabilities		**4,275**	3,075	3,857
Loans and debentures		**10,204**	10,561	10,229
Liability for leases	3.1	**1,034**	-	-
Employee benefits		**267**	259	272
Derivatives and other liabilities		**210**	251	234
Liabilities for deferred taxes		**74**	99	73
Provisions		**40**	48	40
Total non-current liabilities		**11,829**	11,218	10,848
Total liabilities		**16,104**	14,293	14,705
Total equity		**2,257**	2,325	2,144
Total liabilities and equity		**18,361**	16,618	16,849

Shlomo Rodav
Chairman of the Board of Directors

Stella Handler
CEO

Yali Rothenberg
Bezeq Group CFO

Approval date of the financial statements: August 22, 2018

* See Note 3.1 for information about early adoption of IFRS 16, Leases.

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

Condensed Consolidated Interim Statements of Income

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018*	2017	2018*	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues (Note 10)	**4,694**	4,916	**2,333**	2,463	9,789
Costs of activity					
General and operating expenses (Note 11)	**1,679**	1,932	**838**	973	3,891
Salaries	**1,013**	998	**503**	494	2,005
Depreciation and amortization	**1,062**	852	**537**	424	1,715
Other operating expenses (income), net (Note 12)	**107**	(5)	**84**	(1)	68
	3,861	3,777	**1,962**	1,890	7,679
Operating profit	**833**	1,139	**371**	573	2,110
Finance expenses (income)					
Financing expenses	**256**	246	**129**	120	477
Financing income	**(38)**	(43)	**(19)**	(18)	(60)
Financing expenses, net	**218**	203	**110**	102	417
Profit after financing expenses, net	**615**	936	**261**	471	1,693
Share in losses of equity-accounted investees	**(2)**	(4)	**(1)**	(2)	(5)
Profit before income tax	**613**	932	**260**	469	1,688
Income tax	**158**	224	**65**	111	453
Profit for the period	**455**	708	**195**	358	1,235
Basic earnings per share (NIS)	**0.16**	0.26	**0.07**	0.13	0.45

Condensed Consolidated Interim Statements of Comprehensive Income

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018*	2017	2018*	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Profit for the period	**455**	708	**195**	358	1,235
Items of other comprehensive income (loss) (net of tax)	**26**	(8)	**5**	(14)	(8)
Total comprehensive income for the period	**481**	700	**200**	344	1,227

* See Note 3.1 for information about early adoption of IFRS 16, Leases.

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

Condensed Consolidated Interim Statements of Changes in Equity

	Share capital	Share premium	Capital reserve for transactions between a corporation and a controlling shareholder	Other reserves	Deficit	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Attributable to shareholders of the Company						
Six months ended June 30, 2018 (Unaudited)*						
Balance as at January 1, 2018	**3,878**	**384**	**390**	**(85)**	**(2,423)**	**2,144**
Profit for the period	**-**	**-**	**-**	**-**	**455**	**455**
Other comprehensive income for the period, net of tax	**-**	**-**	**-**	**26**	**-**	**26**
Total comprehensive income for the period	**-**	**-**	**-**	**26**	**455**	**481**
Transactions with shareholders recognized directly in equity						
Dividends to Company shareholders (see Note 9)	**-**	**-**	**-**	**-**	**(368)**	**(368)**
Balance as at June 30, 2018	**3,878**	**384**	**390**	**(59)**	**(2,336)**	**2,257**
Six months ended June 30, 2017 (Unaudited):						
Balance as at January 1, 2017	3,878	384	390	(88)	(2,361)	2,203
Profit for the period	-	-	-	-	708	708
Other comprehensive loss for the period, net of tax	-	-	-	(8)	-	(8)
Total comprehensive income for the period	-	-	-	(8)	708	700
Transactions with shareholders recognized directly in equity						
Dividend to Company shareholders	-	-	-	-	(578)	(578)
Balance as at June 30, 2017	3,878	384	390	(96)	(2,231)	2,325

Condensed Consolidated Interim Statements of Changes in Equity (Contd.)

	Share capital	Share premium	Capital reserve for transactions between a corporation and a controlling shareholder	Other reserves	Deficit	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Attributable to shareholders of the Company						
Three months ended June 30, 2018 (Unaudited)*						
Balance as at April 1, 2018	**3,878**	**384**	**390**	**(64)**	**(2,163)**	**2,425**
Profit for the period	**-**	**-**	**-**	**-**	**195**	**195**
Other comprehensive income for the period, net of tax	**-**	**-**	**-**	**5**	**-**	**5**
Total comprehensive income for the period	**-**	**-**	**-**	**5**	**195**	**200**
Transactions with shareholders recognized directly in equity						
Dividends to Company shareholders (see Note 9)	**-**	**-**	**-**	**-**	**(368)**	**(368)**
Balance as at June 30, 2018	**3,878**	**384**	**390**	**(59)**	**(2,336)**	**2,257**
Three months ended June 30, 2017 (Unaudited)						
Balance as at April 1, 2017	3,878	384	390	(82)	(2,011)	2,559
Profit for the period	-	-	-	-	358	358
Other comprehensive loss for the period, net of tax	-	-	-	(14)	-	(14)
Total comprehensive income for the period	-	-	-	(14)	358	344
Transactions with shareholders recognized directly in equity						
Dividend to Company shareholders	-	-	-	-	(578)	(578)
Balance as at June 30, 2017	3,878	384	390	(96)	(2,231)	2,325
Year ended December 31, 2017 (Audited)						
Balance as at January 1, 2017	3,878	384	390	(88)	(2,361)	2,203
Profit in 2017	-	-	-	-	1,235	1,235
Other comprehensive income (loss) for the year, net of tax	-	-	-	3	(11)	(8)
Total comprehensive income for 2017	-	-	-	3	1,224	1,227
Transactions **with shareholders recognized directly in equity**						
Dividend to Company shareholders	-	-	-	-	(1,286)	(1,286)
Balance as at December 31, 2017	3,878	384	390	(85)	(2,423)	2,144

* See Note 3.1 for information about early adoption of IFRS 16, Leases.

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

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Condensed Consolidated Interim Statements of Cash Flows

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018*	2017	2018*	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Cash flows from operating activities					
Profit for the period	**455**	708	**195**	358	1,235
Adjustments:					
Depreciation and amortization (Note 3.1)	**1,062**	852	**537**	424	1,715
Share in losses of equity-accounted investees	**2**	4	**1**	2	5
Financing expenses, net	**224**	227	**113**	117	426
Capital gain, net	**(6)**	(19)	**(5)**	(13)	(66)
Income tax expenses	**158**	224	**65**	111	453
Loss from impairment of goodwill	**-**	-	**-**	-	87
Change in trade and other receivables	**134**	16	**60**	23	193
Change in inventory	**13**	(12)	**18**	8	(35)
Change in trade and other payables	**(110)**	(39)	**(152)**	(15)	10
Change in provisions	**15**	(1)	**7**	(2)	15
Change in employee benefits	**84**	3	**77**	9	(33)
Change in other liabilities	**(16)**	(34)	**(17)**	(25)	(34)
Net income tax paid	**(300)**	(228)	**(93)**	(122)	(446)
Net cash from operating activities	**1,715**	1,701	**806**	875	3,525
Cash flow used for investing activities					
Purchase of fixed assets	**(581)**	(580)	**(308)**	(303)	(1,131)
Investment in intangible assets and deferred expenses	**(206)**	(206)	**(111)**	(103)	(399)
Payment of permit fees for the Sakia complex (Note 7)	**(112)**	-	**(112)**	-	-
Investment in deposits with banks and others	**(1,934)**	-	**(764)**	-	(276)
Proceeds from bank deposits and others	**563**	558	**488**	554	564
Proceeds from the sale of fixed assets	**31**	28	**23**	18	98
Payment of betterment tax for the sale of the Sakia complex (Note 7)	**(80)**	-	**(80)**	-	-
Miscellaneous	**8**	1	**4**	8	(4)
Net cash from (used in) investment activities	**(2,311)**	(199)	**(860)**	174	(1,148)

Condensed Consolidated Interim Statements of Cash Flows (Contd.)

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018*	**2017**	**2018***	**2017**	**2017**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Cash flow from financing activities					
Issue of debentures and receipt of loans	**320**	1,418	**-**	1,418	2,517
Repayment of debentures and loans	**(182)**	(869)	**(182)**	(645)	(1,587)
Payments of principal and interest for leases (Note 3.1)	**(221)**	-	**(96)**	-	-
Dividend paid (Note 9)	**(368)**	(578)	**(368)**	(578)	(1,286)
Interest paid	**(204)**	(199)	**(199)**	(177)	(415)
Payment to Eurocom DBS for acquisition of shares and DBS loan	**-**	(61)	**-**	-	(61)
Miscellaneous	**(7)**	(7)	**(4)**	(5)	(12)
Net cash from (used in) financing activities	**(662)**	(296)	**(849)**	13	(844)
Increase (decrease) in cash and cash equivalents, net	**(1,258)**	1,206	**(903)**	1,062	1,533
Cash and cash equivalents at beginning of period	**2,181**	648	**1,826**	792	648
Cash and cash equivalents at end of period	**923**	1,854	**923**	1,854	2,181

* See Note 3.1 for information about early adoption of IFRS 16, Leases.

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

1. General

1.1 Reporting Entity

Bezeq – The Israel Telecommunication Corporation Limited ("the Company") is a company registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The consolidated financial statements of the Company as at June 30, 2018 include those of the Company and its subsidiaries (together referred to as "the Group"). The Group is a principal provider of communication services in Israel (see also Note 14 – Segment Reporting).

1.2 Investigation of the Israel Securities Authority and the Police Force

For information about the investigation of the Israel Securities Authority and the Police Force, see Note 1.2.1 and 1.2.2 to the 2017 Annual Financial Statements.

The Company does not have full information about the investigations, their content, the materials and 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, at this stage, the Company is prevented from and avoided the review of all the matters that were raised in the investigations, and this restricts all matters relating to audits and assessments in this matter.

Accordingly, the Company is unable to assess the effects of the investigations, their findings and their results on the Company and its officers, on the internal control in the Company, and on the financial statements, and on the estimates used in the preparation of these financial statements, if any.

Following the special circumstances as described above and the restrictions that were specified, the Company performed compensatory actions, reviews and tests and procedures in order to ensure that the financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") and the Israel Securities Regulations (Periodic and Immediate Reports), 1970. In this respect, the Company, carried out the following actions, among others:

A. A special review of the adequacy of the control processes in the Company by outside consultants, led by the Company's Internal Auditor and under the supervision of a special, independent committee from among the Company's Board members.

B. Retaining the services of professional accounting support to assist the process of preparing the financial statements of DBS for 2017.

C. The addition of supplementary procedures on specific subjects in order to enhance the internal control over financial reporting and over disclosure on those subjects.

D. Changes in the composition of the Group's senior officers

2. Basis of Preparation

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

2.2 The condensed consolidated interim financial statements do not contain all the information required in full annual financial statements, and should be reviewed in the context of the annual financial statements of the Company and its subsidiaries as of December 31, 2017 and the year then ended, and their accompanying notes ("the Annual Financial Statements"). The notes to the interim financial statements include only the material changes that have occurred from the date of the most recent Annual Financial Statements until the date of these consolidated interim financial statements.

2.3 The condensed consolidated interim financial statements were approved by the Board of Directors on August 22, 2018.

2.4 Use of estimates and judgments

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

The judgments made by management when applying the Group's accounting policy and the principal assumptions underlying assessments that involve uncertainty, are consistent with those used in the Annual Financial Statements, other than as set out below and in Note 3 regarding early application of IFRS 16.

Subject	Principal assumptions	Possible effects
Determining the lease term	When determining the term of the lease, the Group takes into consideration the period in which the lease cannot be canceled, including options to extend that will probably be exercised and/or options to cancel that will probably not be exercised.	An increase or decrease in the initial measurement of a right-of-use asset and a lease liability and in depreciation and financing expenses in subsequent periods.
Discount rate for a lease liability	The Group discounts the lease payments at the incremental borrowing rate (the borrowing rate that the Group would be required to pay to borrow the amounts required to obtain an asset at a similar value to the right-of-use asset in a similar economic environment, in a similar period and with similar collateral)	An increase or decrease in the lease liability, right-of-use asset, capital, and amortization and financing expenses to be recognized

3. Reporting Principles and Accounting Policy

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

3.1 Initial application of IFRS 16, Leases

3.1.1 Further to Note 3.17.2 to the Annual Financial Statements as at December 31, 2017 and for the year then ended, as from January 1, 2018 ("the Initial Application Date"), the Group early adopts IFRS 16, Leases ("IFRS 16" or "the Standard").

The main effect of early adoption of IFRS 16 is reflected in annulment of the existing requirement from lessees to classify leases as operating (off-balance sheet) or finance leases and the presentation of a unified model for the accounting treatment of all leases like the accounting treatment of finance leases in the previous accounting standard on leases, IAS 17. Accordingly, until the date of initial application, the Group classified most of the leases in which it is the lessee as operating leases, since it did not substantially bear all the risks and rewards from the assets.

In accordance with IFRS 16, for agreements in which the Group is the lessee, the Group applies a unified accounting model, by which it recognizes a right-of-use asset and a lease liability at the inception of the lease contract for all the leases in which the Group has a right to control identified assets for a specified period of time. Accordingly, the Group recognizes depreciation and amortization expenses in respect of a right-of-use asset, examines the right-of-use asset for impairment in accordance with IAS 36, Impairment of Assets, and recognizes financing expenses on the lease liability. Therefore, as from the date of initial application, lease expenses relating to assets leased under an operating lease, which were presented as part of general and administrative expenses in the income statement, are recognized as assets that are depreciated in the depreciation and amortization expense items.

The Group applied IFRS 16 using the cumulative effect approach without a restatement of comparative information.

In respect of all the leases, the Group has elected to apply the transitional provision of recognizing a lease liability at the initial application date according to the present value of the future lease payments discounted at the incremental interest rate of the lessee at that date and concurrently recognizing a right-of-use asset at the same amount of the liability, adjusted for any prepaid or accrued lease payments that were recognized as an asset or liability before the date of initial application. Therefore, application of IFRS 16 did not have an effect on the balance of the Group's equity and retained earnings at the date of initial application.

Upon initial application, the Group also elected to apply the following expedients, as permitted by the Standard:

A. Relying on a previous assessment of whether an arrangement is a lease or contains a lease at the application date of the Standard. Accordingly, the agreements that were previously classified as operating leases are accounted for in accordance with the new standard, and the agreements that were previously classified as service contracts continue to be accounted for as such without change.

B. Applying a single discount rate to a portfolio of leases with similar characteristics

C. Not separating non-lease components from the lease components and accounting for all the components as a single lease component

D. Relying on a previous assessment of whether a contract is onerous in accordance with IAS 37 at the transition date, as an alternative to assessing the impairment of right-of-use assets

E. Excluding initial direct costs from the measurement of the right-of-use asset at the date of initial application

F. Using hindsight in determining the lease period if the contract includes options to extend or cancel the lease

3.1.2 Presented below are the principal accounting policies for leases in which the Group is the lessee, which were applied as from January 1, 2018 following the application of IFRS 16:

(1) Determining whether an arrangement contains a lease

At the inception of the arrangement, the Group determines whether the arrangement is or contains a lease, and examines whether the arrangement transfers the right to control the use of an identifiable asset for a period of time in return for payment. When assessing whether the arrangement transfers control over the use of an identifiable asset, the Group estimates, over the lease term, whether it has both rights set out below:

(a) The right to essentially obtain all the economic rewards associated with the use of the identifiable asset

(b) The right to direct the use of the identifiable asset

For lease contracts that include non-lease components, such as services or maintenance, which are related to a lease component, the Group elected to account for the contract as a single lease component without separating the components.

(2) Leased assets and lease liability

Contracts that award the Group the right to control the use of an identifiable asset over a period of time for a consideration are accounted for as leases. At initial recognition, the Group recognizes a liability at the present value of the future minimum lease payments (these payments do not include variable lease payments that are not linked to the CPI, or to any change in the rate of interest, or any change in the exchange rate), and concurrently, the Group recognizes a right-of-use asset at the amount of the liability, adjusted for lease payments paid in advance or accrued, plus direct costs incurred in the lease.

Since the interest rate implicit in the lease is not readily determinable, the incremental borrowing rate of the Group is used (the borrowing rate that the

Group would be required to pay to borrow the amounts required to obtain an asset at a similar value to the right-of-use asset in a similar economic environment, in a similar period and with similar collateral).

Subsequent to initial recognition, the asset is accounted for using the cost model and it is amortized over the lease term or the useful life of the asset (whichever is earlier).

(3) The lease term

The lease term is the non-cancellable period of the lease plus periods covered by an extension or termination option if it is reasonably certain that the Group will exercise or not exercise the option.

(4) Depreciation of a right-of-use asset

After lease commencement, a right-of-use asset is measured on a cost basis less accumulated depreciation and accumulated impairment losses and is adjusted for re-measurements of the lease liability. Depreciation is calculated on a straight-line basis over the useful life or contractual lease period, whichever earlier, as follows:

Type of asset	Weighted average of depreciation period as at January 1, 2018
Cellular communications sites	6.5
Buildings	7
Vehicles	2

3.1.3 At the date of initial application of IFRS 16, the Group recognized right-of-use assets and lease liabilities in the amount of NIS 1.5 billion.

In measurement of the lease liabilities, the Group discounted lease payments using the nominal incremental borrowing rate at January 1, 2018. The discount rates used to measure lease liabilities range between 1.3% and 3.6% (weighted average of 1.5%).

Discounted interest rates were calculated on the basis of the market value of the marketable debentures issued by the Company. To determine the discount interest for each period, the risk-free curve was adjusted according to the risk incorporated in the debentures issued by the Company. The range of interest is affected by differences in the lease term.

The difference between the Group's agreements for the minimum contractual lease payments in the amount of NIS 1,020 million, as reported in Note 18.1 to the Annual Financial Statements, and the lease liabilities recognized at the initial application date of IFRS 16, amounting to NIS 1.5 billion, is mainly due to the options for extending the lease, which will most likely be exercised, which were not included in the reporting in Note 18.1 to the Annual Financial Statements.

3.1.4 The tables below summarize the effects on the condensed consolidated interim statement of financial position as at June 30, 2018 and on the condensed consolidated interim statements of income and cash flows for the six and three months then ended, assuming that the Group's previous policy regarding leases continued during these periods.

Effect on the condensed consolidated interim statement of financial position as at June 30, 2018

	In accordance with the previous policy	Change	In accordance with IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
Other receivables	345	**(57)**	**288**
Right-of-use assets	-	**1,424**	**1,424**

Trade and other payables	1,666	**(83)**	**1,583**
Current maturities of liabilities for leases	-	**417**	**417**
Long-term lease liabilities	-	**1,034**	**1,034**
Equity	2,258	**(1)**	**2,257**

Effect on the consolidated interim statement of income for the six months ended June 30, 2018:

	In accordance with the previous policy	Change	In accordance with IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
General and operating expenses	1,883	**(204)**	**1,679**
Depreciation and amortization expenses	867	**195**	**1,062**
Operating profit	824	**9**	**833**
Financing expenses	208	**10**	**218**
Profit after financing expenses	616	**(1)**	**615**
Profit for the period	456	**(1)**	**455**

Effect on the consolidated interim statement of income for the three months ended June 30, 2018:

	In accordance with the previous policy	Change	In accordance with IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
General and operating expenses	940	**(102)**	**838**
Depreciation and amortization	439	**98**	**537**
Operating profit	367	**4**	**371**
Financing expenses	105	**5**	**110**
Profit after financing expenses	262	**(1)**	**261**
Profit for the period	196	**(1)**	**195**

Effect on the consolidated interim statement of cash flow for the six months ended June 30, 2018:

	In accordance with the previous policy	Change	In accordance with IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
Net cash from operating activities	1,508	**207**	**1,715**
Net cash used in investing activities	(2,325)	**14**	**(2,311)**
Net cash from financing activities	(441)	**(221)**	**(662)**

Effect on the consolidated interim statement of cash flow for the three months ended June 30, 2018:

	in accordance with the previous policy	Change	In accordance with IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
Net cash from operating activities	717	**89**	**806**
Net cash used in investing activities	(867)	**7**	**(860)**

Net cash from financing activities	(753)	**(96)**	**(849)**

3.2 Initial application of IFRS 9, Financial Instruments (2014)

As from January 1, 2018, the Group applies IFRS 9, Financial Instruments, which replaces 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 Initial application of the Standard did not have a material quantitative effect on the Group's financial statements.

4. Group Entities

4.1 A detailed description of the Group entities appears in Note 12 to the Annual Financial Statements. Below is a description of the material changes that occurred in connection with the Group entities since publication of the Annual Financial Statements.

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

4.2.1 Further to Note 12.2.1 to the Annual Financial Statements regarding the Company's advance payments on account of the second contingent consideration for acquisition of the shares and loans of DBS, on April 22, 2018, a liquidation order was issued for Eurocom Communications Ltd. which came into effect on May 3, 2018, and a liquidation order was issued for Eurocom DBS Ltd. Due to the above, the Company adjusted the fair value of the amount expected to be returned to it from the surplus of advance payments that it paid, to NIS 25 million. As a result, the Company recognized financing expenses in the amount of NIS 18 million in the statement of income for the first quarter of 2018.

4.2.2 Further to Note 18.2 to the Annual Financial Statements regarding the amendment to the agreement between DBS and Space Communications Ltd. ("Spacecom") in 2018, on March 29, 2018, the amendment was signed. In April 2018, the satellite segment leased by DBS was replaced following the amendment to the 2017 agreement.

4.2.3 In April 2018, Spacecom announced that it had received a letter from a government entity, according to which "government entities intend to operate a satellite at the Israel Aerospace Industries at point 4.00 W in accordance with their requirements." Spacecom further stated that it is unable to estimate the feasibility and likelihood of operating such a satellite. In July 2018, Spacecom announced that it is continuing to assess several alternatives for the construction of Amos 8, including possible cooperation with the Government of Israel.

4.2.4 In April 2018, the manufacturer of the HD Zapper and 4K PVR K decoders that DBS acquires announced that it intends to discontinue the manufacture of the decoders in November 2018. In July 2018, DBS signed two agreements with other suppliers for the manufacture and supply of decoders by an alternative manufacturer.

4.2.5 In May 2018, Cisco informed DBS that it had sold its multi-channel television services to a third party. And according to Cisco publications, this transaction has been signed and not yet completed. DBS is assessing the significance of this notice, taking into account its agreements with Cisco and its relevant operations.

4.2.6 On July 5, 2018, the shareholders' loan to DBS (including accrued interest), the balance of which amounted to NIS 97 million on that date, was converted to capital which was recorded in the financial statements of DBS as a premium on shares, and an additional investment was made in the capital of DBS against a premium in the amount of NIS 100 million.

4.2.7 Following the conversion of the shareholders loans and investment in the capital in 2016 and the conversion of the Company's share in the debentures of DBS to capital in the period, the equity of DBS as at June 30, 2018 and December 31, 2017 amounted to NIS 761 million and NIS 348 million, respectively. As at June 30, 2018, the working capital deficit of DBS amounts to NIS 393 million. The management of DBS believes that the financial resources at its disposal, which include the deficit in working capital, conversion of loans to capital and investment in equity by the Company, will be sufficient for the operations of DBS for the coming year.

5. Income tax

As at June 30, 2018, the Company's assets include a deferred tax asset of NIS 1,166 million for the carry-forward losses of DBS. Recognition of this asset is based on the forecast for its utilization in the future in accordance with the approval of the Tax Authority, as described in Note 7.6.1 to the financial statements as at December 31, 2017, which will take place after the Ministry of Communications approves the cancellation of the structural separation at Bezeq.

The Company also presented the Authorities with other alternatives, which require their approval, and if they are approved, they will allow the utilization of the tax asset.

The assumption of the utilization of the tax asset in the merger as part of the cancellation of the structural separation in Bezeq, as aforesaid, or in one of the other alternatives, is based on the Company's assessment that it is more likely than not that the approvals will be obtained for one of the alternatives that will allow the utilization of the tax asset.

6. Assessment of impairment in the cellular communications segment

In view of the intensifying competition in the cellular market, Pelephone updated its forecasts for the coming years. As a result, the Company estimated the recoverable amount of the cash-generating cellular communications unit as at June 30, 2018.

The value in use of the cellular communications cash-generating unit for Bezeq Group was calculated by discounting future cash flows (DCF) based on a four and a half year cash flow forecast as of the end of the current period with the addition of the salvage value. The cash flow forecast is based, among other things, on Pelephone's performance in recent years and assessments regarding the expected trends in the cellular market (the number of players, level of competition, price level, and regulation aspects). The main assumption underlying the forecast is that competition in the market will continue with high intensity in the short term and that market convergence and price increases will occur in the medium to long term. The revenue forecast is based on assumptions regarding the number of Pelephone subscribers, the average revenue per user, and the volume of sales of terminal equipment, and the operating, selling, marketing and investment expenses were adjusted to the volume of Pelephone's activity.

The nominal capital used was 9.97% (after tax). In addition, it was assumed that the permanent growth of Pelephone will be 2.5%.

The valuation was made by an independent appraiser. Based on this valuation, the Group was not required to record amortization for impairment of a cellular communication cash-generating unit.

7. Investment property

Further to Note 18.8 to the Annual Financial Statements regarding the Company's agreement for the sale of a real estate asset in the Sakia complex, as at the date of the financial statements, the buyer deposited NIS 183.3 million with a trustee on account of the consideration for the transaction.

On May 21, 2018, a demand was received from the Israel Land Authority ("ILA") for payment of a permit fee in the amount of NIS 148 million (linked to the CPI). In June 2018, the Company paid an amount of NIS 112 million on account of the demand and in July 2018, the Company deposited a bank guarantee in the amount of NIS 44 million for the balance of the demand plus VAT.

In addition, on August 5, 2018, the Company received a demand for payment from the local planning and building committee in Or Yehuda, for betterment tax in the amount of NIS 143.5 million for disposal of the property by way of a sale.

The Company filed an objection to the demand for the permit fees and it is reviewing the demand for the betterment tax, including with respect to its duty to bear the levy, in whole or in part, on the level of the contractual relations with the Israel Land Authority. It should be noted that the amount for a permit fee to be determined at the end of the proceedings may also affect the amount of the betterment tax the Company will be required to pay to the Planning Committee.

The Company believes that the final amount of the permit fee and the betterment tax that it will be required to pay is expected to be low and possibly even lower than the total amount of the requirements.

If the Company is required to pay the full amount of the betterment tax and the full amount of the demand for the permit fee, then the capital gain to be recorded in its financial statements is expected to amount to NIS 250 million. The Company 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 real estate asset in the Sakia complex was presented as investment property. Investment property is initially measured at cost. In subsequent periods, investment property is measured at cost less accumulated depreciation.

8. Contingent Liabilities

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

In the opinion of the managements of the Group companies, based, among other things, on legal opinions as to the likelihood of success of the Legal Claims, the financial statements include adequate provisions of NIS 104 million, where provisions are required to cover the exposure arising from such Legal Claims.

In the opinion of the managements of the Group companies, the additional exposure (beyond these provisions) as at June 30, 2018 for claims filed against Group companies on various matters and which are unlikely to be realized, amounted to NIS 6 billion. There is also additional exposure of NIS 3.3 billion for claims, the chances of which cannot yet be assessed.

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

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

8.1 Following is a detailed description of the Group's contingent liabilities as at June 30, 2018, classified into groups with similar characteristics:

Claims group	Nature of the claims	Balance of provisions	Additional exposure	Exposure for claims that cannot yet be assessed
		(Unaudited)		
		NIS million		
Customer claims	Mainly motions for certification of class actions concerning contentions of unlawful collection of payment and impairment of the service provided by the Group companies.	**64**	**3,868**	**1,467**
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.	**8**	**2,009**(1)	**1,818** (2)
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).	**31**	**28**	**-**
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.	**-**	**102**	**1**
Claims for punitive damages, real estate and infrastructure	Claims for alleged physical damage or damage to property caused by Group companies and in relation to real estate and infrastructure. The additional amount of exposure for punitive damages does not include claims for which the insurance coverage is not disputed.	**-**	**68**	**-**
Total legal claims against the Company and subsidiaries		**104**	**6,079**	**3,287**

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

(2) Two motions for certification of a class action amounting to a total of NIS 1.8 billion, filed in June 2017 against the Company, officers in the Group and companies in the group of the Company's controlling shareholders regarding the transaction for the Company's acquisition of DBS shares from Eurocom DBS Ltd. In accordance with the court's decision, a joint motion is expected to be filed instead of these two motions. At the request of the Attorney General, the procedure was stayed, at this stage, until August 22, 2018. On August 21, 2018, the Attorney General requested to update the court again by December 31, 2018 of the possibility of advancing the proceeding. A court ruling has not yet been handed down.

8.2 See Notes 17.2 to 17.4 to the Annual Financial Statements regarding additional proceedings against the Group companies and officers.

9. Equity

9.1 On April 26, 2018, the general meeting of the Company's shareholders approved the distribution of a cash dividend of NIS 368 million to the Company's shareholders (following the recommendation of the Company's Board of Directors of March 28, 2018). The dividend was paid on May 10, 2018.

9.2 On August 22, 2018, the Company's Board of Directors decided to recommend to the general meeting of the Company's shareholders to distribute a cash dividend to shareholders in the amount of NIS 318 million for the profits of the first half of 2018 (70% of the net profit for the first half of 2018). As at the approval date of the financial statements, the dividend has not yet been approved by the general meeting.

10. Revenues

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018	**2017**	**2018**	**2017**	**2017**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Domestic fixed-line communication (Bezeq Fixed-Line)					
Internet - infrastructure	**766**	737	**386**	367	1,488
Fixed-line telephony	**580**	634	**286**	311	1,255
Transmission and data communication	**387**	392	**191**	193	775
Cloud and digital services*	**128**	113	**66**	57	230
Other services	**111**	109	**57**	54	205
	1,972	1,985	**986**	982	3,953
Cellular telephony - Pelephone					
Cellular services and terminal equipment	**848**	864	**428**	439	1,743
Sale of terminal equipment	**352**	372	**164**	181	757
	1,200	1,236	**592**	620	2,500
Multi-channel television - DBS	**750**	840	**375**	416	1,650
International communications, ISP, and NEP services - Bezeq International	**664**	752	**325**	394	1,467
Others	**108**	103	**55**	51	219
	4,694	4,916	**2,333**	2,463	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.

11. General and Operating and Expenses

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018	**2017**	**2018**	**2017**	**2017**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Terminal equipment and materials	**360**	432	**171**	230	855
Interconnectivity and payments to domestic and international operators	**388**	402	**196**	206	805
Maintenance of buildings and sites*	**139**	285	**68**	138	595
Marketing and general	**291**	278	**146**	134	636
Content services	**325**	323	**169**	162	584
Services and maintenance by sub-contractors	**139**	131	**68**	64	260
Vehicle maintenance	**37**	81	**20**	39	156
	1,679	1,932	**838**	973	3,891

* See Note 3.1 for information about early implementation of IFRS 16, Leases.

12. Other Operating Expenses (Income), Net

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018	**2017**	**2018**	**2017**	**2017**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Provision for severance pay in voluntary redundancy	**93**	12	**81**	12	23
Capital gains (mainly for disposal of real estate)	**(6)**	(19)	**(5)**	(13)	(66)
Others	**20**	2	**8**	-	24
Loss from impairment of goodwill	**-**	-	**-**	-	87
Total operating expenses (income), net	**107**	(5)	**84**	(1)	68

13. Financial Instruments

13.1 Fair value

13.1.1 Financial instruments at fair value for disclosure purposes only

The table below shows the differences between the carrying amount and the fair value of financial liabilities. The methods used to estimate the fair values of financial instruments are described in Note 29.8 to the Annual Financial Statements.

	June 30, 2018		June 30, 2017		December 31, 2017	
	Carrying amount (including accrued interest)	Fair value	Carrying amount (including accrued interest)	Fair value	Carrying amount (including accrued interest)	Fair value
	(Unaudited)		(Unaudited)		(Audited)	
	NIS million		NIS million		NIS million	
Loans from banks and institutions (unlinked)	**4,689**	**4,839**	3,648	3,826	4,436	4,693
Debentures issued to the public (CPI-linked)	**4,096**	**4,293**	4,127	4,297	4,088	4,338
Debentures issued to the public (unlinked)	**1,646**	**1,658**	1,668	1,687	1,649	1,745
Debentures issued to financial institutions (CPI-linked)	**13**	**13**	212	214	15	17
Debentures issued to financial institutions (unlinked)	**252**	**268**	353	383	302	326
	10,696	**11,071**	10,008	10,407	10,490	11,119

13.1.2 Fair value hierarchy

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

	June 30, 2018	June 30, 2017	December 31, 2017
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Level 1: Investment in marketable securities at fair value through profit or loss	**9**	19	14
Level 2: forward contracts	**(157)**	(185)	(212)
Level 3: contingent consideration for a business combination	**25**	56	43

14. Segment Reporting

14.1 Operating segments

	Six months ended June 30, 2018 (Unaudited):						
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi-channel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	1,972	1,200	663	750	109	-	4,694
Inter-segment revenues	155	21	25	-	7	(208)	-
Total revenues	2,127	1,221	688	750	116	(208)	4,694
Depreciation and amortization	415	317	88	158	11	73	1,062
Segment results – operating profit (loss)	860	4	64	(18)	(13)	(64)	833
Financing expenses	254	10	8	15	1	(32)	256
Financing income	(14)	(27)	(1)	(25)	-	29	(38)
Total financing expenses (income), net	240	(17)	7	(10)	1	(3)	218
Segment profit (loss) after financing expenses, net	620	21	57	(8)	(14)	(61)	615
Share in losses of associates	-	-	-	-	(2)	-	(2)
Segment profit (loss) before income tax	620	21	57	(8)	(16)	(61)	613
Income tax	155	5	13	1	-	(16)	158
Segment results – net profit (loss)	465	16	44	(9)	(16)	(45)	455
Segment assets*	9,418	4,102	1,313	1,575	188	418	17,014
Investment in associates	-	-	5	-	(7)	11	9
Goodwill	-	-	6	-	10	1,322	1,338
Segment liabilities*	14,467	1,396	538	814	94	(1,205)	16,104

* Segment assets and liabilities include the right-of-use assets and liabilities for leases, due to early adoption of IFRS 16, Leases, as described in Note 3.1.

14. Segment Reporting (contd.)

14.1 Operating segments (contd.)

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

14. Segment Reporting (contd.)

14.1 Operating segments (contd.)

	Three months ended June 30, 2018 (Unaudited):						
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi-channel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	**986**	**592**	**325**	**375**	**55**	**-**	**2,333**
Inter-segment revenues	**78**	**10**	**11**	**-**	**4**	**(103)**	**-**
Total revenues	**1,064**	**602**	**336**	**375**	**59**	**(103)**	**2,333**
Depreciation and amortization	**211**	**159**	**45**	**79**	**5**	**38**	**537**
Segment results – operating profit (loss)	**387**	**2**	**30**	**(17)**	**(5)**	**(26)**	**371**
Financing expenses	**127**	**7**	**4**	**4**	**1**	**(14)**	**129**
Financing income	**(8)**	**(13)**	**-**	**(11)**	**1**	**12**	**(19)**
Total financing expenses (income), net	**119**	**(6)**	**4**	**(7)**	**2**	**(2)**	**110**
Segment profit (loss) after financing expenses, net	**268**	**8**	**26**	**(10)**	**(7)**	**(24)**	**261**
Share in losses of associates	**-**	**-**	**-**	**-**	**(1)**	**-**	**(1)**
Segment profit (loss) before income tax	**268**	**8**	**26**	**(10)**	**(8)**	**(24)**	**260**
Income tax	**66**	**1**	**6**	**-**	**-**	**(8)**	**65**
Segment results – net profit (loss)	**202**	**7**	**20**	**(10)**	**(8)**	**(16)**	**195**

14. Segment Reporting (contd.)

14.1 Operating segments (contd.)

	Three months ended June 30, 2017 (Unaudited):						
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi-channel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	983	620	394	416	50	-	2,463
Inter-segment revenues	75	12	13	-	5	(105)	-
Total revenues	1,058	632	407	416	55	(105)	2,463
Depreciation and amortization	177	99	33	71	6	38	424
Segment results – operating profit (loss)	496	30	45	49	(8)	(39)	573
Financing expenses	89	-	1	36	1	(7)	120
Financing income	(7)	(14)	-	(4)	(6)	13	(18)
Total financing expenses (income), net	82	(14)	1	32	(5)	6	102
Segment profit (loss) after financing expenses, net	414	44	44	17	(3)	(45)	471
Share in losses of associates	-	-	-	-	(2)	-	(2)
Segment profit (loss) before income tax	414	44	44	17	(5)	(45)	469
Income tax	97	10	11	168	-	(175)	111
Segment results – net profit (loss)	317	34	33	(151)	(5)	130	358

14. Segment Reporting (contd.)

14.1 Operating segments (contd.)

	Year ended December 31, 2017 (Audited)						
	Domestic fixed-line communication	**Cellular communications**	**International communications and internet services**	**Multi-channel television**	**Other**	**Adjustments**	**Consolidated**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Revenues from external sources	3,953	2,500	1,466	1,650	220	-	9,789
Inter-segment revenues	291	46	71	-	17	(425)	-
Total revenues	4,244	2,546	1,537	1,650	237	(425)	9,789
Depreciation and amortization	728	383	135	285	20	164	1,715
Segment results – operating profit (loss)	1,971	72	174	163	(20)	(250)	2,110
Financing expenses	439	3	12	81	-	(58)	477
Financing income	(36)	(54)	(4)	(10)	(5)	49	(60)
Total financing expenses (income), net	403	(51)	8	71	(5)	(9)	417
Segment profit (loss) after financing expenses, net	1,568	123	166	92	(15)	(241)	1,693
Share in profits (losses) of associates	-	-	-	-	(4)	(1)	(5)
Segment profit (loss) before income tax	1,568	123	166	92	(19)	(242)	1,688
Income tax	396	28	39	336	-	(346)	453
Segment results – net profit (loss)	1,172	95	127	(244)	(19)	104	1,235
Segment assets	9,086	3,271	1,199	1,502	174	269	15,501
Investment in associates	-	-	5	-	(6)	11	10
Goodwill	-	-	6	-	10	1,322	1,338
Segment liabilities	13,901	536	410	1,154	64	(1,360)	14,705
Investments in fixed assets and intangible assets	851	331	169	237	19	-	1,607

14.2 Adjustment of profit or loss for reporting segments

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018	**2017**	**2018**	**2017**	**2017**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Operating profit for reporting segments	**910**	1,239	**402**	620	2,380
Financing expenses, net	**(218)**	(203)	**(110)**	(102)	(417)
Amortization of surplus cost for intangible assets and others	**(64)**	(85)	**(26)**	(38)	(250)
Share in losses of associates	**(2)**	(4)	**(1)**	(2)	(5)
Loss for operations classified in other categories and other adjustments	**(13)**	(15)	**(5)**	(9)	(20)
Income before taxes on income	**613**	932	**260**	469	1,688

	June 30, 2018	December 31, 2017
	(Unaudited)	**(Audited)**
	NIS million	**NIS million**
Assets		
Assets from reporting segments	**16,419**	15,069
Assets attributable to operations in other categories	**191**	178
Goodwill not attributable to an operating segment	**1,322**	1,322
Surplus cost not attributable to an operating segment	**1,616**	1,636
Less inter-segment assets and other adjustments	**(1,187)**	(1,356)
Consolidated assets	**18,361**	16,849

Liabilities		
Liabilities from reporting segments	**17,215**	16,001
Liabilities attributable to operations in other categories	**94**	64
Less inter-segment liabilities	**(1,205)**	(1,360)
Consolidated liabilities	**16,104**	14,705

15. Additional Significant Events in the Reporting Period

15.1 The Company's Board of Directors approved an early retirement plan in 2018 at a cost of NIS 90 million. The retirement plan is for the early retirement of 75 employees, in accordance with the terms of the valid collective agreement. In its financial statements for the first half of 2018, the Company recorded expenses in the amount of NIS 90 million, of which NIS 80 million was for the second quarter.

15.2 Further to Note 13.3.4 to the Annual Financial Statements regarding the terms that the Company undertook for the loans and debentures, on April 22, 2018, a liquidation order was issued for Eurocom Communications Ltd. (which came into effect on May 3, 2018) and as part of the liquidation ruling, the court clarified that the ruling does not derogate from the control permit in the Company. The ruling to liquidate Eurocom Communications has no implications on the Company's debentures and loans.

15.3 Further to Note 28.6 to the Annual Financial Statements regarding the Company's insurance policy for directors and officers liability in the Company and its subsidiaries, on May 21, 2018, the general meeting of the Company's shareholders approved an amendment to the Company's compensation policy according to which the annual premium for officers insurance in the Company will not exceed USD 1 million, with a deductible of up to USD 1 million.

15.4 For information about the undertaking to issue Debentures (Series 9) of the Company in 2018 and the raising of debt in March 2018 in the amount of NIS 320 million, see Note 13.6 to the Annual Financial Statements.

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

16.1 Pelephone Communications Ltd.

Selected data from the statement of financial position

	June 30, 2018	June 30, 2017	December 31, 2017
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	**931**	1,225	1,128
Non-current assets	**3,171**	2,119	2,143
Total assets	**4,102**	3,344	3,271
Current liabilities	**655**	474	442
Long-term liabilities	**741**	95	94
Total liabilities	**1,396**	569	536
Equity	**2,706**	2,775	2,735
Total liabilities and equity	**4,102**	3,344	3,271

Selected data from the statement of income

	Six months ended June 30		Three months ended June 30		Year ended December 31,
	2018	2017	2018	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from services	**869**	884	**438**	449	1,782
Revenues from sales of terminal equipment	**352**	376	**164**	183	764
Total revenues from services and sales	**1,221**	1,260	**602**	632	2,546
Cost of services and sales	**1,054**	1,082	**523**	529	2,171
Gross profit	**167**	178	**79**	103	375
Selling and marketing expenses	**118**	100	**56**	51	215
General and administrative expenses	**45**	43	**21**	22	88
	163	143	**77**	73	303
Operating profit	**4**	35	**2**	30	72
Financing expenses	**10**	-	**7**	-	3
Financing income	**(27)**	(28)	**(13)**	(14)	(54)
Financing income, net	**(17)**	(28)	**(6)**	(14)	(51)
Profit before income tax	**21**	63	**8**	44	123
Income tax	**5**	13	**1**	10	28
Profit for the period	**16**	50	**7**	34	95

16.2 Bezeq International Ltd.

Selected data from the statement of financial position

	June 30, 2018	June 30, 2017	December 31, 2017
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	**434**	523	490
Non-current assets	**890**	711	720
Total assets	**1,324**	1,234	1,210
Current liabilities	**302**	310	295
Long-term liabilities	**236**	112	115
Total liabilities	**538**	422	410
Equity	**786**	812	800
Total liabilities and equity	**1,324**	1,234	1,210

Selected data from the statement of income

	Six months ended June 30		Three months ended June 30		Year ended December 31,
	2018	2017	2018	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from services	**688**	791	**336**	407	1,537
Operating expenses	**463**	546	**225**	288	1,058
Gross profit	**225**	245	**111**	119	479
Selling and marketing expenses	**102**	94	**52**	46	187
General and administrative expenses	**58**	56	**30**	27	115
Other expenses (income), net	**1**	1	**(1)**	1	3
	161	151	**81**	74	305
Operating profit	**64**	94	**30**	45	174
Financing expenses	**8**	4	**4**	1	12
Financing income	**(1)**	(1)	**-**	-	(4)
Financing expenses, net	**7**	3	**4**	1	8
Profit before income tax	**57**	91	**26**	44	166
Income tax	**13**	22	**6**	11	39
Profit for the period	**44**	69	**20**	33	127

16.3 DBS Satellite Services (1998) Ltd.

Selected data from the statement of financial position

	June 30, 2018	June 30, 2017	December 31, 2017
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	**251**	502	269
Non-current assets	**1,324**	1,408	1,233
Total assets	**1,575**	1,910	1,502
Current liabilities	**644**	976	804
Long-term liabilities	**170**	474	350
Total liabilities	**814**	1,450	1,154
Equity	**761**	460	348
Total liabilities and equity	**1,575**	1,910	1,502

Selected data from the statement of income

	Six months ended June 30		Three months ended June 30		Year ended December 31,
	2018	2017	2018	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from services	**750**	840	**375**	416	1,650
Operating expenses	**649**	628	**331**	313	1,260
Gross profit	**101**	212	**44**	103	390
Selling and marketing expenses	**66**	64	**31**	29	131
General and administrative expenses	**53**	47	**30**	25	96
	119	111	**61**	54	227
Operating profit (loss)	**(18)**	101	**(17)**	49	163
Financing expenses	**15**	72	**4**	36	81
Financing income	**(25)**	(13)	**(11)**	(4)	(10)
Financial expenses (income), net	**(10)**	59	**(7)**	32	71
Profit (loss) before income tax	**(8)**	42	**(10)**	17	92
Income tax	**1**	174	**-**	168	336
Loss for the period	**(9)**	(132)	**(10)**	(151)	(244)

Condensed Separate Interim Financial Information as of June 30, 2018

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

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

To:
The Shareholders of "Bezeq"- The Israel Telecommunication Corporation Ltd.

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

Introduction

We have reviewed the separate interim financial information presented in accordance with Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970 of "Bezeq"- The Israel Telecommunication Corporation Ltd. (hereinafter – "the Company") as of June 30, 2018 and for the six-month and three-month period then ended. The separate interim financial information is the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express a conclusion on the separate interim financial information based on our review.

We did not review the separate interim financial information of an investee company the investment in which amounted to NIS 71 million as of June 30, 2018, and the loss from this investee company amounted to NIS 18 million and NIS 7 million for the six-month and three-month periods then ended, respectively. The financial statements of that company were reviewed by other auditors whose review report thereon was furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial statements of that company, is based solely on the said review report of the other auditors.

Scope of Review

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

Conclusion

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

Emphasis of Matter

Without qualifying our abovementioned conclusion, we draw attention to Note 8.1, which refers to Notes 1.2.1 and 1.2.2 to the annual consolidated financial statements of 2017, regarding the Israel Securities Authority's (ISA) investigation of the suspicion of committing offenses under the Securities' Law and Penal Code, in respect to transactions related to the controlling shareholder, and the transfer of the investigation file to the District Attorney's Office, and regarding the opening of a joint investigation by the Securities Authority and the Unit for Combating Economic Crime at Lahav 433. As stated in the above note, at this stage, the Company is unable to assess the effects of the investigations, their findings and their effect on the Company and its officers, on the evaluation of the internal controls of the Company, and on the financial statements and on the estimates used in the preparation of these financial statements, if any.

Without qualifying our abovementioned conclusion, we draw attention to lawsuits filed against the Company which cannot yet be assessed or the exposure in respect thereof cannot yet be estimated, as set forth in Note 5.

Somekh Chaikin
Certified Public Accountants (Isr.)

August 22, 2018

Condensed Separate interim information of Financial Position

	June 30, 2018*	June 30, 2017	December 31, 2017
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Assets			
Cash and cash equivalents	**632**	1,284	1,769
Investments	**1,658**	-	275
Trade receivables	**710**	695	685
Other receivables	**224**	204	172
Eurocom DBS Ltd, an affiliate	**25**	56	43
Loans granted to investees	**100**	97	69
Investment in DBS debentures	**-**	203	202
Total current assets	**3,349**	2,539	3,215
Trade and other receivables	**101**	110	121
Property, plant and equipment	**4,975**	4,934	4,933
Intangible assets	**227**	220	224
Investment in investees	**7,306**	7,085	6,958
Loans granted to investees	**191**	138	196
Right of use assets - see Note 1.3	**302**	-	-
Investment in DBS debentures	**-**	461	257
Non-current and other investments	**143**	128	141
Investment property - see Note 8.5	**130**	-	-
Total non-current assets	**13,375**	13,076	12,830
Total assets	**16,724**	15,615	16,045

Condensed Separate Interim Information of Financial Position (contd.)

	June 30, 2018* (Unaudited) NIS million	June 30, 2017 (Unaudited) NIS million	December 31, 2017 (Audited) NIS million
Liabilities			
Debentures, loans and borrowings	**1,775**	748	1,589
Loan from an investee	**-**	105	-
Trade and other payables	**604**	501	604
Current tax liabilities	**-**	104	148
Employee benefits	**306**	257	223
Current maturities for lease liabilities - see Note 1.3	**100**	-	-
Provisions (Note 5)	**74**	48	59
Total current liabilities	**2,859**	1,763	2,623
Debentures and loans	**10,185**	10,524	10,223
Loans from a subsidiary	**755**	475	570
Employee benefits	**225**	220	229
Current lease liabilities - see Note 1.3	**212**	-	-
Derivatives and other liabilities	**193**	241	220
Deferred tax liabilities	**38**	67	36
Total non-current liabilities	**11,608**	11,527	11,278
Total liabilities	**14,467**	13,290	13,901
Capital			
Share capital	**3,878**	3,878	3,878
Share premium	**384**	384	384
Reserves	**331**	294	305
Deficit	**(2,336)**	(2,231)	(2,423)
Total equity attributable to equity holders of the Company	**2,257**	2,325	2,144

Total liabilities and equity	**16,724**	15,615	16,045

Shlomo Rodav Chairman of the Board of Directors	**Stella Handler** CEO	**Yali Rothenberg** Bezeq Group CFO

Date of approval of the financial statements: August 22, 2018

* See Note 1.3 concerning early application of IFRS 16 - Leases

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

Condensed Separate Interim Information of Profit or Loss

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018*	2017	2018*	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues (Note 2)	**2,127**	2,136	**1,064**	1,058	4,244
Costs of activities					
Salaries	**460**	444	**232**	220	891
Depreciation and amortization	**415**	357	**211**	177	728
Operating and general expenses (Note 3)	**285**	331	**145**	166	677
Other operating expenses (income), net (Note 4)	**107**	(5)	**89**	(1)	(23)
	1,267	1,127	**677**	562	2,273
Operating profit	**860**	1,009	**387**	496	1,971
Financing expenses (income)					
Financing expenses	**254**	186	**127**	89	439
Financing income	**(14)**	(12)	**(8)**	(7)	(36)
Financing expenses, net	**240**	174	**119**	82	403
Profit after financing expenses, net	**620**	835	**268**	414	1,568
Company's share in (losses) earnings of investees, net	**(10)**	72	**(7)**	41	63
Profit before income tax	**610**	907	**261**	455	1,631
Income tax	**155**	199	**66**	97	396
Profit for the period attributable to the owners of the Company	**455**	708	**195**	358	1,235

Condensed Separate Interim Information of Comprehensive Income

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018	2017	2018	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Profit for the period	**455**	708	**195**	358	1,235
Items of other comprehensive income (loss), net of tax	**26**	(8)	**5**	(14)	(8)
Total comprehensive income for the period attributable to equity holders of the Company	**481**	700	**200**	344	1,227

* See Note 1.3 concerning early application of IFRS 16 - Leases

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

Condensed Separate Interim Information on Cash Flows

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018*	2017	2018*	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Cash flows from operating activities					
Profit for the period	**455**	708	**195**	358	1,235
Adjustments:					
Depreciation and amortization	**415**	357	**211**	177	728
Company's share in (earnings) losses of investees, net	**10**	(72)	**7**	(41)	(63)
Financing expenses, net	**232**	165	**118**	78	358
Capital gain, net	**(4)**	(19)	**(3)**	(14)	(65)
Income tax expenses	**155**	199	**66**	97	396
Change in trade and other receivables	**(50)**	10	**14**	(5)	61
Change in trade and other payables	**(18)**	(62)	**(115)**	(95)	2
Change in provisions	**15**	-	**10**	(2)	11
Change in employee benefits	**78**	(6)	**78**	6	(37)
Miscellaneous	**-**	1	**(1)**	1	6
Net cash (used in) from operating activities due to transactions with subsidiaries	**8**	(33)	**10**	(7)	(39)
Net income tax paid	**(273)**	(183)	**(83)**	(88)	(368)
Net cash from operating activities	**1,023**	1,065	**507**	465	2,225
Cash flows from investment activities					
Investment in intangible assets and other investments	**(59)**	(51)	**(29)**	(25)	(110)
Proceeds from the sale of property, plant and equipment	**29**	26	**22**	16	94
Investment in bank deposits and others	**(1,934)**	-	**(764)**	-	(276)
Proceeds from payment of bank deposits and others	**558**	546	**482**	546	547
Payment of license fees for the Sakia complex	**(112)**	-	**(112)**	-	-
Payment of betterment tax for sale of the Sakia complex	**(80)**	-	**(80)**	-	-
Investment in DBS debentures	**-**	-	**-**	-	(20)
Return on investment in DBS debentures	**-**	-	**-**	-	194
Purchase of property, plant and equipment	**(348)**	(378)	**(172)**	(194)	(715)
Miscellaneous	**9**	(26)	**5**	(19)	(12)
Net cash from investment activities due to transactions with subsidiaries	**80**	(98)	**121**	8	5
Net cash flows from (used in) investment activities	**(1,857)**	19	**(527)**	332	(293)

Condensed Separate Interim Information of Cash Flows (contd.)

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018*	2017	2018*	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Cash flow from finance activities					
Issue of debentures and receipt of loans	**320**	1,418	**-**	1,418	2,517
Repayment of debentures and loans	**(175)**	(842)	**(175)**	(618)	(1,363)
Dividends paid	**(368)**	(578)	**(368)**	(578)	(1,286)
Payment to Eurocom DBS for acquisition of DBS shares and loans	**-**	(61)	**-**	-	(61)
Interest paid	**(203)**	(174)	**(197)**	(159)	(397)
Principal and interest payment on lease	**(62)**	-	**(29)**	-	-
Net cash from financing activities for transactions with subsidiaries	**185**	255	**45**	150	245
Net cash from (used for) financing operations	**(303)**	18	**(724)**	213	(345)
Net increase (decrease) in cash and cash equivalents	**(1,137)**	1,102	**(744)**	1,010	1,587
Cash and cash equivalents at beginning of period	**1,769**	182	**1,376**	274	182
Cash and cash equivalents at the end of the period	**632**	1,284	**632**	1,284	1,769

* See Note 1.3 concerning early application of IFRS 16 - Leases

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

Notes to the Condensed Separate Interim Financial Information

1. Manner of preparing financial information

1.1 Definitions

"The Company": Bezeq The Israel Telecommunication Corporation Limited

"Investee", the "Group", "Subsidiary": as these terms are defined in the Company's consolidated financial statements for 2017.

1.2 Principles used for preparing financial information

The condensed separate interim financial information is presented in accordance with Regulation 38(D) of the Securities Regulations (Periodic and Immediate Reports),1970 ("the Regulation") and the Tenth Addendum of the Securities Regulations (Periodic and Immediate Reports),1970 ("the Tenth Addendum") with respect to the separate interim financial information of the corporation. They should be read in conjunction with the separate financial information for the year ended December 31, 2017 and in conjunction with the condensed interim consolidated financial statements as at June 30, 2018 ("the Consolidated Financial Statements").

The accounting policies used in preparing these condensed separate interim financial information are in accordance with the accounting policies set out in the separate financial information as of and for the year ended December 31, 2017.

1.3 First-time Application of Accounting Standards

As of January 1, 2018, the Company is applying early adoption of IFRS 16 (the "Standard").

For further information concerning the first-time adoption of IFRS 15 see Note 3.1 to the Consolidated Financial Statements.

The tables below present a breakdown of the effects on the condensed consolidated interim statement of financial position as at June 30, 2018 and on the condensed consolidated statement of income and interim statement of cash flows for the six and three months then ended, assuming that the Company's previous policy regarding operational leases would have continued in this period.

Effect on the condensed interim statement of financial position as at June 30, 2018:

	Per the previous policies	Change	Per IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
Other receivables	226	**(2)**	**224**
Right of use assets	-	**302**	**302**
Trade and other payables	616	**(12)**	**604**
Current maturities of lease liabilities	-	**100**	**100**
Non-current leasing liabilities	-	**212**	**212**
Capital	2,257	**-**	**2,257**

Effect on the interim statement of income for the six months ended June 30, 2018:

	Per the previous policies	Change	Per IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
General and operating expenses	331	**(46)**	**285**
Depreciation and amortization costs	371	**44**	**415**
Operating profit	858	**2**	**860**
Financing expenses, net	238	**2**	**240**
Profit after financing expenses	620	**-**	**620**
Profit for the period	455	**-**	**455**

Effect on the interim statement of income for the three months ended June 30, 2018:

	Per the previous policies	Change	Per IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
General and operating expenses	168	**(23)**	**145**
Depreciation and amortization costs	189	**22**	**211**
Operating profit	386	**1**	**387**
Financing expenses, net	118	**1**	**119**
Profit after financing expenses	268	**-**	**268**
Profit for the period	195	**-**	**195**

Effect on the interim statement of cash flows for the six months ended June 30, 2018:

	Per the previous policies	Change	Per IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
Net cash from operating activities	975	**48**	**1,023**
Net cash used for investing activities	(1,871)	**14**	**(1,857)**
Net cash used for financing activities	(241)	**(62)**	**(303)**

Effect on the interim statement of cash flows for the three months ended June 30, 2018

	Per the previous policies	Change	Per IFRS 16
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million
Net cash from operating activities	485	**22**	**507**
Net cash used for investing activities	(534)	**7**	**(527)**
Net cash used for financing activities	(695)	**(29)**	**(724)**

For information regarding the first time application of additional accounting standards see Note 3.2 to the Consolidated Financial Statements

2. Revenues

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018	2017*	2018	2017*	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Internet - infrastructure	**799**	763	**403**	381	1,544
Fixed-line telephony	**593**	654	**291**	320	1,281
Transmission and data communication	**491**	494	**244**	244	975
Cloud and digital services	**128**	113	**66**	57	230
Other services	**116**	112	**60**	56	214
	2,127	2,136	**1,064**	1,058	4,244

* Cloud and digital services were reclassified and presented separately to reflect the changes in revenue mix.

3. Operating and General Expenses

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018	2017	2018	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Maintenance of buildings and sites*	**65**	92	**31**	45	185
Marketing and general	**89**	86	**49**	44	188
Interconnectivity and payments to communications operators	**55**	60	**27**	29	118
Services and maintenance by sub-contractors	**40**	36	**20**	19	73
Vehicle maintenance*	**15**	35	**8**	17	69
Terminal equipment and materials	**21**	22	**10**	12	44
	285	331	**145**	166	677

* See Note 1.3 concerning early application of IFRS 16 - Leases

4. Other operating expenses (income), net

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2018	2017	2018	2017	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Provision for severance pay in voluntary redundancy	**93**	12	**81**	12	23
Capital gain from the sale of property, plant and equipment (mainly real estate)	**(4)**	(19)	**(3)**	(14)	(65)
Others	**18**	2	**11**	1	19
Total operating income, net	**107**	(5)	**89**	(1)	(23)

5. CONTINGENT LIABILITIES

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

In the opinion of the Company's management, based, inter alia, on legal opinions as to the likelihood of success of these litigations, the financial statements include appropriate provisions in the amount of NIS 74 million, where provisions are required to cover the exposure arising from such litigation.

At June 30, 2018:

Provision	* Amount of additional exposure for which probability of realization cannot be foreseen	* Exposure for claims that cannot as yet be assessed
NIS million		
74	3,397 [(1)]	2,231 [(2)]

* CPI-linked, before interest

Furthermore, other claims have been filed against the Company as class actions with respect to which the Company has additional exposure beyond the aforesaid amounts, which cannot be quantified as the exact amounts of the claims are not stated in the claims.

1) Including exposure of NIS 2 billion for a motion to certify a class action filed by a shareholder against the Company and officers in the Company, claiming Company reporting failures concerning the wholesale market and decrease in interconnect fees, which the plaintiff estimates at NIS 1.1 billion or NIS 2 billion (depending on the method to be determined for calculating the damage).

2) Including two motions for certification of class action suits, for a total amount of NIS 1.8 billion, filed in June 2017 against the Company, officers of the Group and companies of the group that is the controlling shareholder of the Company, concerning the transaction for the Company's acquisition of DBS shares from Eurocom DBS Ltd. Pursuant to the court's decision, a consolidated motion is expected to be filed, replacing these two motions. Attorney General's request, a stay of the proceedings was granted until August 22, 2018. On August 21, 2008, the Attorney General requested to again update the court by December 31, 2018 regarding possible progress of the proceeding. The court's ruling in this matter has not yet been given.

5.2 See Notes 11.2 to 11.4 to the Annual Financial Statements for 2017 with regard to additional proceedings against the Company and its officers.

For further information concerning contingent liabilities see Note 8 to the Consolidated Financial Statements.

6. Dividends from investees

6.1 In May 2018, Bezeq International Ltd. paid a cash dividend to the Company, which was announced in March 2018, in the amount of NIS 58 million.

6.2 In May 2018, Pelephone paid a cash dividend to the Company, which was announced in March 2018, in the amount of NIS 45 million.

6.3 In August 2018 the board of directors of Pelephone decided to distribute a dividend to the Company in the amount of NIS 16 million in October 2018.

6.4 In August 2018 the board of directors of Bezeq International decided to distribute a dividend to the Company in the amount of NIS 44 million in October 2018.

7. Inter-company loans

7.1 On January 15, 2018, the Company received a loan from Pelephone in the amount of NIS 140 million. The loan bears annual interest of 3.48 % and is repayable in four equal annual installments commencing from December 1, 2022.

7.2 On February 12, 2018, the Company provided a loan to Bezeq International in the amount of NIS 95 million. The loan bears annual interest of 2.61 % and is repayable in four equal annual installments commencing from February 12, 2019.

7.3 On May 30, 2018, the Company received a loan from Pelephone in the amount of NIS 45 million. The loan bears annual interest of 3.48 % and is repayable in four annual installments commencing from December 1, 2022.

7.4 With regard to the loans provided to DBS as capital and additional investment in capital, see Note 4.2.7 to the Consolidated Financial Statements.

8. Events during and subsequent to the Reporting Period

8.1 For further information concerning the Securities Authority and police investigations see Note 1.2 to the Consolidated Financial Statements.

8.2 For further information concerning an engagement for the issue of debentures and receipt of a loan see Note 15.4 to the Consolidated Financial Statements.

8.3 With regard to the conversion of the Company's investment in DBS debentures (Series B) into DBS share capital in February 2018, see Note 13.4 to the Consolidated Financial Statements.

8.4 With regard to the second conditional consideration to Eurocom DBS, based on DBS's business results and the estimated fair value of the amount that is expected to be returned to the Company from surplus advance payments made, see Note 4.2.1 to the Consolidated Financial Statements.

8.5 For further information concerning the Company's engagement in an agreement for the sale of a property in the Sakia complex, see Note 7 to the Consolidated Financial Statements.

8.6 For further information concerning employee retirement see Note 15.1 to the Consolidated Statements.

Chapter E:

Quarterly report on the effectiveness of internal control over financial reporting and disclosure for the period ended June 30, 2018

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

1. Report of internal control over financial reporting and disclosure:

Quarterly report on the effectiveness of internal control over financial reporting and disclosure, pursuant to Regulation 38C(a) of the Periodic and Immediate Reports Regulations, 1970:

Management, under the supervision of the Board of Directors of “Bezeq” The Israel Telecommunication Corp Limited, ("the Company"), is responsible for establishing and maintaining appropriate internal control over financial reporting and disclosure in the Company.

For this matter, the members of Management are:

1. Stella Handler, CEO[1];
2. Ehud Mezuman, VP Human Resources Division;
3. Eyal Kamil, VP Operations and Logistics Division;
4. Itamar Harel, VP Private Division;
5. Amir Nachlieli, Legal Counsel;
6. Guy Hadass, VP Corporate Communications;
7. Gil Rosen, VP Marketing & Innovation Division;
8. Yali Rothenberg, Bezeq Group CFO;
9. Yaacov Zano, VP IT and Network Division;
10. Yaacov Paz, VP Business Division;
11. Sharon Fleischer Ben-Yehuda, VP Regulation;

In addition to the said members of Management, the following serve in the Group’s headquarters[2]:

1. Yehuda Porat, Head of Security Unit;
2. Lior Segal, Internal Auditor;
3. Shelly Bainhoren, Group Corporate Secretary and Internal Compliance Officer;

Internal control over financial reporting and disclosure includes controls and procedures in the Company, which were planned by the CEO and the most senior financial officer, or under their supervision, or by whoever fulfills those functions in practice, under the supervision of the Board of Directors of the Company, and were designed to provide reasonable assurance as to the reliability of the financial reporting and the preparation of the reports in accordance with the provisions of the law, and to ensure that information that the Company is required to disclose in the reports it publishes in accordance with the provisions of the law is collected, processed, summarized and reported on the date and in the format laid down in law.

Internal control includes controls and procedures planned to ensure that the information that the Company is required to disclose as aforesaid, is accumulated and forwarded to the Management of the Company, including to the CEO and the most senior financial officer or to whoever fulfills those functions in practice, in order to enable decisions to be made at the appropriate time in relation to the disclosure requirements.

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[1] Expected to end her tenure on August 31, 2018.

[2] Amikam Shorer, Group Chief Strategy and Corporate Development Officer, ended his tenure on July 31, 2018.

Due to its structural limitations, the internal control over financial reporting and disclosure is not intended to provide absolute assurance that misstatement or omission of information from the reports will be prevented or will be detected.

In the quarterly report on the effectiveness of the internal controls over financial reporting and disclosure that was attached to the Quarterly Report for the period ended March 31, 2018 ("the Last Quarterly Report on Internal Control"), it was found that the internal control was ineffective on account of several significant deficiencies identified in the entity level controls, and which in the opinion of Management and the Board cumulatively represents a material weakness, as detailed below.

Up until the reporting date no event or matter was brought to the attention of the Board and Management that would change the assessment of the effectiveness of the internal control as found in the Last Quarterly Report on Internal Control;

At the reporting date, based on what was stated in the Last Quarterly Report on Internal Control, there is a material weakness, and accordingly the internal control is ineffective.

Disclosure concerning the material weakness was provided by the Company for the first time in the Last Annual Report on Internal Control published on March 29, 2018. Since that date the Company has not found any additional material weakness and the Company is working to correct the material weakness, as detailed below in this Chapter.

Below are details of the material weakness in the internal control:

An Investigation of the Israel Securities Authority is being conducted against the Company and DBS. The Investigation involved the questioning of the Chairman of the Company's Board of Directors (at that time), the CEO of the Company (at that time), the CEO and CFO of DBS (at that time), and other senior officers and additional senior employees in the Bezeq Group. On November 6, 2017, the Israel Securities Authority published a press release regarding the conclusion of the Investigation and transfer of the Investigation file to the Tel-Aviv District Attorney's Office (Taxation and Economics). According to the press release, the Israel Securities Authority concluded that there is prima facie evidence establishing the involvement of the main suspects in the case in offenses of fraudulent receipt of funds, leaking material from the Independent Committee to the controlling shareholder and his relatives concerning transactions with interested parties, and promoting the Company's interests at the Ministry of Communications in violation of the Penal Code and the Securities Law.

On February 18, 2018, a new joint investigation was opened by the Israel Securities Authority and the Israel Police against several of the Company's senior officers. To the best of the Company's knowledge, these 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 some also of offenses under the Prohibition of Money Laundering Law.

For further details on these matters see section 1.1.6 of the Chapter, Description of Company Operations in the 2017 Periodic Report and the Company's Immediate Reports referred to in that section.

The Company does not have complete information about the Investigations, their content, nor 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 proceedings, at this stage the Company must refrain from conducting any examinations relating to matters that arose in the course of those investigations. This limits the Company in all matters related to performing audit activity and reviews in this matter. Accordingly, the Company is unable to assess the effects of the investigations, their findings and their effect on the Company and its officers, on the assessment of the internal controls of the Company, on the financial statements and on the estimates used in the preparation of these financial statements, if any. Similarly, it is not possible to determine, in respect of matters related to these Investigations, whether all significant deficiencies and material weaknesses have been identified and assessed as part of the assessment of the internal control over financial reporting and disclosure.

Without derogating from the foregoing, a number of significant deficiencies identified in the assessment of the effectiveness of internal control over financial reporting and disclosure are deficiencies arising from or impacted by the Investigations as stated above. Among them, during the period of the Investigations as stated, conditions were set for release under restrictions of some of those under investigation serving or who had served in key positions in the Company and DBS, which led to the extended absence of some of those under investigation, thereby constraining the Company and Group companies in their operations. As a result, and due to the large number of meetings of the Board and their committees in the Company and DBS in the period from the opening of the Investigation, there were also delays in preparation of the minutes of a significant number of meetings of the Board and their committees in these companies in 2017. In addition, there were indications of procedural deficiencies in respect of the work of the Independent Committee of the Board of Directors related to the engagements that, to the best of the Company's knowledge, are under investigation.

Moreover, it was found that a limited number of employees who took part in the change management control process in one of the Company's IT systems acted in an improper manner in contravention of the Company's procedures. In addition, suspicion arose, as part of the Company's internal review concerning the period after November 1, 2017, that the Company's Corporate Secretary (at that time) listened in on discussions to which she was prohibited from being privy to.

In addition, in some of the Group companies, a lack of procedures and a need to update certain procedures were found.

Management and the Board are implementing various actions, under the constraints arising from the Investigations, with assistance from outside professional consultants, to act to correct the material weakness and in order to deepen the correctness of the Company's control process and to ensure that despite there being a material weakness in the internal control, the reports are prepared in compliance with the law. All this is in addition to the various developments that have occurred in the Company from the start of the Investigations, all as detailed below.

Actions carried out by the Company and developments that occurred until reporting date of the Company's Report for the second quarter of 2018:

1. The Company has retained the services of professional accounting support to assist in the process of preparing the financial statements of DBS for 2017. Similarly, as part of the preparation of the 2017 Periodic Report, the Company and DBS have added supplementary procedures on specific subjects in order to enhance the internal control over financial reporting and disclosure on those subjects.

2. In the period following the opening of the Investigation and until the reporting date of the 2017 Periodic Report, there were changes in the composition of the Company's Board of Directors and Management, and, among other things, director David Granot was appointed Interim Chairman of the Board by the Company's Board (he served in this position until April 30, 2018); directors Shaul Elovitch and Or Elovitch (who have been investigated as part of the Investigations) resigned their positions and in their place two new directors were appointed by the Company's Board; Mr. Yaacov Paz, Vice President of the Business Division, was appointed temporarily as the Company's Interim CEO (until March 27, 2018).

3. During the process to identify and appoint candidates to the Company's Board of Directors, which was carried out with the support of a specialist company in the field, on April 26, 2018 the Annual General Meeting of the Company's shareholders elected a new composition of the Board including 2 new external directors (in addition to the three external directors serving in the Company), 2 independent directors and 6 directors who are not necessarily independent directors (including one director from among the employees), so that at reporting date there are 13 directors serving. Similarly, on April 30, 2018 the Company's Board decided to elect Mr. Shlomo Rodav as Chairman of the Company's Board of Directors.

   Further to this, new appointments were made of directors to the Company's board committees and to the boards of the subsidiaries.

4. The employees who took part in the change management control process in one of the Company's IT systems and who acted in an improper manner in contravention of the Company's procedures, have been moved to other positions that are not involved in the financial reporting and disclosure process, and supplementary procedures have been implemented in respect of those employees. In addition, the change management process for the IT system has been examined and updated. The work procedures have also been clarified and training has been carried out for employees of the Technologies and Network Division that take part in the internal control on financial reporting and disclosure.

5. In addition, the former Corporate Secretary has been transferred to another position that is not one of an officer (and later ended her employment in the Company).

6. Bezeq Group has implemented a special review of the issues of corporate governance led by the Company's Internal Auditor and supported by outside consultants. The work included deeper reviews on the issues of risk management, compliance, enforcement and internal control. The Group companies are working to implement adjustments according to the guidelines decided upon.

7. The Company carried out a special review of the appropriateness of the Company's control processes. The review was carried out by outside consultants, led by the Company's Internal Auditor and under the supervision of a special, independent committee from among the Company's Board members. The review was completed, however, it was limited in scope and did not include factual reviews in respect of matters raised in the Investigations. Further to this review, the special committee approved various changes to the control processes and the work within the Company, which have commenced and are expected to be completed by the end of 2018.

8. Preparation of minutes of Board meetings and those of its committees of the Company and DBS held in 2017 has been completed.

9. The Group companies are working to complete the missing procedures and to update procedures as required, the forecast being to finish the work by December 31, 2018

10. In June 2018 the Company's Board decided on the appointment of a new CEO for the Company, Mr. David Mizrachi, who will commence in the position on September 1, 2018. The Company's present CEO is expected to complete her tenure on August 31, 2018.

11. In July 2018 the procedure of the Board's work was modified, further to the assessment carried out by the Company assisted by outside professional consultants. Similarly, the Company completed its examination of the effectiveness of the Board's work. The results have been presented to the Company's Audit Committee and Board of Directors.

12. In July 2018 the Group's Chief Strategy and Corporate Development Officer, the CEO and the CFO of DBS completed their tenures. In August 2018 the CEO of Pelephone started to serve as CEO of DBS, in addition to his role as CEO of Pelephone. In addition, a new CFO has been appointed for DBS.

13. Once the constraints on carrying out reviews and controls related to issues that arose in the Investigations are lifted, the review of all matters related to subjects that arose during those Investigations will be completed as required.

2. Declaration of Executives:

A. Declaration of the CEO in accordance with Regulation 38C(d)(1) of the Securities Regulations (Periodic and Immediate Reports), 1970[3]:

I, Stella Handler, declare that:

1. I have reviewed the quarterly report of “Bezeq” The Israel Telecommunication Corp Limited, ("the Company") for the second quarter of 2018 ("the Reports").
2. To the best of my knowledge, the reports do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the reporting period.
3. To the best of my knowledge, the financial statements and other financial information in the Reports fairly present in all material respects, the financial condition, results of operations and cash flows of the Company as of the dates and for the periods presented in the Reports.
4. I have disclosed to the auditor of the Company, to the Board of Directors, to the Audit and the Financial Statements Committees of the Board of Directors of the Company, based on my most recent evaluation of internal control over financial reporting and disclosure:
   A. All the significant deficiencies and material weaknesses in the design or operation of the internal control over financial reporting and disclosure which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information, in a way that could cast doubt on the reliability of the financial reporting and the preparation of the financial statements in accordance with the provisions of the law;

   B. Any fraud, whether or not material, that involves the CEO or anyone directly subordinate to the CEO, or which involve other employees who have a significant role in the Company’s internal control over financial reporting and disclosure
5. I, alone or together with others in the Company:
   A. Established controls and procedures, or ensured the establishment and maintaining of controls and procedures under my supervision, designed to ensure that material information relating to the Company, including its subsidiaries as defined in the Israel Securities Regulations (Annual Financial Statements), 2010 is brought to my knowledge by others in the Company and in the subsidiaries, particularly during the period of preparation of the Reports

   B. Established controls and procedures, or ensured the establishment and maintaining of controls and procedures under my supervision, designed to provide reasonable assurance regarding the reliability of the financial reporting and the preparation of the financial statements in accordance with the provisions of the law, including in accordance with accepted accounting principles

   C. No event or matter that occurred in the period between the date of the last report (quarterly or periodic, as applicable) and this reporting date was reported to me that would change the

[3] This declaration is subject to the limitations arising from the Investigations, as stated in the preamble to this Chapter in the Company’s 2017 Periodic Report.

conclusions of the Board and Management concerning the effectiveness of internal controls over the Company’s financial reporting and disclosure.

Nothing in the foregoing shall derogate from my responsibility or that of anyone else in law.

Date: August 22, 2018

Stella Handler, CEO;

B. Declaration of the CFO of the Company and the Group in accordance with Regulation 38C(d)(2) of the Securities Regulations (Periodic and Immediate Reports), 1970[4]:

I, Yali Rothenberg, declare that:

1. I have reviewed the interim financial statements and other financial information included in the reports for the interim period of “Bezeq” The Israel Telecommunication Corp Limited, ("the Company") for the second quarter of 2018 ("the Reports" or “the Reports for the Interim Period”).

2. To the best of my knowledge, the interim financial statements and other financial information included in the Reports for the Interim Period do not include any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the Reports;

3. To the best of my knowledge, the interim financial statements and other financial information in the Reports for the Interim Period fairly present, in all material respects, the financial condition, results of operations and cash flows of the Company as of, and for, the dates and periods presented in the Reports:

4. I have disclosed the following to the auditor of the Company, to the Company’s Board of Directors, to the Audit and the Financial Statements Committees of the Board of Directors of the Company, based on my most recent evaluation of the internal control over financial reporting and disclosure:

   A. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting and disclosure, insofar as they refer to the interim financial statements and other financial information included in the Reports for the Interim Period, which are reasonably likely to adversely affect the Company’s ability to record, process, summarize or report financial information in a way that could cast doubt on the reliability of the financial reporting and the preparation of the financial statements in accordance with the provisions of the law; and -

   B. Any fraud, whether or not material, that involves the CEO or anyone directly subordinate to the CEO, or which involve other employees who have a significant role in the Company’s internal control over financial reporting and disclosure.

5. I, alone or together with others in the Company:

   A. Established controls and procedures, or ensured the establishment and maintaining of controls and procedures under our supervision, designed to ensure that material information relating to the Company, including its subsidiaries as defined in the Israel Securities Regulations (Annual Financial Statements), 2010, is brought to my knowledge by others in the Company and in the subsidiaries, particularly during the period of preparation of the Reports; and -

   B. Established controls and procedures or ensured the establishment and maintaining of controls and procedures under my supervision, designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements in accordance with the provisions of the law, including in accordance with accepted accounting principles;

[4] This declaration is subject to the limitations arising from the Investigations, as stated in the preamble to this Chapter in the Company’s 2017 Periodic Report.

C. No event or matter that occurred in the period between the date of the last report (quarterly or periodic, as applicable) and this reporting date was reported to me in respect of the interim financial statements and to any other financial information included the Reports for the Interim Period, that would change in my opinion the conclusions of the Board and Management concerning the effectiveness of the internal control over the Company's financial reporting and disclosure.

Nothing in the foregoing shall derogate from my responsibility or that of anyone else in law.

Date: August 22, 2018

Yali Rothenberg,
Bezeq Group CFO

Bezeq the Israeli Telecommunication Corporation Ltd.

Impairment Test of Goodwill attributable to the Mobile Segment as of June 30, 2018

August 2018

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

Prometheus
Financial Advisory

14 Kreminitzky St., Tel Aviv 6789912 I Tel.: 03-5617801 I Fax: 03-5617765

Disclaimer

Prometheus Financial Advisory Ltd ("**Prometheus**" or the "**Firm**") was requested by Bezeq the Israeli Telecommunication Corp. Ltd. ("**Bezeq**" or the "**Client**" or the "**Company**") on July 27, 2018, through its VP Finance and CFO, Mr. Yali Rothenberg, to conduct an impairment test of goodwill attributable to the Mobile Segment - Pelephone Communications Ltd. (the "**Mobile Segment**" or "**Pelephone**"), for the Company's financial statements as of June 30, 2018 (the "**Report**"). The Report was prepared because signs of impairment were identified.

For the purpose of preparing this Report, we relied upon financial and other information including prospective financial information obtained from the Company and/or anyone on their behalf (the "**Information**"). We assumed that the Information is credible and therefore did not perform an independent audit of the information. In addition, nothing suggesting that the Information may be unreasonable has come to our attention. The Information has not been examined in an independent manner, and therefore this Report does not constitute a verification of the Information's correctness, completeness and accuracy. In case the Information is not complete nor accurate or credible, the results of this valuation might change. We reserve the right to update this Report in light of new information which might have not been known to us. We shall not be liable for the manner of the Client's or Pelephone's presentation of any financial data quoted in the Report in terms of its accuracy, completeness, accounting compliance and implications of its accounting presentation, as far as any such implications exist. This Report includes prospective information, as defined in the Securities Law, 5728-1968, obtained, among others from the Company. The realization of this information is not certain. The information is based in part on data that was known to the Company prior to the preparation of this Report, as well as on various assumptions, forecasts, and many external factors; including the state of relevant markets, potential competitors and the general state of the economy. There is no certainty that such assumptions or forecasts will be realized, in whole or in part.

Economic evaluations aim to reflect in a reasonable and fair manner a given state of being at a given time, based on known information, while considering relevant basic assumptions and forecasts. To remove doubt, this Report is valid only for its preparation date.

This Report does not constitute a due diligence review and is not meant to replace such a review. In addition, this Report is not intended to determine value for a specific investor, and there is nothing in this Report to constitute legal advice or opinion.

This Report does not include any accounting audit regarding compliance with accounting rules. We are not liable for the manner in which the Client's and/or Pelephone's financial statements are prepared and audited in connection with the accuracy and completeness of the data presented in these statements and the implications of their accounting presentation, as far as such exist.

This Report includes a description of the methodology and main assumptions and analyses used by us. The description does not purport to provide a full and detailed breakdown of all the procedures that we applied in formulating the Report.

We hereby confirm that we are an independent expert, with no personal interest in the Company and/or Pelephone, and/or their controlling stakeholders, and/or the outcome of this Report. Our fee for preparing this Report is not contingent on the outcome of our work.

We hereby confirm that we have no personal stake in the Company and/or Pelephone and their controlling stakeholders.

Calculations and figures presented herein have generally been rounded. As the underlying calculations were performed on exact figures, adding or multiplying table values may result in minor differences compared to the presented figures.

Disclaimer

The Client shall not be entitled to receive from us, whether under a contract or in damages, by law or otherwise, any amount for loss of profits, data or goodwill or for any incidental or indirect consequential damage, or as punitive or special compensation, in respect to claims arising or related in another manner to the preparation of this Report, whether the likelihood of such loss or damage was foreseen or not, subject to us not acting with malice or gross negligence. Moreover and without derogating from the generality of the foregoing, insofar as we will be obligated to pay any amount or will be required to pay for a peremptory ruling, and any direct and reasonable expense arising in relation to performance of this Report, we will be indemnified by the Client immediately upon our first written request, and in any event, no later than 14 days from the date of receipt of a demand letter by registered mail for any amount exceeding three times our fees under this contract, unless we acted with malice or gross negligence.

The Firm has given its consent to include the Report in Bezeq’s financial statements as of June 30, 2018.

Sources of Information & Previous Valuations

Previous valuations

The Firm conducted an impairment test of the goodwill of Pelephone and segments within Bezeq as of December 31, 2017. Following is a comparison of the of Pelephone and its key parameters (this Report) as of June 30,2018 and the valuation as of December 31, 2017:

Report	Enterprise Value (NIS millions)	No. of subscribers in 2022 (TY)	ARPU in 2022 (TY)	Discount rate (post-tax)	Permanent growth
Impairment test of December 31, 2017	5,403	2,918	70	9.97%	2.5%
Impairment test as of June 30, 2018	3,907	3,062	61	9.97%	2.5%

Main information sources used in the preparation of the Report

- Bezeq's audited financial statements (which include Pelephone's data) for 2013-2017
- Pelephone's audited financial statements for 2014-2017
- Pelephone's financial statements (draft) as of June 30, 2018
- A multiannual projection prepared by Pelephone's management
- Report regarding the global wireless communications market: BAML Q1 2018 Global Wireless Matrix
- Additional data provided to us by the Company at our request
- Background information and market data, obtained from publically available sources
- Data from the Central Bureau of Statistics and the Bank of Israel
- Bloomberg
- Discussions and meetings with Bezeq and Pelephone executives

Profile of the Appraising Firm and the Appraisers

Prometheus Financial Advisory specializes in providing clients with financial and economic advisory services as well as expert opinions. The firm is led by its CEO, CPA Yuval Zilberstein, and Eng. Eyal Szewach. The Firm is committed to personal service, while providing clients with in-depth value added advisory services. The Firm's executives were involved in most major transactions in Israel in recent years and have decades of experience in providing expert opinions for boards of directors, tax and securities authorities, and courts.

Prometheus has extensive experience in conducting valuations of similar scopes and areas of operation as the enterprise evaluated in this Report, including:

- Valuation of the cellular segment of HOT (HOT Mobile) as part of impairment test of goodwill as of September 30, 2016 and September 30, 2017.
- Valuation of Cellcom Communications as of June 30, 2017 as part of consultation on tier elimination for an independent committee of IDB's directors.
- Valuation of the fixed-line segment, the mobile segment (Pelephone) and the multichannel television segment (YES) as part of an impairment test of goodwill, for Bezeq, as of December 31, 2017.

The work was prepared by a team headed by Mr. Eyal Szewach, founding partner and holder of a B.Sc in Electronic Engineering from The Technion and an MBA from Tel-Aviv University. Mr. Szewach is an expert with over 10 years experience in conducting valuations, financial statement analysis, preparation of expert opinions and various types of economic consulting.

Sincerely,

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Prometheus Financial Advisory Ltd.

August 21, 2018

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Executive Summary

Executive Summary

Brief Description of Bezeq and Pelephone

Bezeq Group

Bezeq the Israeli Telecommunication Corp. Ltd. is a public company traded on the TASE. Bezeq is a key provider of telecom services: domestic fixed-line communication, mobile radio-telephone (cellular telephony), international communication (ILD), multichannel satellite television, internet access and infrastructure services, maintenance and development of communication infrastructures, provision of communication services to other providers, and other services related to its area of operation.

Pelephone

Pelephone Communications Ltd. was incorporated in Israel in 1985. It engages in the provision of cellular communication services, and sale and repair of equipment. Pelephone operates under a license from the Ministry of Communications - a general cellular telephony license. The license is valid until 2022 with an extension option, subject to the provisions of the license, for a further six-year term, and for further more six-year renewal terms.

Pelephone is one of the six mobile network operators (MNOs) in the Israeli market, and one of the three largest well-established cellular companies in Israel. The other operators, namely Partner, Cellcom, HOT Mobile, Golan Telecom and Xfone, are its main competition. As at the end of Q1 2018, Pelephone held a 24% market share.

Valuation Methodology

The valuation of Pelephone's operations was conducted using the discounted cash flow method (DCF). Pelephone's projected cash flows relied, inter alia, on its results in 2015-2017, actual results for Q1 2018, unaudited results in Q1 2018 and Pelephone management's projections for H2 2018 and for 2019-2022.

We estimated, as best as we could, the probability of realization of different parameters, based on information presented to us and on independent analysis.

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Executive Summary

Valuation Summary

Main Assumptions

It was assumed that there will be growth in Pelephone's subscriber base, mainly in postpaid subscribers, and to a lesser extent - in prepaid subscribers, to c. 3,062K as of the end of 2022. A gradual growth in ARPU from NIS 57 in H1 2018 to NIS 61 in 2022 was assumed. A permanent growth rate of 2.5% and a post-tax discount rate of 9.97% were assumed.

Valuation Results

The enterprise value of Pelphone, based on the assumptions in this valuation, was estimated at c. NIS 3,907M as of June 30, 2018. According to information provided by Bezeq, the carrying amount of this segment was c. NIS 2,164M, therefore, there is no need for impairment.

Synergy and Network Sharing

The valuation does not include potential synergies that may arise from cancellation of the structural separation obligation, because there is a large difference between the enterprise value of the segment and its carrying amount and because they were not assessed as part of the valuation as of December 31, 2017. Moreover, if Pelephone enters into a network sharing agreement with another operator, such occurrence may materially affect its value. Since Pelephone's management does not have concrete plans to enter into such an agreement and in view of the large difference between the enterprise value of the segment and its carrying amount, such a scenario was not taken into account.

Valuation Summary

Sensitivity Analyses

Sensitivity analysis of the changes in the cellular segment's enterprise value dependent on the discount rate and permanent growth:

		Discount rate				
		7.97%	8.97%	9.97%	10.97%	11.97%
Permanent growth	1.5%	4,690	4,008	3,487	3,078	2,749
	2.0%	5,053	4,269	3,684	3,231	2,869
	2.5%	5,481	4,572	**3,907**	3,401	3,003
	3.0%	5,996	4,925	4,162	3,593	3,152
	3.5%	6,626	5,342	4,457	3,810	3,318

Sensitivity analysis of the changes in the cellular segment's enterprise value dependent on the subscriber base as of the end of 2022:

EV in NIS M dependent on subscriber base at the end of 2022				
2,962	3,012	3,062	3,112	3,162
3,594	3,750	**3,907**	4,064	4,221

A change of 50K in subscribers in 2022 affects the EV by c. NIS 157M.

Sensitivity analysis of the changes in the cellular segment's enterprise value dependent on the ARPU in 2022:

EV dependent on ARPU in 2022				
57	59	61	63	65
2,778	3,342	**3,907**	4,471	5,035

A change of NIS 1 in the ARPU in 2022 affects Pelephone's EV by c. NIS 282 million.

Note regarding subscriber and ARPU assumptions and analysis

The revenue from Pelephone's prepaid subscribers is not material compared to its total revenue. Pelephone's management decided to revise the definition of an active subscriber so as not to include IoT subscribers, and to add separate reference for prepaid subscribers, according to which a prepaid subscriber will be categorized as active from the date at which charging is executed, and will be derecognized as active if no outgoing use is made for six months.

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The change will enter into effect at the beginning of Q3 2018 and as a result, 426K prepaid subscribers are expected to be derecognized from Pelephone's active subscriber listing. The above is expected, at the date of the change, to lead to an increase in ARPU of c. NIS 11.

This change will not affect Pelephone's revenue and cash flows or the assumptions and results of this valuation.

Feasibility test: Comparison to change in Cellcom and Partner's EV

As noted in the analysis in this Report, the entry of a sixth MNO into the cellular market negatively affected price levels and intensified competition, and as a result the value of the cellular companies decreased.

Pelephone's EV was estimated by us at c. NIS 3,907M, a decrease of c. 27.7% compared to our estimation of c. NIS 5,403M in the valuation as of December 31, 2017.

In the following feasibility test, the above decrease in Pelephone's EV was compared to the change in Cellcom and Partner's EV, as derived from market data. Following is a comparison of Cellcom and Partner's EV as of June 30, 2018 to December 31, 2017:*

NIS M	December 31, 2017	June 30, 2018	% change
Cellcom enterprise value	6,223	5,050	**(19%)**
Partner enterprise value	4,616	3,248	**(30%)**

As can be seen in the table, Cellcom and Partner's EV declined by c. 19%-30% in the six months beginning December 31, 2017, similar to the decrease in Pelephone's EV in this valuation, compared to the valuation as of December 31, 2017.

* Source: TASE website and the companies' financial statements

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Financial Advisory

Executive Summary

Valuation Summary

Comparison to the Valuation as of December 31, 2017

The Firm conducted an impairment test of the goodwill of Pelephone and other Bezeq segments as of December 31, 2017. Following is a comparison of Pelephone's current valuation and its key assumptions (this Report) to the valuation as of December 31, 2017:

Report	Enterprise Value (NIS millions)	No. of subscribers in 2022 (TY)	ARPU in 2022 (TY)	Discount rate (post-tax)	Permanent growth
Impairment test of December 31, 2017	5,403	2,918	70	9.97%	2.5%
Impairment test as of June 30, 2018	3,907	3,062	61	9.97%	2.5%

As can be seen in the above table, Pelephone's EV was estimated at c. NIS 3,907M, compared to c. NIS 5,403M as of December 31, 2017. The main reason for the decrease is a downward update of long-term ARPU projections due to intensification of competition in the cellular market, which is expressed, inter alia, by the entry of a sixth MNO in April 2018, and in our estimation, a delay in restoration of equilibrium of the cellular market. Moreover, a certain negative deviation was measured between the actual financial results in H1 2018 (in annual terms) compared to estimates assumed for this period in the previous valuation. As shown on the previous page, the EV of Cellcom and Partner's declined similarly to the decline derived in this valuation, in the period from December 31, 2017 through June 30, 2018.

Chapter A - Description of Pelephone's Operations

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Chapter A - Description of Pelephone's Operations

Description of Pelephone

Pelephone

Pelephone Communications Ltd. was incorporated in Israel in 1985. It engages in the provision of cellular communication services and sale and repair of equipment.

Pelephone operates under a license from the Ministry of Communications - a general cellular telephony license. The license is valid until 2022 with an extension option, subject to the provisions of the license, for further six-year terms.

Pelephone is one of the six mobile network operators (MNOs) on the market and one of the three largest cellular companies in Israel. The other operators, namely Partner, Cellcom, HOT Mobile, Golan Telecom and Xfone, are its main competition. As at of end of Q1 2018, Pelephone held a 24% market share.

Pelephone generates its revenue in the following areas:

- **Basic telephone services** - A bundle of services, including voice and related services such as call waiting, follow-me, voicemail, conference calls, etc.
- **Data services** - On 3G and 4G networks.
- **Content services** - Pelephone offers its customers content services, such as data storage backup services (Pelephone Cloud), antivirus, cyber protection, TV channels viewing (Super TV) and a music library (Musix) that enables listening to a variety of music on mobile phones and PCs.
- **Roaming services** - Pelephone offers its customers roaming with their personal phones in in over 220 countries. It also provides incoming roaming services to inbound customers of foreign operators, staying in Israel.
- **Sale of equipment** - Pelephone offers different types of mobile phones, hands-free devices and related accessories. It also provides its customers with other equipment such as tablets, laptops, modems, speakers, headphones and other electronic products.
- **Maintenance and repair services** - Pelephone offers a repair and extended warranty service for a monthly fee, or for a one-time fee at the time of the repair.

Chapter A - Description of Pelephone's Operations

Description of Pelephone

Pelephone (cont.)

Following are Pelphone's main KPIs for 2015-H1 2018:

Fig. 1: Pelephone – KPIs

	Note	2015	2016	2017	H1 2018
No. of subscribers (K)	1	2,651	2,402	2,525	2,601
% change			(9.4%)	5.2%	3.0%
ARPU	2	64	63	61	57
% change			(1.7%)	(4.4%)	(6.2%)

1. The reduction in the number of subscribers in 2016 derived from a derecognition of 499K CDMA subscribers. In contrast to trends among Cellcom and Partner, Pelephone recruited 124K subscribers in 2017 and 76K in H1 2018, most of them postpaid subscribers, mainly due to the diversity of distribution channels and sub-brands' operations, as part of the growth strategy adopted by the management. The growth in subscribers partially compensated for the ARPU erosion, leading to a slowdown in the revenue decline rate.

2. In recent years, ARPU is in a downtrend due to increased competition following the entry of new competitors into the market, who started marketing various cellular communications bundles at low prices as part of market penetration measures. Entry into the market of We, the sixth MNO in Israel, intensified the level of competition, leading to a decline in bundle prices among existing operators.

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Chapter B – The Israeli Telecommunications Market

Chapter B – The Israeli Telecommunications Market

Telecommunications market in Israel

General

The telecommunications market is divided into six main sub-markets:

1. Cellular telephony
2. Fixed-line telephony (including VOB/VOIP)
3. Multichannel television (satellite/cable/IPTV)
4. Internet service provider services (ISP)
5. International services (ILD)
6. Broadband infrastructure (ADSL/cable/fiber)

The global telecom market in general and the Israeli market in particular, are characterized by rapid development and frequent changes in technological and regulatory aspects. When in the past competition in the telecom market was concentrated between independent communications providers in each operating segment separately, in recent years, there is a trend of merging into telecom groups that operate in several segments simultaneously, utilizing business synergies, subject to regulatory restrictions.

Recent regulatory changes in the cellular segment enabled the entry of additional and relatively small participants, such as virtual operators and MNOs.

Moreover, technological and strategic changes in the television segment enabled the entry of IPTV operators and streaming services. Currently, the four major telecommunications groups - Bezeq, HOT, Cellcom and Partner, operate in all segments:

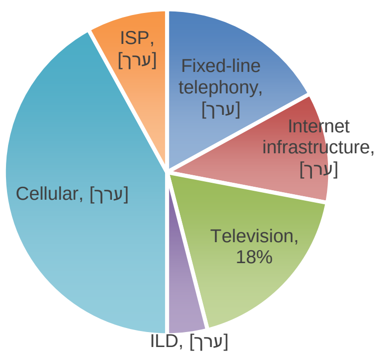
	Bezeq	Cellcom	Partner	HOT
Fixed-line telephony	Yes	Yes	Yes	Yes
Internet services	Yes (Bezeq + Bezeq International)	Yes	Yes	Yes (HOT Telecom + HOTnet
Televisio n	Yes	Yes	Yes	Yes
ILD	Yes (Bezeq International)	Yes (Netvision)	Yes (012 Smile)	Yes
Mobile	Yes (Pelephone)	Yes	Yes	Yes (HOT Mobile)

In 2016, the telecom market's aggregated revenue amounted to NIS 20.2 billion, a decrease of 5.5% compared to 2015, mainly due to competition and reductions in price levels in some segments.

Chapter B – The Israeli Telecommunications Market

Telecommunications market in Israel

Fig. 2: Distribution of Revenue in the Telecommunications Sector - 2016 [1]



Main Telecom Companies

<u>Bezeq Group</u>

Bezeq Group is active in all market segments. It was declared a monopoly in its main areas of operation by the Antitrust Authority.

1. *Source: Public information published by the Ministry of Communications*

Bezeq Group is subject to several regulatory restrictions in terms of collaborations between the Group's companies, including the structural separation obligation.

<u>HOT</u>

As with Bezeq, HOT is also active in all segments, whereas the structural separation obligation applies to it in its cellular and ISP segments. As opposed to Bezeq, the obligation of services unbundling applies only between the cellular and ISP services and the other services. Therefore, it can offer a triple bundle that includes telephony, internet infrastructure and TV services.

<u>Cellcom</u>

Cellcom offers its customers cellular services, fixed-line telephony, ILD, ISP and related services, and OTT TV services. As of the valuation date, Cellcom also offers a Quarttro bundle that includes television, fixed-line telephony, cellular and internet. In August 2018, Cellcom signed a memorandum of understanding with IBC (a fiber venture) for Cellcom to invest in IBC.

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Telecommunications market in Israel – Cellular

Partner

Partner offers cellular services, fixed-line telephony, international telephone services, ISP and related services. In June 2017, Partner started offering OTT TV, thereby becoming the fourth telecom group to operate in all segments. It is also independently deploying optical fibers nationwide. According to its announcements, Partner has reached deployment of 170K households.

Cellular Market - General

Cellular communications operates through two main elements - mobile phones and fixed broadcasting facilities. Mobile phones transmit radio waves to antenna installations of broadcasting facilities. The cellular technologies used in Israel nowadays are known as GSM (2G), UMTS (3G) and LTE (4G). Currently, there is a trend of lateral adoption of 4G technology, due to increasing demand for data by consumers.

Until 2012, four MNOs operated in the cellular market: Pelephone, Cellcom, Partner and Mirs (now HOT Mobile). As opposed to the first three operators, until 2012 Mirs' technology was based on an Integrated Digital Enhanced Network (IDEN), which was used mainly by public entities such as the IDF and several companies that had a need for that service. As part of regulatory measures taken by the MoC to intensify competition in the cellular market, since 2012 new operators have entered the market:

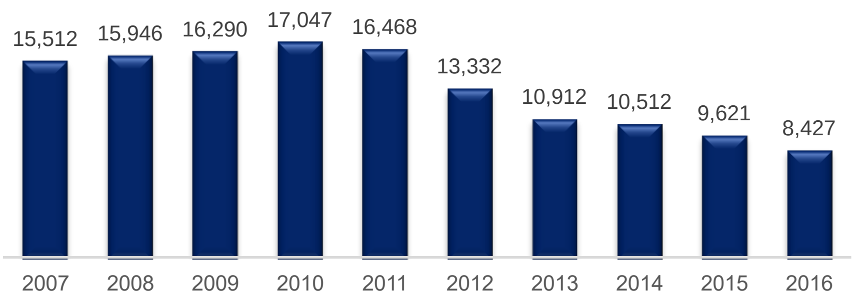
1. **MNOs:** Golan Telecom, HOT Mobile, and We (Xfone), which was launched in April 2018.
2. **MVNOs:** Operators such as Rami Levy Communications, Telser, U-Phone, Home Cellular, etc. Many of the MVNOs were acquired by the MNOs.

Entry of new operators led to an increase in churn rates of veteran companies and an ongoing price war, which combined resulted in erosion of profits of veteran operators.

Chapter B – The Israeli Telecommunications Market

Telecommunications market in Israel – Cellular

Fig. 3: Revenue in the cellular market 2007-2016 [2]



The revenue in the celluar market has declined from a peak level of NIS 17 billion in 2010 to NIS 8.5 billion in 2016, despite the continuous increase subscribers.

Business Environment and Competition

In 2011, the MoC held a frequencies tender aimed at adding two new operators to the industry. In April 2011, HOT Mobile and Golan Telecom were announced as winners. The new operators signed domestic roaming agreements with veteran operators as an interim solution until deployment completion of their independent network. As part of market penetration measures, new operators offer bundles that include data, calls and SMS at a fixed monthly price (unlimited bundles). Opening the market to competition led to decreased prices and increased customer portability, resulting in ongoing erosion in veteran operators' results.

In April 2018, Xfone launched its operations as an MNO under the We brand, intensifying competition in the market and evoking a response among the existing operators of further price reductions.

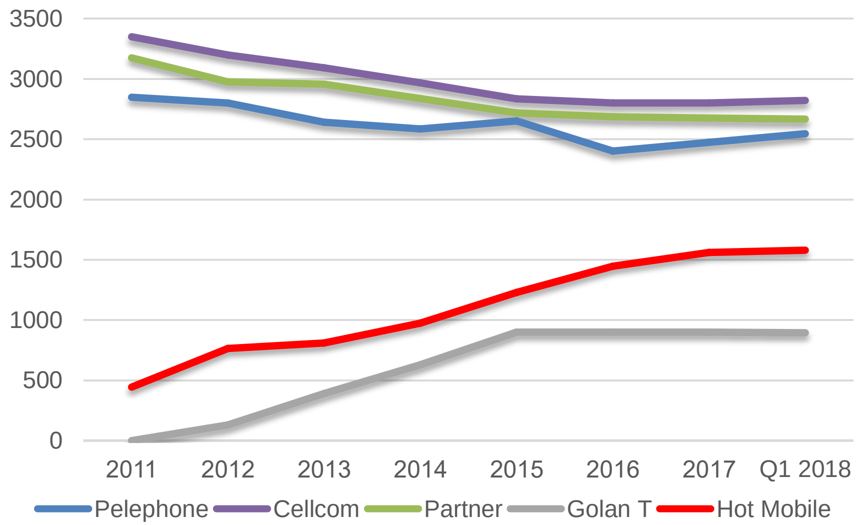
During the cellular market reform, virtual operators (MVNOs) were also added, whose impact was less substantial.

2. *Source: Public reports of the MoC regarding revenue in the cellular market*

Telecommunications market in Israel – Cellular

Subscribers and ARPU

Fig. 4: MNO Subscribers[3]

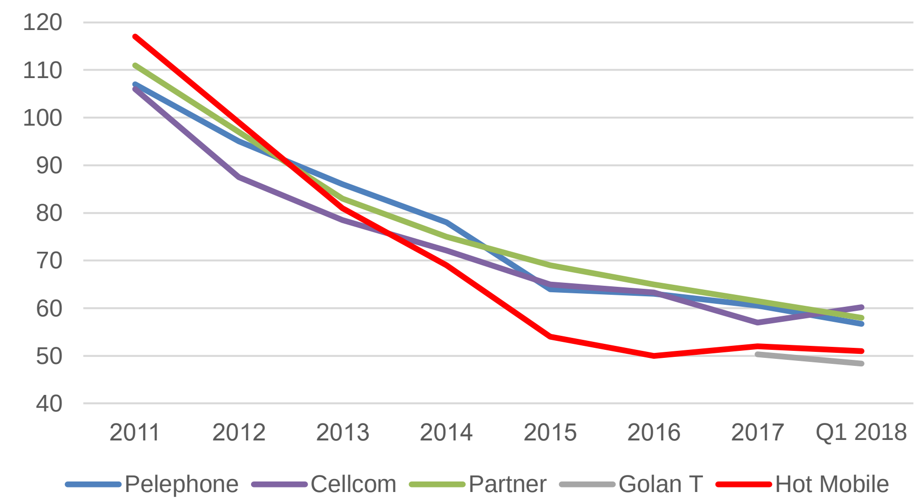


As can be seen in the above chart, veteran operators have lost subscribers since the reforms, when Cellcom and Partner have absorbed most of the decrease. In 2017, the downtrend was substantially halted in Pelephone, due to the growth strategy which it is implementing. Between the beginning of 2017 and the end of the first quarter of 2018, Pelephone recruited 144K subscribers.

3. *Source: the companies' financial statements*

The loss of subscribers in Cellcom was halted from the beginning of 2017, although not significantly – 21K subscribers were added between the beginning of 2017 and the end of Q1 2018. Partner continues to lose subscribers at a moderate rate - from the beginning of 2017 through the end of Q1 2018, it lost 19K subscribers. HOT Mobile and Golan Telecom recruited subscribers at a rapid rate since the reform, when in the last three years HOT Mobile is continuing positive recruitment (with a certain slowdown in Q1 2018) and Golan Telecom's subscriber Base is stagnant.

Fig. 5: ARPU of MNOs[4]



4. *Source: The companies' financial statements*

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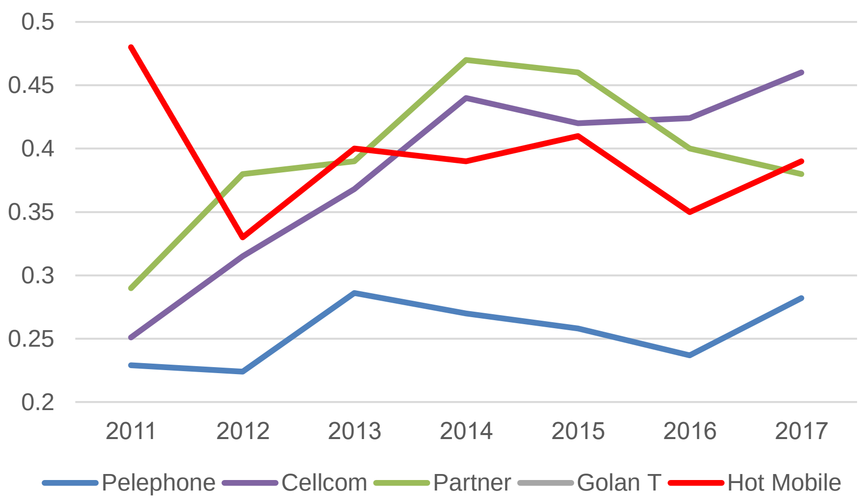
Telecommunications market in Israel – Cellular

As can be seen in fig. 5, the operators ARPU is in continuous erosion. Among the veteran operators, the ARPU has eroded by c. 50%, from a level of c. NIS 106-111 in 2011 to a level of c. NIS 58-62 in 2017. In the last two years, the erosion rate slowed among all operators. In Q1 2018, ARPU erosion continued moderately (except in Cellcom where it rose slightly).

Fig. 6: Churn rates [5]



5. *Source: The companies' financial statements*

As can be seen in the above chart, the churn rate of the MNOs increased with the opening of the market to competition.

Recent developments

Network sharing

In view of the competition and ARPU erosion, certain entities in the market entered into network sharing agreements - joint cellular network maintenance and development, in order to save costs. Following is an overview of the existing agreements as of the valuation date.

- <u>HOT Mobile – Partner:</u> In November 2013, Partner and HOT Mobile announced the signing of an agreement to establish a partnership to maintain, develop and operate a single advanced cellular network for both companies, when which will hold half of the rights thereof. According to the announcement, each of the parties will continue to hold and operate their core network separately and will provide cellular communication services to their customers only. In April 2015, both companies announced that the MoC approved the agreement.

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Telecommunications market in Israel – Cellular

- Golan Telecom – Cellcom: On January 3, 2017, a collaboration between Cellcom and Golan Telecom was announced, with an aim of joint development of networks and technologies. In March 2017, the Antitrust Commissioner and MoC approved the agreement.
- Xfone - Cellcom: In July 2016, Cellcom signed an agreement with 018 Xfone Ltd for a sharing of Cellcom's 4G network and the provision of hosting services on the 2G and 3G networks. On March 20, 2017, the MoC approved the agreement.

Golan Telecom - Electra Transaction

On January 3, 2017, Electra Consumer Products Ltd. ("Electra") reported the acquisition of 100% of Golan Telecom's shares for a consideration of NIS 350M. On April 5, 2017, following approval of the transaction by the Antitrust Commission and the MoC, the transaction was completed.

Elimination of purchase tax on cellular phones

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

Entry of Xfone into the market

In January 2018, Xfone announced the launching of its operations as an MNO under the We brand. In practice, the operations were launched in April 2018. The impact of We on the cellular market was felt mainly in the response of other players, which was expressed in a certain price erosion of bundles and an data volumes offered as part of the bundles. We does sell equipment. We estimate that its operations are not profitable and will continue do be so at the price level which it offers and therefore we believe that changes are expected in the medium to long term, which will tame competition on its part.

Chapter B – The Israeli Telecommunications Market

Telecommunications market in Israel – Cellular

Fig. 7: Services EBITDA rates in select countries for Q1 2018 [6]

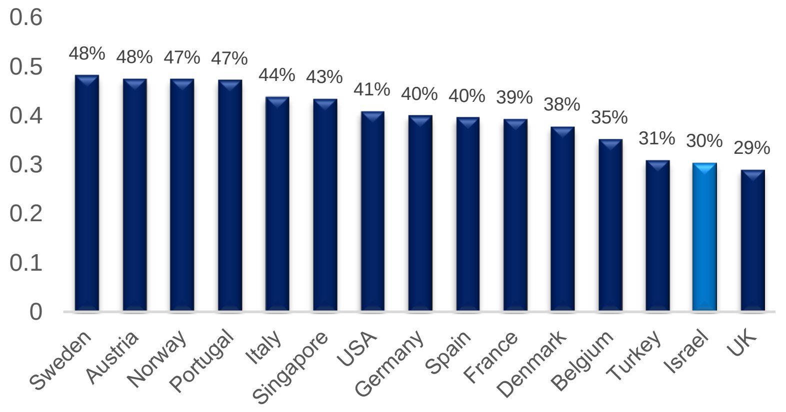


Fig. 8: Average EBITDA rate of veteran operators in Israel [7]

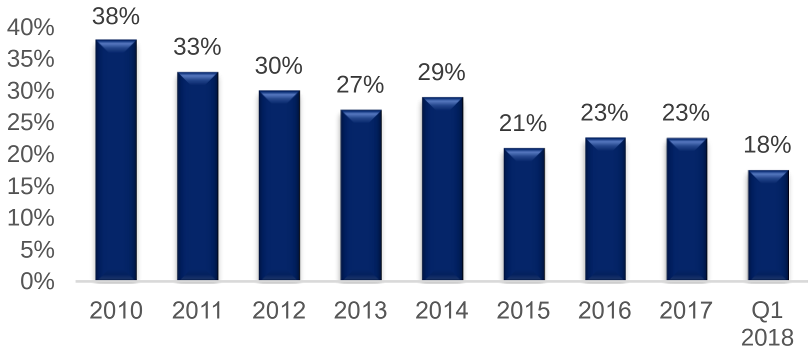


Fig. 7 shows that the EBITDA rate from services is higher in most developed countries than in Israel, due to the fierce competition in the Israeli market in recent years.

Fig. 8 shows that the average EBITDA rate of the veteran operators declined between 2010 and 2017. The above data does not take into account the impact of IFRS 15 (adopted by the companies in 2017), which positively impacted EBITDA figures. Net of the effect of these standards, there would have been an even greater decrease in EBITDA.

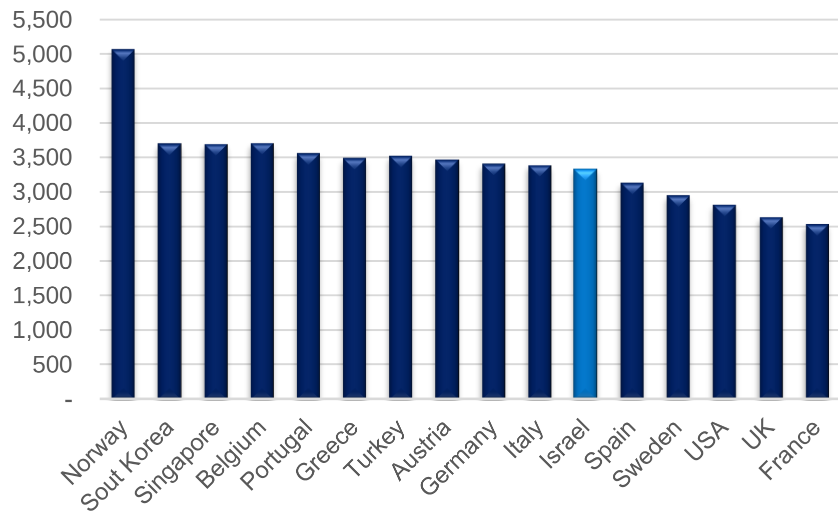
6. *Source: Merrill Lynch Global Wireless Matrix Q1 2018*

7. *Source: Financial statements of Bezeq, Cellcom and Partner*

Chapter B – The Israeli Telecommunications Market

Telecommunications Market in Israel – Cellular

Fig. 9: HHI in Select Countries, Q1 2018 [8]



The Herfindahl-Hirschman Index is a market concentration measure and the accepted indicator of the market concentration in a sector. As shown in the above chart, the market concentration in Israel is relatively low according to this index, although there are more competitive countries.

Cellular Market – Conclusion

The cellular market is highly competitive in recent years. This competition lead to a decline in revenue and to higher churn and portability rates than what was prevalent before the reforms.

Although erosion is more moderate in recent years due to a decrease in consumer sensitivity to further price reductions and following the acquisition of Golan Telecom by Electra, the launch of We, which led to intensification of competition in the market, may lead to a delay of restoration of market equilibrium.

In our estimation and the estimation of professionals in this market, the current ARPU levels are not economically feasible and it is reasonable to assume that in the coming years there will be multiple moderate increases or a few sharp increases in bundle prices.

8. *Source: Merrill Lynch Global Wireless Matrix Q1 2018*

Chapter C - Analysis of Financial Statements

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Chapter C - Analysis of Financial Statements

Balance Sheet

Pelephone's balance sheet for December 31, 2015-2017 (audited data) and June 30, 2018 (draft financial statements) are presented below:

NIS M	December 31, 2015	December 31, 2016	December 31, 2017	June 30, 2018
Assets	**Audited**	**Audited**	**Audited**	**Unaudited**
Current assets	1,420	1,275	1,128	931
Non-current assets	1,854	2,019	2,142	3,171
Total assets	**3,274**	**3,294**	**3,271**	**4,102**
Liabilities + Equity				
Current liabilities	448	465	442	655
Non-current liabilities	70	104	94	741
Equity	2,756	2,725	2,735	2,706
Liabilities + Equity	**3,274**	**3,294**	**3,271**	**4,102**

Balance sheet analysis

Total assets increased in June 30, 2018 compared with December 31, 2017, mainly due to the formation of Pelephone's right of use asset for its leases. This change is due to early adoption of IFRS 16. As a mirror image of this asset, short and long term liabilities representing the current and non-current lease payments were recorded.

The assets of the operation (excluding right of use assets) continued to decrease in H1 2018, mainly due to a decrease in revenue.

Chapter C - Analysis of Financial Statements

P&L Statements

Pelephone's P&L statements for 2015-2017 (audited data) and for H1 2018 (draft financial statements) are presented below:

NIS M	2015 Audited	2016 Audited	2017 Audited	H1 2018A Unaudited
Service revenues	1,999	1,819	1,782	869
Change YOY		(9.0%)	(2.0%)	
Revenues from sales of equipment	891	812	763	352
Change YOY		(8.9%)	(5.9%)	
Total Revenues	**2,890**	**2,630**	**2,545**	**1,221**
Change YOY		**(9.0%)**	**(3.2%)**	
Payroll	381	378	384	195
% of revenue	13.2%	14.4%	15.1%	16.0%
General and operating expenses	1,928	1,839	1,706	704
% of revenue	66.7%	69.9%	67.0%	57.7%
D&A	418	380	383	317
% of revenue	14.5%	14.5%	15.1%	26.0%
Total operating expenses	**2,728**	**2,597**	**2,474**	**1,217**
% of revenue	**94.4%**	**98.7%**	**97.2%**	**99.7%**
Other operating expenses	5	1	0	(0)
Operating profit	**157**	**32**	**72**	**4**
% of revenue	**5.4%**	**1.2%**	**2.8%**	**0.3%**
D&A	418	380	383	317
EBITDA	**576**	**412**	**455**	**321**
% of revenue	**19.9%**	**15.7%**	**17.9%**	**26.3%**
Net of the effect of IFRS 16 Standard:				
- Lease payments	-	-	-	(125)
Adjusted EBITDA (net of the effect of IFRS 16)	**576**	**412**	**455**	**196**
% of revenue	**19.9%**	**15.7%**	**17.9%**	**16.1%**
CAPEX	426	241	308	159
% of revenue	14.7%	9.2%	12.1%	13.0%
Adjusted EBITDA minus CAPEX	**150**	**171**	**146**	**37**
% of revenue	**5.2%**	**6.5%**	**5.8%**	**3.0%**

Analysis[10]

Revenue

- Revenues from services: Revenues from services continued to decline in H1 2018, mainly due to further ARPU erosion, inter alia, because of intensification of competition in the market following the entry of a sixth operator. In annual terms, the revenue from services decreased by NIS 44M or 2.5%.
- Revenues from equipment sales: The revenue from equipment sales decreased in the H1 2018 by 7.8% (annual rate), mainly due to the cancellation of purchase taxes on imported cellular phones and a decline in quantities sold.

In summary, revenue figures in H1 2018 represent a continuation of the downtrend, although at a lower rate than in the past.

10. Figures presented up to the EBITDA item are based on Pelephone's reporting method. At the beginning of 2018, Pelephone adopted the IFRS 16 standard in its financial statements. The above analysis of the P&L statement, the following analysis of future cash flows in the valuation chapter, and the carrying amount are net of the effect of this standard, expressed in adjusted EBITDA and cash flow figures.

Chapter C - Analysis of Financial Statements

Profit and Loss

Costs, EBITDA (adjusted), CAPEX, and operating cash flows

Pelephone's expenses did not change materially in H1 2018 compared to 2017.

The **adjusted EBITDA** margin eroded in H1 2018 by 1.8% compared to the margin in 2017.

Operating profit stood at c. NIS 4 million.

In terms of operating cash flows (before changes in working capital and tax expenses) there was an erosion as expressed in the **adjusted EBITDA minus CAPEX** when the rate declined by c. 2.8% in H1 2018 compared to 2017, mainly due to the decline in revenues.

In conclusion, in H1 2018 Pelephone's profits eroded to minimal levels, mainly due to heightened competition. The results are not materially different from Pelephone's budget for that period.

Chapter D - Valuation

Valuation Methodology

General

The valuation of Pelephone was conducted using the discounted cash flow method (DCF).

The unlevered DCF is the accepted method in finance for evaluating a "going concern".

In the DCF method, the enterprise value is the current value of future unlevered free cash flows projected in the forecast period, whereas the "terminal value" reflects the current value of the future cash flows from the end of the projection period to infinity.

The basic principle assumed in the analysis is that the operation is an active and "going concern", which will operate infinitely and hence, the objective is to reach the current value of the projected cash flows to infinity.

The basis for evaluation using this method is analysis and assessment of the ability of the business to generate cash flows and increase future profits. These cash flows are discounted at an appropriate discount rate.

The DCF analysis is appropriate and reasonable as long as the basic assumptions on which it is based are correct, relatively accurate and reflect future expectations on a high probability level. Moreover, the analysis is sensitive to selection of appropriate discount rates, i.e., the analysis, the model and the results are as "good" and "correct" as the assumptions on which the model relies.

Pelephone's projected cash flows relied, inter alia, on its results in 2015-2017, actual results in Q1 2018, unaudited results in Q2 2018 and Pelephone management's forecast for H2 2018 and 2019-2022.

Prometheus estimated, to the best of its ability, the probability of the realization of different parameters, based on information presented to us by Bezeq and Pelephone and on independent analysis.

We note that the value presented in this Report is value-in-use.

Chapter D - Valuation

Main Assumptions

General

The revenue from Pelephone's prepaid subscribers is not material compared to its total revenue. Pelephone's management decided to revise the definition of an active subscriber so as not to include IoT subscribers, and to add separate reference for prepaid subscribers, according to which a prepaid subscriber will be categorized as active from the date at which charging is executed, and will be derecognized as active if no outgoing use is made for six months.

The change will enter into effect at the beginning of Q3 2018 and as a result, 426K prepaid subscribers are expected to be derecognized from Pelephone's active subscriber listing. The above is expected, at the date of the change, to lead to an increase in ARPU of c. NIS 11.

This change will not affect Pelephone's revenue and cash flows or the assumptions and results of this valuation.

Revenue

Revenues from services

<u>Subscribers</u>

The veteran cellular operators are experiencing a decline in subscribers. In contrast, Pelephone has achieved growth in its subscriber base in recent years, mainly due to successful implementation of a growth strategy that includes, inter alia, expansion and diversification of distribution channels. In H1 2018, Pelephone recruited 76K subscribers, mostly postpaid. In H2 2018 and in 2019-2022, a cumulative positive recruitment of c. 462K subscribers, mostly postpaid, was assumed. The total subscriber base will grow from c. 2,601K subscribers at the end of H1 2018 to c. 3,062K subscribers at the end of 2022.

<u>ARPU</u>

Current price levels are not profitable for all market participants already at the operating profit level and are not sustainable in the long term. The number of operators in the Israeli cellular market

Chapter D - Valuation

Main Assumptions

Is relatively high for a market of its size. We find it reasonable that in the long term, prices will increase to an economically feasible and sustainable level. It was assumed that due to the market competition, ARPU erosion will continue in H2 2018 and in 2019. Between 2020 and 2022, a gradual increase in ARPU was assumed, up to a level of NIS 61 (similar to ARPU levels in 2017). This increase represents an erosion in prices in real terms.

Projected KPIs

Year	H1 2018	H2 2018	2019E	2020E	2021E	2022E
Total subscribers, end of period	**2,601**	**2,692**	**2,817**	**2,917**	**2,992**	**3,062**
% change			4.6%	3.5%	2.6%	2.3%
ARPU	**57**	**56**	**54**	**55**	**57**	**61**

Revenues from equipment sales

It was assumed that the revenue from sales of equipment will stand at c. NIS 753M per annum in forecast years. The reason for the stability assumed for revenue from equipment sales is continued implementation the Pelephone's distribution channel expansion strategy.

Combining the above assumptions, Pelephone's total revenues will grow from c. NIS 2,513M in 2018 to c. NIS 2,951M in 2022.

NIS M	H1 2018A	H2 2018E	2018E	2019E	2020E	2021E	2022E
Service revenues	869	891	1,760	1,801	1,908	2,039	2,198
Revenues from sales of equipment	352	401	753	753	753	753	753
Total revenues	**1,221**	**1,292**	**2,513**	**2,554**	**2,661**	**2,792**	**2,951**

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Main Assumptions

Expenses

Following is a table illustrating our assumptions for Pelephone's operating expenses in the second half of 2018 and in 2019-2022. *

NIS M	H1 2018A	H2 2018E	2018E	2019E	2020E	2021E	2022E
Payroll	(195)	(195)	(390)	(388)	(388)	(388)	(388)
% of revenue	16.0%	15.1%	15.5%	15.2%	14.6%	13.9%	13.2%
Operating expenses	(704)	(761)	(1,466)	(1,472)	(1,489)	(1,496)	(1,480)
% of revenue	57.7%	58.9%	58.3%	57.6%	55.9%	53.6%	50.2%
Lease payments	(125)	(122)	(247)	(237)	(246)	(247)	(247)
% of revenue	10.3%	9.4%	9.8%	9.3%	9.3%	8.8%	8.4%
Total operating expenses (excl. D&A)	**(1,025)**	**(1,078)**	**(2,103)**	**(2,098)**	**(2,123)**	**(2,131)**	**(2,115)**
% of revenue	83.9%	83.5%	83.7%	82.1%	79.8%	76.3%	71.7%
Other operating expenses	0	-	0	-	-	-	-

Payroll expenses: Pelephone is implementing continuous reduction in the number of positions due to digitization of customer service and voluntary retirements programs. It was assumed that the reduction in the number of positions in forecast years will be offset by a yearly 3% wage increase, so that the payroll expense level will remain at c. NIS 388M from 2019 onwards. Pelephone management assumed higher streamlining in its projections.

Operating expenses: A certain reduction in operating expenses was assumed due to reduced projected costs in sites rental, and switching to digital service processes, based on Pelephone management's estimation. We find this reduction reasonable when comparing to historical results. It was assumed that interconnect expenses will increase simultaneously with the projected growth in the subscriber base.

* It should be noted that the above expenses include lease payments, which due to an early adoption of the IFRS 16 are presented differently in Pelephone's reports since the beginning of 2018. The adjustment made in order to present proforma figures is presented within the "Lease payments" section.

Main Assumptions

EBITDA (adjusted)

Combining the above assumptions regarding revenues and expenses, it was assumed that adjusted EBITDA will grow from c. NIS 410M in 2018 (16.3% of revenues) to c. NIS 836M in 2022 (28.3% of revenue). We note that EBITDA figures presented below are calculated differently than Pelephone's figures since we eliminated the affect of IFRS 16 (which the Company and Pelephone applied since the beginning of 2018 in their reporting).

NIS million	H1 2018A	H2 2018E	2018E	2019E	2020E	2021E	2022E
Adjusted EBITDA	**196**	**214**	**410**	**457**	**538**	**661**	**836**
% of revenue	16.1%	16.5%	16.3%	17.9%	20.2%	23.7%	28.3%

Tax expenses

A corporate tax rate of 23% was assumed, based on the current statutory tax rate in Israel.

CAPEX

The CAPEX in the projection is based on Pelephone management's assumptions. In the terminal year, a CAPEX-to-revenues ratio of 13% was assumed, similar to levels in 2022.

Working capital

It was assumed that the working capital deficit-to-revenues ratio will be in between 2%-3%, similar to historical levels.

Chapter D - Valuation

Main Assumptions

Discount rate

The discount rate used in this valuation stood at c. 9.97% and is based on the calculation of the discount rate used for the valuation conducted by us as of December 31, 2017, based on the CAPM model. The reason for the lack of change is that in our opinion the risk within the cellular market and Pelephone's specific risk did not decrease, whereas the calculation based on the CAPM model for June 30, 2018 shows a decrease in the discount rate.

Permanent growth

The cellular market is characterized by excess growth of c. 3% per annum in terms of subscribers. Since it is assumed that prices are expected to increase in the long term, combined with a natural increase in the number of subscribers and development of new revenue channels, such Internet of Things (IoT), it was assumed that the permanent growth will be c. 2.5%, similar to the growth rate assumed in the valuation as of December 31, 2017.

Chapter D - Valuation

Projected Cash Flows

NIS M	H1 2018A	H2 2018E	2018E	2019E	2020E	2021E	2022E	TY
Service revenues	869	891	1,760	1,801	1,908	2,039	2,198	
Revenues from sales of equipment	352	401	753	753	753	753	753	
Total revenues	**1,221**	**1,292**	**2,513**	**2,554**	**2,661**	**2,792**	**2,951**	**3,025**
% change yoy			(1.3%)	1.6%	4.2%	4.9%	5.7%	2.5%
Payroll expenses	(195)	(195)	(390)	(388)	(388)	(388)	(388)	
% of revenues	16.0%	15.1%	15.5%	15.2%	14.6%	13.9%	13.2%	
Operating expenses	(704)	(761)	(1,466)	(1,472)	(1,489)	(1,496)	(1,480)	
% of revenues	57.7%	58.9%	58.3%	57.6%	55.9%	53.6%	50.2%	
Payments for leases	(125)	(122)	(247)	(237)	(246)	(247)	(247)	
% of revenues	10.3%	9.4%	9.8%	9.3%	9.3%	8.8%	8.4%	
Total operating expenses (excl. D&A)	**(1,025)**	**(1,078)**	**(2,103)**	**(2,098)**	**(2,123)**	**(2,131)**	**(2,115)**	
% of revenues	83.9%	83.5%	83.7%	82.1%	79.8%	76.3%	71.7%	
Other operating expenses	0	-	0	-	-	-	-	
Adjusted EBITDA	**196**	**214**	**410**	**457**	**538**	**661**	**836**	**857**
% of revenues	16.1%	16.5%	16.3%	17.9%	20.2%	23.7%	28.3%	28.3%
D&A	(198)	(203)	(401)	(390)	(382)	(377)	(381)	(393)
Adjusted operating profit	**(2)**	**11**	**9**	**67**	**155**	**284**	**455**	**463**
% of revenues	(0.2%)	0.8%	0.3%	2.6%	5.8%	10.2%	15.4%	15.5%
Tax expenses		(2)		(15)	(36)	(65)	(105)	(107)
Tax rate		23.0%		23.0%	23.0%	23.0%	23.0%	23.0%
CAPEX	(159)	(153)	(312)	(427)	(363)	(369)	(379)	(393)
% of revenues	(13.0%)	(11.8%)	(12.4%)	(16.7%)	(13.6%)	(13.2%)	(12.8%)	(13%)
Positive (negative) cash flows from changes in working capital		11		4	0	0	0	2
Cash flows		**70**		**19**	**139**	**226**	**353**	**359**
Discount period		0.25		1.00	2.00	3.00	4.00	4.00
Discounted cash flows		**68**		**17**	**115**	**170**	**241**	**3,279**

Chapter D - Valuation

Valuation Results

Valuation Summary

Valuation Results	NIS M
Value of discounted cash flows in forecast years	611
Value of discounted cash flow in the TY	3,279
Value of remaining D&A – TY	16
Enterprise value	**3,907**

The enterprise value of Pelphone, based on the assumptions in this valuation, was estimated at c. NIS 3,907M as of June 30, 2018. According to information provided by Bezeq, the carrying amount of this segment was c. NIS 2,164M, therefore, there is no need for impairment.

Synergy and Network Sharing

The valuation does not include potential synergies that may arise from cancellation of the structural separation obligation, because there is a large difference between the enterprise value of the segment and its carrying amount and because they were not assessed as part of the valuation as of December 31, 2017. Moreover, if Pelephone enters into a network sharing agreement with another operator, such occurrence may materially affect its value. Since Pelephone's management does not have concrete plans to enter into such an agreement and in view of the large difference between the enterprise value of the segment and its carrying amount, such a scenario was not taken into account.

Valuation Results

Sensitivity Analyses

Sensitivity analysis of the changes in the cellular segment's enterprise value dependent on the discount rate and permanent growth:

		Discount rate				
		7.97%	8.97%	9.97%	10.97%	11.97%
Permanent growth	1.5%	4,690	4,008	3,487	3,078	2,749
	2.0%	5,053	4,269	3,684	3,231	2,869
	2.5%	5,481	4,572	**3,907**	3,401	3,003
	3.0%	5,996	4,925	4,162	3,593	3,152
	3.5%	6,626	5,342	4,457	3,810	3,318

Sensitivity analysis of the changes in the cellular segment's enterprise value dependent on the subscriber base as of the end of 2022:

EV in NIS M dependent on subscriber base at the end of 2022				
2,962	3,012	3,062	3,112	3,162
3,594	3,750	**3,907**	4,064	4,221

A change of 50K in subscribers in 2022 affects the EV by c. NIS 157M.

Sensitivity analysis of the changes in the cellular segment's enterprise value dependent on the ARPU in 2022:

EV dependent on ARPU in 2022				
57	59	61	63	65
2,778	3,342	**3,907**	4,471	5,035

A change of NIS 1 in the ARPU in 2022 affects Pelephone's EV by c. NIS 282 million.

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Valuation Results

Feasibility test: Comparison to change in Cellcom and Partner's EV

As noted in the analysis in this Report, the entry of a sixth MNO into the cellular market negatively affected price levels and intensified competition, and as a result the value of the cellular companies decreased.

Pelephone's EV was estimated by us at c. NIS 3,907M, a decrease of c. 27.7% compared to our estimation of c. NIS 5,403M in the valuation as of December 31, 2017.

In the following feasibility test, the above decrease in Pelephone's EV was compared to the change in Cellcom and Partner's EV, as derived from market data. Following is a comparison of Cellcom and Partner's EV as of June 30, 2018 to December 31, 2017:*

NIS M	December 31, 2017	June 30, 2018	% change
Cellcom enterprise value	6,223	5,050	**(19%)**
Partner enterprise value	4,616	3,248	**(30%)**

* Source: TASE website and the companies' financial statements

As can be seen in the table, Cellcom and Partner's EV declined by c. 19%-30% in the six months beginning December 31, 2017, similar to the decrease in Pelephone's EV in this valuation, compared to the valuation as of December 31, 2017.

Appendices

Appendix A

WACC

Discount Rate Calculation

Marking	Parameter	Value	Remarks
D/V	Debt to Asset Value	26%	Based on the median of the comparable companies
E/V	Equity to Asset Value	74%	(D/V) = 1 - (E/V)
D/E	Debt to Equity	35%	(E/V)/(D/V) = (D/V)
βUL	Comparables' Unlevered Beta	0.75	To assess Pelephone's beta, we chose a group of similar companies. According to our examination, there are no traded companies that are identical to Pelephone. Therefore, we chose companies who are similar to Pelephone, but are different from each other, to create a mix that better expresses its characteristics. The beta is calculated on a weekly basis for a five year period.
Tax	Valued Company Long Term Tax Rate	23.0%	The corporate tax rate in Israel
βL	Valued Company's Levered Beta	0.95	βL= βUL*{1+(1-Tax)*(D/E)}
Rf	Risk Free Interest	3.0%	Nominal yield to maturity of Israeli government bonds for a period of 15 years as of June 30, 2018
MRP	Market Premium	5.9%	Israeli market premium, based on Damodaran's data as of January 2018
SRP	Specific Risk Premium	3.5%	Size premium for medium sized companies based on Duff and Phelps' data for 2018
Re	Cost of Equity	12.03%	RE = Rf + βL * MRP + SRP
Rd	The Company's Cost of Debt	4.6%	Pelphone's cost of debt was calculated by comparing the yield to maturity on Bezeq's traded bond (series 9) vs. the yield to maturity on Israeli government bonds for the same duration. This difference was then adjusted for a period of 15 years
WACC	**Weighted Average Cost of Capital**	**9.81%**	**WACC = Re *(E/V) + Rd*(D/V)*(1-TAX)**

The above table shows the calculation of the discount rate of Pelephone as of June 30, 2018, based on the CAPM model. Since in our estimation, the risk in the cellular market and the specific risk to Pelephone did not decrease, a discount rate of 9.97% was used, the same as used in our valuation as of December 31, 2017.

Comparables – additional information

Company	Unlevered Beta	D/V
Partner	0.76	29%
Cellcom	0.54	53%
Telenor	0.82	18%
O2	0.73	17%
US Cellular Corp	0.78	26%
Orange Belgium	0.68	26%
Median	**0.75**	**26%**

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Appendix B

Carrying Amount

Carrying Amount

Following is the carrying amount of the assessed operations, as provided to us by Bezeq.

Section	Value (NIS M)
Operating assets, net	* 2,424
Operating liabilities	(1,287)
Excess cost - Pelephone’s goodwill recorded in Bezeq’s books	1,027
Total carrying amount of Pelephone in Bezeq’s books	**2,164**

* Pelephone’s net operating assets do not include trade receivables for equipment sales in installments, which are presented in current value

Appendix C

Projected Cash Flows (Pre-tax)

Projected Pre-Tax Cash Flows

Projected pre-tax cash flows of Pelephone. The pre-tax discount rate stood at c. 11.91%.

NIS M	H1 2018A	H2 2018E	2018E	2019E	2020E	2021E	2022E	TY
Service revenues	869	891	1,760	1,801	1,908	2,039	2,198	
Revenues from sales of equipment	352	401	753	753	753	753	753	
Total revenues	**1,221**	**1,292**	**2,513**	**2,554**	**2,661**	**2,792**	**2,951**	**3,025**
% change yoy			(1.3%)	1.6%	4.2%	4.9%	5.7%	2.5%
Payroll expenses	(195)	(195)	(390)	(388)	(388)	(388)	(388)	
% of revenues	16.0%	15.1%	15.5%	15.2%	14.6%	13.9%	13.2%	
Operating expenses	(704)	(761)	(1,466)	(1,472)	(1,489)	(1,496)	(1,480)	
% of revenues	57.7%	58.9%	58.3%	57.6%	55.9%	53.6%	50.2%	
Payments for leases	(125)	(122)	(247)	(237)	(246)	(247)	(247)	
% of revenues	10.3%	9.4%	9.8%	9.3%	9.3%	8.8%	8.4%	
Total operating expenses (excl. D&A)	**(1,025)**	**(1,078)**	**(2,103)**	**(2,098)**	**(2,123)**	**(2,131)**	**(2,115)**	
% of revenues	83.9%	83.5%	83.7%	82.1%	79.8%	76.3%	71.7%	
Other operating expenses	0	-	0	-	-	-	-	
Adjusted EBITDA	**196**	**214**	**410**	**457**	**538**	**661**	**836**	**857**
% of revenues	16.1%	16.5%	16.3%	17.9%	20.2%	23.7%	28.3%	28.3%
D&A	(198)	(203)	(401)	(390)	(382)	(377)	(381)	(393)
Adjusted operating profit	**(2)**	**11**	**9**	**67**	**155**	**284**	**455**	**463**
% of revenues	(0.2%)	0.8%	0.3%	2.6%	5.8%	10.2%	15.4%	15%
CAPEX	(159)	(153)	(312)	(427)	(363)	(369)	(379)	(393)
% of revenues	(13.0%)	(11.8%)	(12.4%)	(16.7%)	(13.6%)	(13.2%)	(12.8%)	(13%)
Positive (negative) cash flows from changes in working capital		11		4	0	0	0	2
Cash flows		**72**		**34**	**175**	**291**	**457**	**465**
Discount period		0.25		1.00	2.00	3.00	4.00	4.00
Discounted cash flows		**70**		**31**	**140**	**208**	**291**	**3,151**

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