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

SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2017

OR

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

For the transition period from __________ to __________

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

Date of event requiring this shell company report ____________

Commission file number: 0-30198

INTERNET GOLD – GOLDEN LINES LTD.

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

Israel
(Jurisdiction of incorporation or organization)

2 Dov Friedman Street, Ramat Gan 5250301, Israel
(Address of principal executive offices)

Doron Turgeman, CEO, +972-3-9240000 (phone), +972-3-9399832 (fax)
2 Dov Friedman Street, Ramat Gan 5250301, Israel
(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, NIS 0.01 **Par Value**	**NASDAQ Global Select Market**

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

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

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

Ordinary Shares, par value NIS 0.01 per share …………19,203,186
(as of December 31, 2017)

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

Yes No

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

Yes No

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

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

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

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

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

U.S. GAAP	International Financial Reporting Standards as issued by the International Accounting Standards Board	Other

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

Item 17 Item 18

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

Yes No

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

INTRODUCTION

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

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

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

As used in this annual report, the terms "we," "us" and "our" mean Internet Gold - Golden Lines Ltd. and its subsidiaries, "B Communications" means B Communications Ltd., "SP1" means B Communications (SP1) Ltd., "SP2" means B Communications (SP2) Ltd., "Eurocom Communications" means Eurocom Communications Ltd., "Bezeq" means Bezeq - The Israel Telecommunications Corp., Ltd.; "Pelephone" means Pelephone Communications Ltd., "Bezeq International" means Bezeq International Ltd. and "YES" (the trade name for DBS) and DBS mean DBS Satellite Services (1998) Ltd. Bezeq, Pelephone, Bezeq International and DBS are sometimes collectively referred to as the Bezeq Group in this annual report. The operations of DBS have been included in Bezeq's consolidated financial statements since March 23, 2015, after Bezeq obtained control of DBS.

Our consolidated financial statements appearing in this annual report are prepared in New Israeli Shekels and are translated into U.S. dollars at the representative rate of exchange at December 31, 2017 (NIS 3.467= $1.00). The dollar amounts so presented should not be construed as representing amounts receivable, payable or incurred in dollars or convertible into dollars. All references in this annual report to "dollars" or "$" are to U.S. dollars and all references in this annual report to “NIS” are to New Israeli Shekels.

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

Forward Looking Statements

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

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

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

Consolidated Statement of Income Data:

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

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

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

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Statements of Financial Position data:

(Amounts in millions)

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

Exchange Rate Information

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

Period	Average
Year ended December 31, 2013	3.611
Year ended December 31, 2014	3.578
Year ended December 31, 2015	3.884
Year ended December 31, 2016	3.841
Year ended December 31, 2017	3.600

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

May 2018 (through May 14)	3.632	3.569

On May 14, 2018, the representative rate of exchange was NIS 3.574 = $1.00 as published by the Bank of Israel.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

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

Risks Directly Related to Internet Gold – Golden Lines

We have a substantial amount of existing debt, which could restrict our financing and operating flexibility and have other adverse consequences; our ability to repay our debt may be affected by Bezeq's dividend distribution policy and the amount of dividends we receive from Bezeq and a default under our outstanding debentures could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We and B Communications have a substantial amount of indebtedness. As of May 14, 2018, we and B Communications had approximately NIS 3.2 billion (approximately $936 million) of debt. Our significant level of debt could have important consequences, including, but not limited to, the following:

making it more difficult for us to service our debt obligations and liabilities;

making us vulnerable to, and reducing our flexibility to respond to, general adverse economic and industry conditions;

requiring that a substantial portion of our cash flows from operations be dedicated to servicing debt, thereby reducing the funds available to us to fund working capital, or other general corporate purposes;

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

adversely affecting public perception of us.

On March 6, 2018, Bezeq's Board of Directors updated the dividend distribution policy of Bezeq, whereby Bezeq will commencing with the upcoming distribution in May 2018, distribute to its shareholders, on a semi-annual basis, a dividend of 70% of the half-yearly profit (after tax) based on Bezeq's consolidated financial statements. Previously, Bezeq had distributed dividends equal to 100% of its half-yearly profit.

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

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

In January 2015, Midroog confirmed a Baa1 stable outlook rating with respect to our Series B, C and D Debentures and in February 2016, Midroog raised the rating for our Series C and D Debentures from Baa1.il to A3.il stable outlook. In February 2017, Midroog affirmed the A3.il local rating of our Series C and D Debentures with a stable outlook. In April 2018, Midroog reduced the A3.il rating to Baa1.il and retained the negative outlook.

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

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

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

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

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

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

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

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

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Any event in which a receiver is appointed with respect to our holdings in SP2 or SP2's holdings in Bezeq will constitute grounds for the cancellation of the Control Permit. In addition, in the event that the Ministers determine that a material change in the details included in the application for the Control Permit has occurred or the members to the Control Permit failed to provide requisite notifications in accordance with the Control Permit, and there is a real concern that the essential service provided by Bezeq will be harmed, the Ministers may cancel the Control Permit or set conditions for its continuation pursuant to the provisions of the Israeli Communications Law.

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

In the event that the Control Permit is cancelled and an application to reissue another control permit is denied, our holdings in Bezeq must be liquidated within 15 to 60 days (depending on the cause for such cancellation) pursuant to the Communications Order.

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

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

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

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

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If we do not maintain control of Bezeq (through B Communications), we may be deemed to be an "investment company" under the Investment Company Act of 1940, which could materially and adversely affect our business.

Section 3(a)(1)(A) of the Investment Company Act of 1940, or the Investment Company Act, defines an investment company as any issuer that is, holds itself out as being, or proposes to be, primarily engaged in the business of investing, reinvesting or trading in securities and Section 3(a)(1)(C) of the Investment Company Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire "investment securities" (within the meaning of the Investment Company Act) having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. However, an issuer will be deemed not to be an investment company if no more than 45% of the value of such issuer's total assets (exclusive of government securities and cash items) consists of, and no more than 45% of such issuer's net income after taxes (for the last four fiscal quarters combined) is derived from, securities other than, among other things, securities issued by companies which are controlled primarily by such issuer. Primary control is presumed if the issuer owns over 25% of the controlled company's voting securities and the issuer has control greater than that of any other person. Accordingly, so long as we maintain control of Bezeq, we will not be deemed an investment company. Recent events may further bring the Control Permit issue into possible question in the future. According to the Control Permit, the control must be held by an "Israeli Party," as defined in the Communications Order. Currently, B Communications and we are deemed to be "Israeli Parties," so long as B Communications and we are controlled by a citizen and resident of Israel. Persons with certain criminal convictions may also not hold a Control Permit. However, if there is a change in ownership of our controlling entity, Eurocom Communications, it should not affect Eurocom Communications' continued status as our controlling shareholder (while the identity of the shareholders of Eurocom will change). Accordingly, we will not lose our Control Permit in this scenario.

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

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

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

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

Subject to these limitations, we nevertheless completed the work necessary to identify a material weakness pertaining to the design of Bezeq's internal control over financial reporting relating to certain matters, which are mainly the subjects of the investigations. Our management then assessed the effectiveness of our own internal control over financial reporting as of December 31, 2017. In conducting its assessment of our internal controls over financial reporting, our management based its evaluation on the framework in "Internal Control – Integrated Framework" (2013) issued by the Committee of Sponsoring Organizations, or the COSO, of the Treadway Commission.

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

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

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

The Bezeq Group's key executives and employees possess substantial knowledge of its business and operations. We cannot assure you that the Bezeq Group will be successful in retaining their services or that the Bezeq Group would be successful in hiring and training suitable replacements without undue costs or delays. As a result, the loss of any of these key executives and employees could cause significant disruptions in the Bezeq Group's business operations, which could materially adversely affect our results of operations. Similarly, our management has been instrumental in our success and loss of any key members of our management could materially adversely affect our financial condition, results of operations and prospects. Recent events have caused the replacement of certain key executives with our consent.

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

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

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

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

For as long as Eurocom Communications has a controlling interest in our company, it, Mr. Shaul Elovitch, chairman of the board of directors of Eurocom Communications (and until recently, chairman of our Board and of B Communications' Board), and the controlling shareholder of Eurocom Communications, will have the ability to exercise a controlling influence over our business and affairs, including any determinations with respect to potential mergers or other business combinations involving us, our acquisition or disposition of assets, our incurrence of indebtedness, our issuance of any additional ordinary shares or other equity securities, our repurchase or redemption of ordinary shares and our payment of dividends. Similarly, as long as Eurocom Communications has a controlling interest in our company, Eurocom Communications (whether under the control of Mr. Shaul Elovitch, the current special managers appointed by court order, or future purchasers) will have the power to determine or significantly influence the outcome of matters submitted to a vote of our shareholders that require a simple majority, including the power to elect all of the members of our board of directors (except external directors, within the meaning of Israeli law). Because our interests and those of Eurocom Communications may differ from the interests of our other shareholders, actions taken by Eurocom Communications with respect to us may not be favorable to our other shareholders.

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

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

Cross officerships, directorships and share ownership. A few of our directors and officers also serve or are employed by B Communications and/or Eurocom Communications. The cross officerships and directorships as well as the ownership interests of our directors and officers in the ordinary shares of Internet Gold or Eurocom Communications could create, or appear to create, conflicts of interest when directors and executive officers are faced with decisions that could have different implications for the different companies; and

Intercompany transactions. From time to time, B Communications, Eurocom Communications or other companies within the Eurocom Group may enter into transactions with us or our subsidiaries or other affiliates. Although the terms of any such transactions will be established based upon negotiations between employees of such companies and us and, when appropriate, subject to the approval of our independent directors or a committee of disinterested directors and in some instances a vote of shareholders, the terms of any such transactions may not be as favorable to us or our subsidiaries or affiliates as may otherwise be obtained in arm’s-length negotiations with unaffiliated third parties.

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

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

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

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

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

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

Risks Relating to the Entire Bezeq Group

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Bezeq measures exposure to changes in exchange rates and inflation by the surplus or deficit of assets against liabilities, based on the type of linkage. While Bezeq's exposure to changes in currency exchange rates against the shekel is low, its exposure to inflation rates is high, and therefore Bezeq takes steps to cover part of the inflation exposure. As a result, the annual rate of inflation and its distribution during the year can have a material influence on the erosion of Bezeq's tariffs and its revenues and expenses during the year, which in turn could have a material adverse impact on its operating results.

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

Negative developments in, or the general weakness of, Israel's economy, in particular increasing levels of unemployment, may have a direct negative impact on the spending patterns of retail consumers, both in terms of the products they subscribe for and usage levels. Stability in the financial market and the strength of economies in countries around the world, have recently been subjected to high volatility. While the Israeli economy has displayed economic resilience, reflected in economic expansion, low levels of unemployment and inflation rates within government targets, the continued increase in of housing prices, global economic shocks and uncertainty in the political and defense arenas may cast doubt over a continuation of these trends. In the event the local economy is negatively impacted following external or internal events, Bezeq's business results may be harmed as consequence of lower revenues (including revenues from affiliates) or due to an increase in finance costs.

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

The Bezeq Group companies provide services using various infrastructure systems that include, among others, exchanges, transmission, data communication and access systems, cables, computerized systems, core network sites, antenna and satellite sites and other systems, and are spread throughout the country If any part of the Bezeq Group's infrastructure becomes subject to a flood, fire, other natural disaster, terrorism, acts of war, a computer virus, a power loss, material bugs in software or other catastrophe or unauthorized access, its operations and customer relations could be materially adversely affected. In addition, disaster recovery, security and service continuity protection measures that the Bezeq Group have, or may in the future undertake, and their monitoring of network performance, may be insufficient to prevent losses. In such event, the Bezeq Group might incur liabilities or reputational damages

The Bezeq Group companies could be subject to labor disruptions.

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

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

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

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

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

Specific Risks Relating to Bezeq's Fixed - Line Communications

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

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

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

Bezeq's tariffs for its main services (including interconnect fees) are subject to government control and intervention. The Minister of Communications is authorized to intervene in existing tariffs and marketing offers and impose directives on Bezeq. On average, controlled tariffs erode in real terms. Significant changes in Bezeq's controlled tariffs, if implemented could have a material adverse effect on Bezeq's business and results. Additionally, the restrictions applicable to Bezeq in marketing alternative payment bundles may make it difficult for Bezeq to provide an appropriate competitive solution to market changes and have placed Bezeq at a disadvantage to those competing with it in the sale of end-to-end service packages using wholesale Bitstream Access services, or BSA services, supplied by Bezeq. In the context of the implementation of a wholesale market, the Ministry of Communications has the power to set the price for which Bezeq will sell its services to license holders. The low prices set by the Ministry of Communications may adversely affect Bezeq's level of revenues and profits.

Specific Risks Relating to Pelephone

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

Competition in the cellular telephony industry has intensified since 2012. This has led to lower prices and higher customer churn rates, which in turn has affected the results of Pelephone. Pelephone expects competition to continue to increase amid the changing legislation in Israel and consolidation in the telecommunications industry that permits certain service providers to market a combination of fixed-line telephony, fixed-line broadband Internet infrastructure access, ISP and pay television services, or a "bundle", for an aggregate price which is lower than the price of the individual products and services in the bundle. These competitive forces may create further downward pressure on prices, which may result in a decrease in the Pelephone's average revenue per user, or ARPU, and increase churn rates. Furthermore, the costs of establishing, maintaining and operating a mobile telephony network per subscriber is expected to be higher for Pelephone if it will not be allowed to operate under some form of network sharing model.

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Pelephone is subject to governmental control and regulation

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Specific Risks Relating to DBS

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

Competition in the broadcast sector with HOT and more recently with Cellcom and Partner TV, and including the ability to subscribe to Netflix and Amazon Prime Video directly, requires DBS to constantly invest in attracting and retaining customers, and dealing with high subscriber churn rates between the companies. Competition also increased due to the increasing use of pirated broadcasts. The broadcasting sector is also exposed to piracy by viewers in viewing broadcasts without paying subscription fees and is exposed to unlicensed public access to content to which the broadcast providers have rights. These competitive forces may create downward pressure on prices, which may result in a decrease in the DBS's ARPU and increase churn rates.

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

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

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

The development of new technologies may render existing technology inferior, forcing DBS to invest large sums to retain its competitive edge. Such technological advances and developments may also facilitate increased accessibility to video content, allowing other providers to offer content viewing services without the need for heavy investment that may make it difficult for DBS to recruit new subscribers, retain existing subscribers and offer its services. In order to compete effectively, DBS may be required to invest large amounts. Alternative multi-channel broadcasting infrastructures, such as DTT, a terrestrial implementation of digital television technology using an aerial to broadcast to a conventional television antenna (or aerial) instead of a satellite dish or cable television connections, and its expansion, may have an adverse impact on the financial results of DBS.

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

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

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

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

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

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

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

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

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

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

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

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

DBS is dependent on third-party encryption systems.

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

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

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

Specific Risks Relating to Bezeq International

Bezeq International’s operations are subject to currency fluctuations.

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

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

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

Risks Related to Our Ordinary Shares

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

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

Quarterly variations in our operating results;

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Global economic conditions;

Price movements in the market price of Bezeq's ordinary shares;

Operating results that vary from the expectations of securities analysts and investors;

Changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;

Regulatory changes that impact pricing of services and competition in Bezeq's markets;

Changes in market valuations of other communications companies;

Announcements of technological innovations or new services by Bezeq or its competitors;

Announcements by Bezeq or its competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;

Changes in the status of Bezeq's intellectual property rights;

Announcements by third parties of significant claims or proceedings against us or Bezeq;

Additions or departures of key personnel;

Future sales of our ordinary shares; and

Stock market price and volume fluctuations.

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

Risks Related to Operations in Israel

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

The Bezeq Group companies and we are organized and based in the State of Israel and Bezeq derives substantially all of its revenues from markets within the State of Israel. As a result, political, economic and military conditions affecting Israel directly influence us. Conflicts in North Africa and the Middle East, including in Egypt and Syria which border Israel, have resulted in continued political uncertainty and violence in the region. Efforts to improve Israel's relationship with the Palestinian Authority have failed to result in a permanent solution, and there have been numerous periods of hostility in recent years. In addition, relations between Israel and Iran continue to be seriously strained, especially with regard to Iran's nuclear program. Such instability may affect the economy, could negatively affect business conditions and, therefore, could adversely affect our operations. To date, these matters have not had any material effect on our business and results of operations; however, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect our business, financial condition and results of operations in the future. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

For U.S. federal income tax purposes, we may be classified as a passive foreign investment company, or PFIC, for any taxable year in which either: (i) 75% or more of our gross income is passive income or (ii) at least 50% of the average quarterly value of our assets for the taxable year produce or are held for the production of passive income. Based on our current and projected income, assets and activities, we believe that we are not currently a PFIC, but there can be no assurance that we will not be classified as such in the future.

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

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

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

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

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

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

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

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

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

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

We were organized under the laws of the State of Israel in April 1992 under the name Euronet Golden Lines (1992) Ltd. In June 1999 we changed our name to Internet Gold - Golden Lines Ltd. We are a public limited liability company under the Israeli Companies Law 1999 and our shares are traded on the NASDAQ Global Select Market and

TASE. Our registered offices and principal place of business are located at 2 Dov Friedman Street, Ramat Gan 5250301, Israel, and our telephone number is +972-72-924-0000. Our website address is www.igld.com. The information on our website is not incorporated by reference into this annual report on Form 20-F.

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

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

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

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

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

Through its wholly-owned subsidiaries, the Bezeq Group is a leading provider in Israel of fixed-line telephony services and fixed-line broadband Internet infrastructure access services, cellular telephony services, ISP services, ILD services, international and domestic data transfer and network services and ICT, pay television services and other communications infrastructures and services. In each of these markets, the Bezeq Group holds a significant market share, as indicated in the chart below.

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

B. Business Overview

Since April 14, 2010, we, through B Communications, have been the controlling shareholder of Bezeq (TASE: BZEQ), Israel's largest telecommunications provider. Bezeq is the principal provider of communications services in Israel, providing a broad range of telecommunications operations and services, including domestic fixed-line, cellular and international communication services, Internet services, multi-channel television, television and radio broadcasts, satellite broadcasts, customer call centers, maintenance and development of communications infrastructures, provision of communications services to other communications providers and the supply and maintenance of equipment on customer premises, which is referred to as network end point, or NEP services. Bezeq was founded as a government company in 1980 and became a public company in 1990 with its shares traded on the TASE and included in the TA-35 Index.

The principal Bezeq Group segments are as follows:

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

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

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

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

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

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

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

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Investigation by Israel's Securities Authority and Israel Police

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

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

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

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

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

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

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

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

Liquidation of Eurocom Communications

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

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

The proposed Arrangement was based on the expected acquisition by the Saidoff Group of Eurocom. Under the Arrangement, the Saidoff Group would receive an option which will allow it to eventually acquire the full 100% interest in Eurocom, or the Saidoff Option. The proposed Arrangement would require significant capital investments by the Saidoff Group in Eurocom, as well as their assistance in settling the balance of the debt of Eurocom and other affiliated companies. Based on the terms of the Arrangement, management of our company does not believe that there will be a "change in control" event with respect to either our company or Eurocom, since the exercise of the Saidoff Option is subject to obtaining the required regulatory approvals, as well as to meeting the following conditions: (i) obtaining the Court's approval of the Arrangement, including possible adjustments that may be demanded by the Court; (ii) obtaining a pre-ruling from the Israeli tax authorities regarding various aspects of the Eurocom Arrangement; (iii) not triggering certain material covenants or adverse effects; and (iv) obtaining the necessary regulatory approvals as required by Israeli law (including a control permit for the "Saidoff Group and its affiliates, that will be required to legally exercise its Option.

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

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

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

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

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

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

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

Recomposing Bezeq’s Board

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

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

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

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

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

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

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

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

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

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

One director from among Bezeq's employees;

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

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

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

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

These ten candidates will include:

one director from among Bezeq's employees;

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

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

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

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

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

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

Our Strategy

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

Competitive Strengths

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

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

The Bezeq Group is the largest and the incumbent telecommunications provider in Israel, offering a broad range of services through its advanced, comprehensive and nationwide telecommunications infrastructure. The Bezeq Group holds a leading position in each of the markets in which it operates. As a leading provider in each of these markets, the Bezeq Group has been able to maintain its strong performance and benefit from economies of scale. In addition, such leading positions across a diverse range of telecommunications offerings reduce the Bezeq Group's exposure to market and regulatory conditions. We believe that the Bezeq Group's ability to maintain a leading position in the Israeli telecommunications market in the face of competitive and regulatory pressures reflects, among other things, the underlying strength of its advanced nationwide network infrastructures, the strength of its brands and its extensive offering of high quality content.

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

Israel is a developed, industrialized market characterized by strong macroeconomic fundamentals. Israel is a member of the Organisation for Economic Co-operation and Development, or OECD, and had GDP per capita of $38,428 in 2017.

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

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

The Bezeq Group has historically made substantial investments in its fully owned infrastructure, which is one of the most technologically advanced in Israel and enables the Bezeq Group to reach customers nationwide. Bezeq has a Next-Generation Network (NGN) based on a core IP network and deployment of an optical fiber network to street cabinets (a network topology known as Fiber to the Curb, or FTTC) and also based on an access network (a system that connects NEPs on the subscriber's premises to the network and engineering systems). Bezeq completed the deployment of the network at the end of 2015. The connection from the home, or the terminal equipment (equipment which is installed on the subscriber's premises, e.g., the actual telephone, private exchanges, fax machines, modems, routers, etc.) through which the subscriber receives the service, to the access network is based on copper cables and optical cables that connect the access systems to the backbone over optic cables (through special pipes or an above ground network) and to a limited degree through wireless systems. Today, using VDSL2 technology, it is possible to provide a bandwidth of up to 100 Mbps downstream, as well as innovative added-value services. Other advantages of the new technology are simplification of the network structure and better management ability.

Pelephone currently operates communications networks using two main technologies:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The following table sets forth the Bezeq Group's operating cash flow and ratio of capital expenditures to revenues for the years ended December 31, 2015, 2016 and 2017. The operations of DBS have been included for the last nine months of 2015.

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

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

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

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

Products and Services

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

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

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

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

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

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

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

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

(2) Free cash flow is a financial index which is not based on GAAP. Free cash flow is defined as cash from operating activities less cash for the purchase/sale of property, plant and equipment, and intangible assets, net. Bezeq presents free cash flow as an additional index for assessing its business results and cash flows because Bezeq believes that free cash flow is an important liquidity index that reflects cash resulting from ongoing operations after cash investments in infrastructure and other fixed and intangible assets.

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

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

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

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

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

(8) Bezeq revenues have been reclassified so that certain revenues are now classified under the Cloud and Digital category. Accordingly, retroactive amendments were made to these items (number of active subscriber lines and average monthly revenue per line and internet subscribers).

Pelephone

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

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

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

(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. A customer may have more than one subscriber number (line).

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

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

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

Bezeq International

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

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

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

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

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DBS

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

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

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

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

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

Domestic Fixed-Line Communications (Bezeq)

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

Fixed-Line Telephony Services

Bezeq had approximately 1.9 million active fixed telephone lines as of December 31, 2017. Bezeq's fixed-line telephony services include basic telephone service on domestic telephone lines and associated value-added services, such as voice mail, caller ID, call waiting, call forwarding and conference calls. Bezeq also offers its business customers national toll-free numbers which provide for full or partial payment for customer calls by the business customer.

Bezeq offers a variety of payment plans, ranging from a monthly subscription fee per fixed telephone line and charge per second of use, to various fixed-line telephony packages comprised of monthly amounts of minutes for a fixed monthly fee.

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

Fixed-Line Broadband Internet Infrastructure Access Services

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

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

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

(in Mbps at the end of each year)

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

Transmission and Data Communication Services

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

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

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

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Cloud and digital services

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

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

Other Services

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

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

Broadcast services

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

Contract work

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

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

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

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

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

	2017	2016	2015
Revenues from Bezeq's fixed-line telephony	1,281	1,392	1,499
Percentage of total Bezeq's Fixed-Line revenues in the segment	30.18%	31.76 %	34.01%
Revenues from Internet infrastructure services	1,544	1,500	1,450
Percentage of total Bezeq's Fixed-Line revenues in the segment	36.38%	34.22 %	32.90%
Revenues from transmission and data communication services	975	1,069	1,053
Percentage of total Bezeq's Fixed-Line revenues in the segment	22.97%	24.397%	23.89%
Revenues from cloud & digital services	230	203	184
Percentage of total Bezeq's Fixed-Line revenues in the segment	5.41 %	4.63 %	4.17 %
Revenues from other services	214	219	221

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Cellular Telephony (Pelephone)

Pelephone is among the leading cellular telephony services providers in Israel. Pelephone provides cellular telephony services, sells handsets and other end-user equipment, and provides repair services for handsets sold by Pelephone.

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

Services provided by Pelephone:

Package services. Package services provided by Pelephone include:

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

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

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

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

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

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

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

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

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

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

Pelephone offers its subscribers comprehensive voice, data and text messaging services and advanced multimedia services through its nationwide network. Pelephone's basic cellular telephony (voice) services include basic call services, call completion services and auxiliary services such as call waiting, call forwarding, voice mail, voice conference call and caller ID. Pelephone's value-added services include short text messages, or SMS, multimedia messages, or MMS, and content services. Pelephone also offers its customers handset repair services for a monthly payment.

Pelephone offers a variety of packages that combine the several services it makes available to subscribers.

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

Revenue from products and services

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

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

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

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

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

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

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

*Revenue from business customers includes revenues from hosting agreements.

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

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

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

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

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

ISP Services

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

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

International data services

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

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

Business Sector-Data Services and ICT

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

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

Multi-Channel Pay Television (DBS)

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

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

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

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

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

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

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

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

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

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

Sting TV Services

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

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

Recent DBS Developments

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

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

Marketing, Sales and Customer Service

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

Domestic Fixed-Line Communications (Bezeq)

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

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

Cellular Telephony (Pelephone)

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

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

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

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

Multi-Channel Pay Television (DBS)

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

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

Networks

Domestic Fixed-Line Communications (Bezeq)

Bezeq has a Next-Generation Network (NGN) based on a core IP network and deployment of an optical fiber network to street cabinets (a network topology known as Fiber to the Curb, FTTC), and also based on an access network (a system that connects NEPs on the subscriber's premises to the network and engineering systems). The connection from the home to the access network is based on copper cables and the connection from the access systems to the backbone is based mainly on optic cables. In addition, some of the peripheral equipment (equipment installed at the subscriber, such as routers) is owned by Bezeq and leased to the customer.

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

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

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

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

Cellular Telephony (Pelephone)

Pelephone has a resilient and advanced network system in Israel, allowing it to offer its services with nationwide coverage and consistent high quality. Pelephone's cellular telephony license is valid until September 8, 2022. During the years ended December 31, 2015, 2016 and 2017, Pelephone had net capital expenditures of NIS 426 million, NIS 241 million and 309 million (approximately $89 million), respectively, for its network infrastructure.

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

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

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

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

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

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

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

Under its mobile telephony license and the Wireless Telegraph Ordinance, Pelephone has rights of use of frequencies in the 850 MHz and 2100 MHz spectrums to operate its UMTS/HSPA network, and in the 1800 MHz spectrum for operating its LTE technology network. During the course of 2017 Pelephone returned two 1 mega bandwidth frequencies in the 850 Mhz spectrum to the national pool of frequencies and towards the end of April 2017 it received a temporary allocation of 5 mega bandwidth on the 1800 Mhz spectrum. This allocation is for limited use and for a limited period and will expire at the end of 2019 or earlier, according to the conditions specified in the allocation.

Infrastructure sharing agreements and providing right of use of networks

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

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

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Golan Telecom - Cellcom - Marathon 018

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

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

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

Construction and Operation of Sites: Permits, Licenses.

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

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

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

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

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

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

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

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

PBX services

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

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

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

Trade receivables

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

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

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

Multi-Channel Pay Television (DBS)

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

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

Competition in the Israeli Telecommunications Market

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

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

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

Communications groups in the Israeli market

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

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

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

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

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

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

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

Fixed-Line Telephony Services Market

Wholesale market

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

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

Telephony

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

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

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

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

Competition in telephony from the cellular companies

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

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

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

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

VoC services

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

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

Internet infrastructure segment

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

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

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

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

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

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

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

Transmission and data communications

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

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

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

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

Other competing infrastructures

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

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

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

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

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

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

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

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

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

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

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

Internet Access-Infrastructure and ISP Services

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

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

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

The transmission and data communications segment

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

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

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

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

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

Cellular Telephony Services Market

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

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

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Cellular network and product innovations

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

Infrastructure sharing

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

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

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

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

Virtual operators - MVNO

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

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

Establishment of cellular networks using advanced technologies

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

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

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

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Smartphones

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

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

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

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

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

ILD Market

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

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

Communication solutions for the business sector

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

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

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

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

Pay Television Services Market

Currently, there are several competing groups on the market.

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

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

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

2017		2016		2015	
Subscribers (in thousands)	Market share	Subscribers (in thousands)	Market share	Subscribers (in thousands)	Market share
587	37 %	614	40 %	635	42 %

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

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

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

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

DTT network

There is a digital terrestrial television broadcasting system (DTT), known as Idan+, through which certain channels are broadcast to the public free of charge. At present, the system is operated by the Second Authority for Television and Radio ("Second Authority"). The Minister of Communications and the Minister of Finance may appoint a private operator for its operation, and the Council may also grant a general broadcasting license which will be financed from subscription fees or commercials. It broadcasts the channels of the Broadcasting Authority (Channel 1 and Channel 33), the commercial channels (Keshet, Reshet and Channel 10), Channel 20, Music Channel (Channel 24), Channel 23 and the Knesset Channel (Channel 99). The DTT operator may broadcast additional channels including radio channels, Educational TV Channel and subject-based and niche channels. The channels are broadcast for a broadcasting fees, however the Ministers of Communications and Finance may decide that the State will subsidize broadcasting fees applicable for subject-based channels and niche channels.

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

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

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

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

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

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

Regulatory

Permit to Control Bezeq Granted to Members of the Eurocom Group

The Israeli Communications Law and the Communications Order provide that the control over Bezeq requires a control permit from the Ministers. As part of B Communications' acquisition of the controlling interest in Bezeq, we, B Communications, SP2, SP1, and other members of the Eurocom group applied for authorization to control Bezeq, pursuant to the Israeli Communications Law and Communications Order. On April 13, 2010, the Control Permit was granted subject to the condition that SP2 is controlled exclusively by the other parties to the control permit. Concurrently, a separate control permit was also granted to Messrs. Shaul Elovitch and Yossef Elovitch, (the controlling shareholders of our company and B Communications), or the Individuals' Control Permit. According to the Communications Order, B Communications is not allowed to transfer control or any Means of Control which will result in a decrease of B Communications' minimum holding requirement in Bezeq without the prior consent of the

Ministers. The foregoing includes a transfer of the Bezeq interest in one transaction or a series of transactions, by one party or together with the other parties to the Control Permit or the parties to the Individuals' Control Permit. However, the parties may transfer the Means of Control of Bezeq among themselves, subject to compliance with certain conditions set forth in the Control Permit.

According to the Control Permit, the parties (through SP2) must hold not less than 30% of any type of Means of Control (as described below) of Bezeq. Such percentage is permitted to decrease below 30% to no less than 29% for a period of six months, in the event of dilution resulting from the exercise of stock options by Bezeq employees. However, the Communications Order prohibits the issuance of shares which will result in a decrease of B Communications' minimum holding requirement in Bezeq (30%) or B Communications ceasing to control Bezeq without the prior consent of the Ministers (certain permitted issuances do not require the Minister's prior consent). Despite the 30% rule, according to Article 3(a3) of the Communications Order, which is included as part of the Control Permit, the parties to the Control Permit may hold less than 30% under certain circumstances, including the requirement that the parties control Bezeq and maintain at least a 25% ownership interest in Bezeq. The parties received explicit governmental approval to keep the Control Permit even at a level of a 25% ownership interest. On February 2, 2016, B Communications announced that its wholly-owned subsidiary, SP2, sold 115,500,000 Bezeq shares. As a result, B Communications received gross proceeds of NIS 8.50 per share, or NIS 982 million in the aggregate (approximately $248 million). B Communications retained a 26.34% ownership interest in Bezeq following the closing of the transaction. In addition to B Communications' ownership of Bezeq shares, an additional 72,360 ordinary shares of Bezeq are held by Ms. Iris Elovitch, the wife of Mr. Elovitch, and 11,556 ordinary shares of Bezeq are held by Ms. Orna Elovitch, the daughter-in-law of Mr. Elovitch.

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

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

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

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

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

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

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

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

At least 19% of each of the Means of Control of SP2 must be held by an Israeli Party at all times; or

At least 19% of the rights to vote at the general meeting of shareholders of SP2 and the rights to appoint directors of SP2 must be held by an Israeli Party at all times; and

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

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

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

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According to the Communications Order a “principal shareholder” or a person with “significant influence” in Bezeq shall not be; (i) a hostile state, a citizen or resident of a hostile state, a corporation registered or incorporated in a hostile state or a corporation controlled by a citizen or resident of a hostile state; or (ii) a government corporation, unless approved by the Ministers.

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

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

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

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

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

The Concentration Law

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

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

Prohibition on a second-tier company controlling another tier company

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

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The Concentration Law prohibits a second-tier company, such as B Communications, from controlling another tier company. In the case of existing pyramidal structures, a second-tier company is entitled to continue to control another tier company that it controlled on the publication date of the Concentration Law for a period of six years from the date of publication of the Concentration Law (until December 10, 2019). For the purpose of the law, Bezeq is considered a third tier company, and accordingly, if by December 10, 2019, B Communications remains a tier company, B Communications will not be allowed to control Bezeq from that date.

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

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

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

Appointment of directors and the composition of the board of a "third- tier" company during the transition period

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

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

Limitations on the provision of credit to corporations and issuer groups

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

Regulatory Requirements Relating to the Bezeq Group

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

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

Structural separation

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

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

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

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

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

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

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

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

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

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

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

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

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

Joint service bundles marketed by the subsidiaries including the services of Bezeq, are also subject, according to their licenses, to similar limitations, including a requirement for unbundling (except for a bundle marketed by a subsidiary that contains only Bezeq’s Internet infrastructure service). These limitations, and in particular the unbundling obligation, which severely limits the Bezeq Group’s ability to offer discounts on the components of the bundle, places the Bezeq Group at a competitively disadvantage as compared to the competing communication groups which are not subject to similar limitation in marketing joint bundles (other than a limitation on marketing a joint bundle of HOT-Net and other HOT Group companies,). Bezeq’s limitation is more significantly manifested with implementation of the wholesale BSA services and the option for ISPs to provide end-to-end services to customers at reduced prices compared with the unbundleable bundles that Bezeq can market.

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

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

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

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

1. Implementation of the wholesale market reform.

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

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

Wholesale services

The wholesale services were established pursuant to the policy document in which the Minister of Communications adopted the main recommendations of the committee appointed to review and revise the structure of Bezeq's tariffs and to set wholesale service tariffs in the communications segment (Hayek Committee). The policy document states, among other things, that owners of country-wide fixed-line access infrastructures who provide retail services, including Bezeq, will be obligated to sell wholesale services to holders of telecommunication licenses on a non-discriminatory basis and with no discounts for size. The document also stipulates the terms for cancellation of the structural separation and that within six months of publication of the Shelf Offering for the sale of wholesale services by the infrastructure owners, the Minister of Communications will take action to change to a method of oversight of Bezeq's prices by setting a maximum price and within nine months and that the Ministry of Communications will formulate regulations aimed at increasing the investment in and upgrading fixed-line communications infrastructure in Israel.

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

BSA services

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

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

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

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

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

Wholesale service use of physical infrastructures

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

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

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

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

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

__Wholesale telephony service__

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

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

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

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

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

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

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State Comptroller's Report dated July 12, 2017

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

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

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

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

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

Amendments of licenses and additional legislation

Hearing about call center waiting times

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

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Amendment of licenses to ensure operational continuity of communication companies in emergencies. On March 1, 2015, the licenses of communications operators were amended, including the licenses of Bezeq, Pelephone and B.P.I. According to the amendments, the license holders must comply with minimum requirements to ensure operational continuity (a business continuity plan and network disaster recovery plan) in the event of emergencies. On November 1, 2016, the Ministry of Communications published a hearing for further amendments to the licenses, including provisions concerning the installation of supporting infrastructure on core sites. Bezeq submitted its comments to the hearing.

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

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

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

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

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

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

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

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

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

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

Bezeq

Control of Bezeq's tariffs

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

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

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

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

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

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

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

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

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

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

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

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

Bezeq's Domestic Carrier license

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

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

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

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

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

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

Bezeq submitted a bank guarantee of US$ 10 million to the Director General of the Ministry of Communications tor secure fulfillment of the terms of the license and for indemnifying the State for any loss it incurs due to their violation by Bezeq. The Director General at the Ministry of Communications is authorized to impose a fine for violation of any of the terms of the license.

During a calendar year, Bezeq may invest up to 25% of its annual income in activities not intended for providing its services (the incomes of Bezeq's subsidiaries are not considered income for this purpose).

The Communications Order

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

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The main provisions of the Communications Order are these:

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

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

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

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

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

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

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

Authority with respect to real estate

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

A network on Private Land will be deployed according to the provisions of the Planning and Construction Law and requires the consent of the landowner, the lessee in perpetuity or the protected tenant, as the case may be. Under the provisions of the Telecommunications (Installation, Operation and Maintenance) Regulations, 1985, if Bezeq is of the opinion that providing a telecommunications service to an applicant requires the installation of a telecommunications device on the applicant's premises (or shared premises), Bezeq may request that the applicant, as a prerequisite for providing the requested service, allocate a suitable place on the premises for installation of the device, for the sole use of Bezeq, and it may use the device to provide service to other applicants as well.

Under the provisions of the Planning and Construction (Application for a Permit, its Terms and Tees) Regulations, 1970, an applicant for a permit to construct a residential building is required to install infrastructures for telephone, radio, television and Internet services so that the customer can choose whichever provider it prefers. In commercial buildings, if preparations for communications are installed, an underground infrastructure must be laid. At the same time, Bezeq's license was amended (as were the licenses of HOT Telecom and DBS), so that if Bezeq uses the internal wiring (part of the access network installed in residences and in apartments intended to be used by those residences only) for provision of its services, it is obliged to provide maintenance services for that wiring installed by the permit applicant, without this granting it any proprietary rights in the internal wiring. Pursuant to the hearing published on May 7, 2015 on the subject of wiring in residential buildings, the Ministry of Communications is holding a round table with Bezeq, DBS, HOT and IBC to reach an arrangement regarding installation of infrastructure in new buildings.

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Immunity and exceptions to liability

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

Regulations and rules under the Communications Law

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

Antitrust laws

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

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

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

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

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

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

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

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

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

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

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

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

The Telegraph Ordinance

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

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

Setting up communications facilities

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

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

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

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

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

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

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

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

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

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

Exemption from a permit to add antennas to existing lawful broadcasting facilities. The addition of an antenna to an existing, lawful broadcasting facility is exempt from a permit, subject to meeting a combination of conditions and exclusions, which are set out in the Planning and Building (Works and Buildings that are Exempt from a Permit) Regulations, 2014. Bezeq is taking the required steps to add antennas to its broadcast facilities according to the mechanism set out in these regulations.

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Pelephone

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Bezeq International

On February 21, 2016 Bezeq International's license was amended by the Director General of the Ministry of Communications and was replaced by a unified general license for providing telecommunications services, or the Unified License. The Unified License, which is valid until May 2, 2025, covers all the services that Bezeq International was permitted to provide to date. Pursuant to Ministry of Communications requirements, Bezeq International provided a bank guarantee of NIS 5 million in compliance with the terms of the Unified License.

Since 2013 the Ministry of Communications has conducted hearings with regard to the re-regulation of the international telecommunications market. Originally, the proposed regulation enabled any fixed-line domestic operator or mobile telephony operator to provide international telecommunications services as part of the service bundles they offer to their subscribers, with conditions, as well as international data transmission and configuration services. Resolutions adopted subsequent to this hearing could have a significant impact on the structure of competition in the international telecommunications sector, and consequently also on the results of Bezeq International's operations. Bezeq International is unable to estimate the scope of the new regulations that are expected to be adopted subsequent to the hearing.

DBS

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

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

Key recommendations to be adopted:

Definition of subscriber content providers

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

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

Original productions

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

Independent channels

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

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

Regulatory requirements for commercial license holders

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

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

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

Must sell requirements and competition in the content sector

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

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

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Cancellation of the basic package and the initial basic package

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

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

Tariff control

The broadcasting license provides provisions regarding the types of fees the licensee may collect from its subscriber