August 6, 2014

Quarterly report for the period ended June 30, 2014

- Update to Chapter A (Description of Company Operations) of the Periodic Report for 2013
- Directors report on the state of the Company's affairs for the period ended June 30, 2014
- Interim Financial Statements as at June 30, 2014

bezeq

Update to Chapter A

(Description of Company Operations)

of the Periodic Report for 2013

bezeq

Update to Chapter A (Description of Company Operations) [1] to the Periodic Report for 2013 ("Periodic Report") of "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company")

1. Description of the general development of Bezeq Group's business

Section 1.1 - Bezeq Group activities and business development

Section 1.1.2 - Mergers and acquisitions - Merger of the Company and DBS, Section 1.6.2(D) - Limitations concerning the control of DBS, and Section 1.6.5(B) - Approvals and limitations as part of the transaction to acquire control of the Company

On March 26, 2014, the Company received the decision of the Antitrust Authority stipulating that when the conditions listed in the decision are met, the limitations that were imposed on Eurocom Group with respect to its holdings in DBS will be cancelled and the merger between the Company and DBS will be permitted (in this section - “the Merger”).

Hereunder are the key conditions for approval of the merger:

- The Company and any person associated with it (in this section - “Bezeq”) will not impose any restriction on the use of fixed-line Internet infrastructure services stemming from the customer’s cumulative surfing volume, and it may not restrict or block the possibility available to a customer to make use of any service or application provided on the Internet.[2]
- Bezeq will deduct amounts for providing multi-channel TV services from the payments of ISPs for connecting them to the Bezeq network.
- Bezeq will sell and provide Internet infrastructure services and TV services under equal conditions for all Bezeq customers (the sale of Internet infrastructure services as part of a bundle will not, in itself, be considered a sale under non-equal conditions).[3]
- Bezeq and DBS will cancel any exclusivity arrangements pertaining to productions that are not original productions and they shall not be party to any such exclusivity arrangements (except in relation to a third party which, on the date of the decision, has a broadcasting license). Furthermore, for two years from the approval date of the merger, Bezeq will not prevent any entity (excluding an entity that has a broadcasting license on the date of the decision) from acquiring rights in original productions (this does not apply to new productions).

The full text of the Antitrust Authority’s decision appears in an Immediate Report of the Company dated March 26, 2014, presented here by way of reference.

Through the Board of Directors sub-committee which was set up to handle the issue, and with the help of external consultants selected by the committee, the Company is making progress in its review of the feasibility of the merger and the options available to it in light of the Commissioner’s aforementioned decision and its conditions, including the purchase of DBS’s shares that are held by Eurocom, as well as other options. As part of this review, the Company is conducting a due diligence of DBS with the help of external consultants.

At this point in time, as part of the review of the options available to the Company, the external consultants chosen by the committee and Eurocom’s advisors are discussing the possible acquisition of DBS shares that are held by Eurocom. There is no certainty that a transaction with Eurocom will actually be finalized, and even if it does, what the outline of the transaction and its conditions will be. If and insofar as subsequent to the completion of the review of feasibility of the merger and the options available to the Company, and completion of the negotiations with Eurocom, a decision is made to enter into a transaction to acquire Eurocom’s DBS shares, such an acquisition

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1 The update is further to Regulation 39A of the Securities Regulations (Periodic and Immediate Reports), 1970, and includes material changes or innovations that have occurred in the corporation in any matter which must be described in the periodic report. The update relates to the Company's periodic report for the year 2013 and refers to the section numbers in Chapter A (Description of Company Operations) in the said periodic report.

2 It is noted that as part of the approval of the merger between Partner Communications Ltd. and Hot Mobile Ltd. from May 22, 2014, a similar condition was determined which will apply to Hot Telecom Limited Partnership.

3 It is noted that as part of the approval of the merger between Partner Communications Ltd. and Hot Mobile Ltd. from May 22, 2014, a similar condition was determined which will apply to Hot Telecom Limited Partnership.

may entail a significant financial expense for the Company, insofar as the transaction is paid for in cash.

The foregoing with respect to the potential ramifications of a possible transaction for the acquisition of DBS's shares that are held by Eurocom is forward-looking information. It should be emphasized that, as noted, at this point in time, the Company is reviewing the feasibility of the merger and the options open to it, although there is no certainty that the transaction will actually materialize and in what format, and/or that the relevant approvals required by law for execution of the transaction will be obtained.

Section 1.2 - Segments of operation

On May 20, 2014, a transaction was completed between the subsidiary Walla! Communications Ltd. ("Walla") and Axel Springer Digital Classifieds Holding GmbH, a foreign media company incorporated in Germany, for the sale of all the share capital of Coral Tell Ltd. ("Coral Tell"), a private company fully controlled by the Company (indirectly, by Walla), which operates the Yad2 website. The full consideration in the amount of NIS 805 million was received upon completion of the transaction and Walla no longer holds any share capital in Coral Tell. The sale agreement signed by the parties on May 5, 2014 includes an undertaking by Walla and the Company not to engage in the areas of operation of Coral Tell for 24 months. In view of the foregoing, the Company recorded pre-tax profit of NIS 582 million in its financial statements for the second quarter of 2014.

Section 1.3.3 - Dividend distribution

For information about a dividend distribution in respect of profits from the second half of 2013 and a recommendation for a dividend distribution in respect of profits from the first half of 2014, see Note 7 to the Company's Financial Statements for the period ended June 30, 2014.

Section 1.4 - Financial information about Bezeq Group's segments of operation

Section 1.4.4 - Main results and operational data

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

	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenues (NIS million)	1,073	1,077	1,101	1,127	1,121	1,129
Operating profit (NIS million)	471	504	459	494	510	535
Depreciation and amortization (NIS million)	172	168	174	174	168	167
EBITDA (Earnings before interest, taxes, depreciation and amortization) (NIS million)(1)	643	672	633	668	678	702
Net profit (NIS million)	314	332	312	360	351	348
Cash flow from operating activities (NIS million)	545	616	526	631	556	561
Payments for investments in property, plant & equipment and intangible assets (NIS million)	207	210	222	198	186	183
Proceeds from the sale of property, plant & equipment and intangible assets (NIS million)	42	28	90	48	124	42
Free cash flow (NIS million) (2)	380	434	394	481	494	420
Number of active subscriber lines at the end of the period (in thousands)(3)	2,205	2,214	2,216	2,223	2,224	2,242
Average monthly revenue per line (NIS) (ARPL)(4)	63	64	70	73	75	75
Number of outgoing minutes (in million)	1,522	1,608	1,742	1,707	1,805	1,788
Number of incoming minutes (in million)	1,428	1,467	1,541	1,521	1,550	1,503
Number of Internet subscribers at the end of the period (in thousands)	1,308	1,289	1,263	1,230	1,202	1,185
Average monthly revenue per Internet subscriber (NIS)	84	82	82	86	85	83
Average packet speed per Internet subscriber (Mbps) (5)	21.9	20.0	18.1	17.3	15.2	10.4
Churn rate (6)	2.8%	3.0%	3.1%	2.8%	3.5%	3.7%

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

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

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

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

(5) For plans with a range of speeds, the maximum plan speeds are taken into account.

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

2. Pelephone

	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenue from services (NIS million)	622	637	688	710	696	714
Revenues from sale of terminal equipment (NIS million)	221	280	295	237	219	250
Total revenue (NIS million)	843	917	983	947	915	964
Operating profit (NIS million)	127	126	76	172	186	174
Depreciation and amortization (NIS million)	105	106	113	111	113	121
EBITDA (Earnings before interest, taxes, depreciation and amortization) (NIS million)(1)	232	232	188*	283	299	295
Net profit (NIS million)	106	108	67*	140	161	153
Cash flow from operating activities (NIS million)	420	349	327	442	468	354
Payments for investments in property, plant and equipment and intangible assets (NIS million)	85	73	77	88	84	66
Free cash flow (NIS million) (1)	335	276	250	354	384	288
Number of subscribers at end of the period (thousands) (2)	2,610	2,631	2,642	2,683	2,702	2,741
Average monthly revenue per subscriber (NIS) (ARPU) (3)	79	80	86	88	85	86
Churn rate (4)	6.5%	7.5%	8.3%	6.2%	6.9%	7.2%

* After adjustment for non-recurring expenses resulting from the implementation of the collective labor agreement detailed in Section 3.9.2 of the Description of Company Operations in the 2013 reports, which also includes increased severance pay as specified in Section 3.9.6 of the same report, Pelephone's EBITDA and net profit in Q4 2013 amounted to NIS 249 million and NIS 109 million respectively.

(1) Regarding the definition of EBITDA and free cash flows, see comments (1) and (2) in the Bezeq Fixed Line table.

(2) Subscriber data include 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 at least one call/ sent one SMS, has not had any web browsing activity or who has not paid for Pelephone services. It is noted that a customer may have more than one subscriber number ("line").

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

3. Bezeq International

	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenues (NIS million)	366	355	368	360	359	346
Operating profit (NIS million)	58	58	56	55	60	56
Depreciation and amortization (NIS million)	33	32	33	33	33	31
EBITDA (Earnings before interest, taxes, depreciation and amortization) (NIS million)(1)	90	90	89	88	93	87
Net profit (NIS million)	41	42	38	39	44	37
Cash flow from operating activities (NIS million)	95	74	77	71	81	58
Payments for investments in property, plant and equipment and intangible assets (NIS million) (2)	23	31	18	21	27	31
Free cash flow (NIS million) (1)	72	43	59	50	54	28
Churn rate (3)	3.7%	4.0%	4.6%	4.7%	4.5%	4.2%

(1) Regarding the definition of EBITDA and cash flows, see notes (1) and (2) in the Bezeq Fixed Line table.

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

4. DBS

	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenues (NIS million)	428	424	417	410	404	404
Operating profit (NIS million)	67	73	61	72	68	67
Depreciation and amortization (NIS million)	74	70	71	66	64	62
EBITDA (Earnings before interest, taxes, depreciation and amortization) (NIS million)(1)	141	143	131	138	132	130
Net profit (loss) (NIS million)	(115)	(34)	(83)	(136)	(101)	(61)
Cash flow from operating activities (NIS million)	106	113	133	126	110	122
Payments for investments in property, plant and equipment and intangible assets (NIS million)	68	78	83	67	84	90
Free cash flow (NIS million) (1)	38	35	50	59	26	32
Number of subscribers (at the end of the period, in thousands) (2)	613	607	601	593	583	578
Average monthly revenues per subscriber (ARPU) (NIS)(3)	234	234	233	233	232	233
Churn rate (4)	3.1%	3.6%	3.0%	3.4%	3.2%	3.8%

(1) Regarding the definition of EBITDA and cash flows, see notes (1) and (2) in the Bezeq Fixed Line table.

(2) Subscriber – one household or one small business customer. In the event of a business customer with many 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.

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

Section 1.5 - Forecast in relation to the Group

Following completion of the transaction to sell all the share capital of Coral Tell, which operates Yad2 (see update to Section 1.2), approval of the provision for the early retirement of employees (see update to Section 2.9.3), and the execution of an agreement by Pelephone to establish an LTE network, below is a revised forecast for the Bezeq Group for 2014, based on the information currently known to the Bezeq Group (there is no change compared with the revised forecast published in the Company's quarterly report at March 31, 2014):

- Net profit attributable to shareholders is expected to be approximately NIS 2 billion.
- EBITDA[4] is expected to be approximately NIS 4.5 billion.
- The Group's free cash flow[5] is expected to be approximately NIS 2.5 billion.[6]

The Company's forecasts detailed above are forward-looking information, as defined in the Securities Law. The forecasts are based on the Company's estimates, assumptions and expectations, including the following:

The forecasts do not include the effects of a provision for the early retirement of employees, insofar as this takes place (over and above any resolutions relating to retirement that have already been passed by the Company, as detailed in the update to Section 2.9.3), investments insofar as there are any for the purchase of frequencies for a 4G LTE network, and the impact of a possible merger with DBS.

The Group's forecasts are based, *inter alia*, on its estimates regarding the structure of competition in the telecommunications market and regulation in this sector, the economic situation and accordingly, the Group's ability to implement its plans in 2014. Actual results might differ significantly from these estimates, taking note of changes which may occur in the foregoing, in business conditions and the effects of regulatory decisions, technology changes, developments in the structure of the telecommunications market, etc. or insofar as one or more of the risk factors listed in Sections 2.21, 3.20, 4.17 and 5.21 in the chapter - Description of Company Operations in the 2013 reports, materializes.

Section 1.6 - General environment and the influence of external factors on the Group's activity

Section 1.6.1 - Emergence of communication groups in the Israeli market and transition to competition among the groups.

Par. C - HOT Group

On May 22, 2014, the Antitrust Authority published a decision of the Antitrust Commissioner ("the Commissioner") giving conditional approval for the infrastructure sharing agreement with Partner Communications Ltd. ("Partner") (see update to Section 3.6.2.C below). This decision prescribes the following conditions that will apply to HOT Telecom Limited Partnership ("HOT Telecom"), a company wholly owned by HOT: (a) HOT Telecom will not place and will not enforce any restriction on the use of fixed-line Internet infrastructure services stemming from the customer's cumulative surfing volume. This includes that HOT Telecom may not set the price and quality of the fixed-line Internet infrastructure services according to the customer's cumulative surfing volume (this condition will remain in force until the earlier of (1) December 31, 2015, (2) 30 days after the Minister of Communications has set laid out the conditions and tariffs for providing wholesale services on HOT Telecom's Internet infrastructures); (b) HOT Telecom will not restrict or block, directly or indirectly, the possibility available to customers to use any service or application provided on the Internet at any time, including by way of setting prices or the use of technology. (c) HOT Telecom's Internet infrastructure services will be sold and supplied on equal terms to all HOT Telecom customers, irrespective of whether or not they purchase additional communications services from HOT. On this,

[4] For a definition of EBITDA, see note (1) to the table in the update to Section 1.4.4 A.

[5] For a definition of free cash flow, see note (2) to the table in the update to Section 1.4.4 A.

[6] It is stipulated that the net proceeds of the sale of Yad2 (net of tax) were presented as part of cash flow from investment activity, and the sale therefore has no effect on the forecast of free cash flow as defined in the Periodic Report (cash from operating activities less cash for the purchase/sale of property, plant and equipment, and intangible assets, net).

it was determined that the sale of discounted Internet infrastructure services as part of a service bundle will not, in itself, be deemed a breach of the conditions.

<u>Section 1.6.3 - Regulatory oversight and changes in the regulatory environment</u>

Par. A - Policy for regulating competition

Concerning a petition by the Company to HCJ in an application for relief to obtain information for its reference at a hearing on the subject of a wholesale market, in a HCJ hearing that took place on March 17, 2014, the parties agreed that they would conduct a thorough dialog and the Company would be allowed to hold a supplementary hearing to exhaust all its arguments. After reaching agreement, the Company withdrew its petition. Subsequently, a first session of the hearing took place at which the Company requested further clarifications. The Ministry sent the Company partial clarifications to which it responded and it is now waiting for additional clarifications.

Concerning a hearing on the subject of a service portfolio for the use of passive infrastructures according to which service providers will be allowed to use the physical infrastructure of the infrastructure owner, on May 1, 2014 the Company submitted its response to the hearing and expressed its objection to the scope and content of the services, and also noted that the defining of the portfolio was beyond the scope of the Ministry's powers and that it constitutes an infringement of the Company's rights.

Concerning a hearing that is under way as part of the Ministry of Communications discussions on the subject of the SLU (Sub Loop Unbundling) service portfolio, whereby service providers will be allowed to use the copper cable infrastructure of infrastructure owners, on July 3, 2014 the Company submitted its comments on the service portfolio which was published by the Ministry of Communications.

As emerges from the foregoing, the hearing on the wholesale market is well under way and the Company has significant comments on the Ministry of Communications' hearing documents, which, in the Company's opinion, include erroneous facts, assumptions and conclusions regarding the price and scope of the wholesale services. In view of the foregoing, and in view of the positions of other relevant entities that are expected to be submitted during the course of the hearing, there is still a great deal of uncertainty as to the final manner of regulation that will apply to the wholesale market. Consequently, at the date of publication of this quarterly report, there is no change in the Company's estimates detailed in this section in the chapter - Description of Company Operations" in the 2013 financial reports.

Par. G - Enforcement and financial sanctions

On July 24, 2014, an amendment to the Consumer Protection Law was published (effective from January 1, 2015, subject to the promulgation of regulations by that date). The amendment allows administrative enforcement action to be taken against one who is in breach of the provisions of the Consumer Protection Law, including - the imposition of progressive financial sanctions on those involved in a breach (including an on-going and recurring breach) of the provisions of the law, the issuing of an administrative warning to the offender, and an undertaking by the offending party to refrain from the breach. Likewise, the amendment also promulgates supervisory powers, including conferring powers on the Director of Consumer Protection to investigate, appoint inspectors and issue administrative orders. Additionally, a section of the law that prohibits exploiting the consumer's distress was replaced with a prohibition on exerting unfair influence, and several presumptions were prescribed that are deemed to be the exertion of unfair influence on the consumer.

Par. H – Market Concentration Law

Sub-par. 2 - Special provisions concerning directors in a third tier company during the transition period - on June 11, 2014, Regulations to Promote Competition and Reduce Concentration (Relief with Regard to the Number of External Directors), 2014, were published. Accordingly, where the director of a company who is appointed according to the proposal of a representative labor union as per a collective labor agreement serves in another tier company, the number of external directors in the tier company required under the Market 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. This provision is relevant for the Company (Bezeq) in which one director serves who was appointed according to the proposal of the representative union. It is noted that in accordance with the provisions of the Law to Promote Competition and Reduce Concentration and the aforementioned regulations, a general meeting of Company shareholders was convened for September 3, 2014, in part to choose an additional external director for the Board of Directors.

Par. I - Ministry of Communications policy concerning Wi-Fi

Pursuant to a secondary hearing on this subject, on August 6, 2014, the Ministry of Communications published its decision to abolish the existing policy and to prescribe in an order, that the establishment and operation of access points (as they are defined in the order) are exempt from licensing and general permit requirements. It was also decided to allow license holders to use WLAN technology, to set up and operate access points based on the conditions of the exemption order, provided that a general license holder who utilizes an access point as part of its public telecommunications network does not collect payment from subscribers for providing Internet access services when the said services are provided through an access point, and it may not lower the use allocation in the Internet access service to which the subscriber is entitled for the relative part that is provided via the access point. Consequently, with the entering into force of the exemption order, if a general license holder applies to the Ministry for an extension of its public telecommunications network through the use of access points, the application will be reviewed subject to that mentioned in the decision document and the law, and its license will be amended accordingly

2. Domestic fixed-line communications; "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company")

Section 2.9.3 - Early retirement plans

On May 15, 2014, the Board of Directors approved a budget of NIS 116.5 million for the early retirement of 101 employees on the early retirement track in accordance with the conditions of the collective labor agreement from December 2006, as amended in December 2010. The Board also approved the early retirement of additional employees on the enlarged severance pay track, based on the Company's requirements. In view of the foregoing, the Company recorded a provision for the above in the amount of NIS 116.5 million in its financial statements for Q2 2014.

Section 2.9.6 - Officers and senior management in the Company

Concerning the Company's compensation policy – on March 19, 2014, a general meeting of the Company's shareholders approved the compensation policy as detailed in the 2013 reports.

Section 2.11 – Working capital

At June 30, 2014, the Company has a working capital deficit in the amount of NIS 501 million (this figure refers to the Company's separate financial statements. In the Company's consolidated financial statements at June 30, 2014, there is working capital surplus in the amount of NIS 1,245 million). On August 6, 2014, the Company's board of directors determined that despite its deficit in working capital, it does not have a liquidity problem. See Section 1.3 of the Directors' Report.

Section 2.13 - Financing

On May 29, 2014, the Company published a shelf prospectus for the issue of shares, debentures, convertible bonds, stock options, options for debentures and commercial papers, of a scope and under conditions to be determined in accordance with shelf proposal reports, if and insofar as the Company should publish them in the future. On this, see the Company's Immediate Report dated May 29, 2014, included here by way of reference.

Section 2.13.6 - Credit rating

On May 13, 2014, Standard & Poor's Maalot Ltd. published affirmation of a rating of ilAA/Stable for the Company and Pelephone (unchanged from the previous rating). The rating report can be seen in an Immediate Report (Amendment) issued by the Company on May 15, 2014, cited here by way of reference.

Section 2.16.1 - Control of Company tariffs

Sub-par. B - A temporary order dated June 1, 2014, stipulated that the tariffs would not be updated on June 2, 2014, and that the postponement will be taken into consideration in the next update

Section 2.17.4 - Early retirement agreements

On April 24, 2014, the Company and Menorah Mivtachim Insurance Ltd. signed an agreement regulating pension payments for the early retirement of Company employees and payment of the remainder old-age and survivors' pensions to employees who retire from the Company under the special collective retirement agreement. The agreement period is until the end of 2016 and it includes a mechanism for Company participation in future yields/losses in the pension portfolio for the retirees which will be managed by Menorah.

Section 2.18 – Legal proceedings

On subsection D concerning an action and application for its certification as a class action, in which it was alleged that the Company unlawfully collected amounts from its subscribers upon disconnection due to failure to make payments - on May 18, 2014 the Company received a court ruling certifying the action as a class action in one of the causes (insofar as it pertains to collection of the fixed payment after discontinuation of the service) and rejecting the application insofar as it pertains to the other causes (disconnection of the additional line, collection of a renewal fee when the line is reconnected or collection of the fixed payment for the line for the period until the discontinuation of the service). Taking note of the above, and given that other causes of the applicants were neglected prior to the issue of the said ruling, and according to information in the Company's possession, the financial implications of the ruling are insignificant to the Company's business

Concerning an action together with an application for its certification as a class action against Coral-Tell - as part of agreement for the sale of Walla's holdings in Coral Tell (see update to Section 1.2), Walla undertook to indemnify the buyer for loss that may be incurred as a result of this move up to the amount of the purchase, subject to the conditions and limitations specified in the agreement.

In June 2014, a claim was filed in the Haifa District Court together with a motion for its certification as a class action. The Plaintiff, who is a customer of the Company's internet infrastructure, alleges that the Company does not permit existing customers to connect to the Company's infrastructure at the prices offered to new customers for the same service. The Plaintiff estimates the total amount of the claim at NIS 144 million (based on personal loss of NIS 10 per month, calculated according to the difference between the price for an existing customer and the price for a new customer, multiplied by 1.2 million existing customers in one year).

3. <u>Mobile radio-telephone (cellular telephony) - Pelephone Communications Ltd. ("Pelephone")</u>

<u>Section 3.1.5A - Establishment of cellular networks using advanced technologies</u>

A. In July 2014, the Ministry of Communications published a tender for the allocation of 4G frequencies. The following may participate in the tender: infrastructure-owning cellular operators, virtual operators, and entities that are not currently cellular operators, all subject to the threshold conditions determined in the tender. According to the tender, eight bands in the 1800 MHz spectrum will be allocated, where each band is 5 MHz and the total bandwidth is 38-40 MHz (depending on who wins the tender), and the minimum price for each 1 MHz is NIS 2 million. The tender includes a limitation on the bandwidth allocation taking into account the existing inventory of frequencies in the 1800 MHz spectrum for each operator. The tender includes provisions concerning requirements for the cover and quality of the network to operate on 4G (LTE), and this within the context of amended cellular licenses, which are more stringent than the current cover and quality requirements. Pelephone intends to participate in the tender.

B. In July 2014, Pelephone received a letter from the Ministry of Communications stating that the Ministry had decided to allow all existing cellular operators who wish to perform an immediate technology upgrade of their systems, to begin using frequency bandwidth of 5 MHz in the 1800 MHz spectrum on LTE technology now. Given that Pelephone does not have an allocation of frequencies on the 1800 MHz spectrum. The Ministry of Communications will allow a temporary allocation of 5 MHz frequency bandwidth to be used for operating the LTE technology, under certain conditions that include submitting an application for such an allocation.

   The temporary allocation of frequencies will be cancelled if Pelephone does not win the frequency tender mentioned in par. A above. Insofar as Pelephone wins the tender, the temporary allocation will be revoked when the frequencies are allocated following the tender, or when the specific frequency in the temporary allocation is allocated to another operator, whichever is earlier.

   On July 15, 2014, Pelephone filed an application in accordance with the Ministry of Communications requirement.

On August 3, 2014, Pelephone received the go-ahead from the Ministry of Communications allowing it to supply 4G services using LTE technology, by means of a temporary allocation of 5 MHz bandwidth on the 1800 MHz spectrum, like its competitors. Pelephone will operate the service immediately and gradually in those areas with LTE infrastructure, enabling the hundreds of thousands of compatible handsets that operate on the Pelephone network to benefit from advanced data services in those locations. Further deployment of the network is currently underway. On this, see also the Company's Immediate Report dated August 3, 2014, included here by way of reference.

At the date of this report, Partner Communications Ltd. and Cellcom Israel Ltd. also announced the launching of a 4G network on 5 MHz on the 1800 MHz spectrum.

Section 3.6.2 C - Infrastructure sharing

In May 2014, the Ministry of Communications ("the Ministry") published a document on "Policy for sharing broadband access networks that belong to general license-holders for providing cellular (mobile radio telephone) services" ("the Policy Document").

Following are the main points of the policy document:[7]

1. The Ministry encourages and will continue to encourage passive sharing of network sites and masts only, as well as the active sharing of antennae only among all operators.
2. In general, the Ministry believes that active sharing on a multi-operator core network (MOCN) format (sharing of antennae, frequencies and radio equipment) is preferable to active sharing on a multi-operator radio access network (MORAN) format (sharing of antennae and radio equipment without the sharing of frequencies), in view of the need to streamline the frequency spectrum. Nevertheless, the Ministry does not rule out the possibility that under special circumstances, it might deem it appropriate to approve an agreement under a MORAN format.
3. In general, the Ministry of Communications will allow the sharing of transmission from cell sites to the centralized radio-based stations in a bandwidth-sharing configuration. However, under exceptional conditions, and at the Ministry's discretion, it might allow sharing of transmission from the cell sites to the centralized radio-based stations in other cases as well.
4. When examining individual network-sharing agreements, the Ministry will take into account the considerations specified in the Policy Document that pertain to four key aspects: the existing level of competition and the potential for harm to the competition, the existing and expected inventory of frequencies and how efficiently they are being used, survivability and redundancy of the networks from the national perspective, and ensuring the level of telecommunications services over time.
5. Based on the foregoing, the Ministry outlined principle guidelines that will be used to examine each individual network-sharing agreement submitted for its approval. The guidelines also stipulate that sharing under an MOCN format will not be allowed for two cellular operators with fully deployed 3G cellular network, but that it will be considered in relation to a new operator with a partially deployed 3G cellular network, together with an established operator with a fully deployed 3G cellular network, and that the Ministry will allow sharing based on an MOCN format, provided that at least 3 independent wireless access networks are being operated in every region in Israel. Other conditions are also prescribed.
6. The Ministry does not intend to allow any sharing of radio (cellular) infrastructure, including shared transmission to radio base stations between Bezeq Group and HOT Group, which are the only owners of fixed-line infrastructure in Israel.
7. The Minister of Communications will consider revoking all or some of the network sharing approvals, depending on the circumstances, if it emerges that harm has been caused to the level of competition, the level of coverage or the level of service to customers.

An initial inspection of the Policy Document conducted by Pelephone shows that the infrastructure sharing agreement that Pelephone signed with Cellcom and Golan in December 2013, apparently does not comply with the threshold conditions in the Policy Document.

As a consequence, on May 25, 2014, Cellcom announced that it had signed an agreement with Golan granting it the right to use the 4G network that it intends to establish. This agreement is in

[7] The policy document appears on the Ministry of Communications website: http://www.moc.gov.il/sip_storage/FILES/0/3550.pdf.

addition to an agreement for the right to use the 2G and 3G networks that Cellcom and Golan signed in December 2013. These agreements are subject to the approvals of the Ministry of Communications and the Antitrust Commissioner. Cellcom's announcement also noted that it is continuing its efforts to implement network sharing, including the sharing of the passive elements on the network sites.

Pelephone is reviewing alternative network sharing options in a manner that will comply with the principles of the Policy Document and Pelephone's recent discussions with the Ministry of Communications and the Antirust Commissioner on the subject of network sharing.

On May 22, 2014, Partner and HOT announced that the Commissioner had resolved to approve the network sharing agreement between them subject to conditions. In its report, Partner noted that it estimates that in principle, the network sharing agreement signed by the companies was consistent with the principles of the policy document and that they are in the process of obtaining the relevant approvals for implementing the network sharing agreement.

The infrastructure sharing model has the potential to reduce the costs of establishing the network and its on-going operation. Consequently, insofar as Pelephone does not receive permission to operate under any network sharing model, the costs of Pelephone's network (with respect to establishment of the networks, acquiring the frequencies and the on-going operation of the network) are likely to be higher than those of its main competitors.

Pelephone's estimates as described above in this section are forward-looking information. At this stage, there is no certainty as to the extent to which the policy document will in future impact Pelephone's ability to operate under an infrastructure sharing model or the format of its operations based on such a model, nor is there any certainty as to the extent to which approval or lack thereof for Pelephone's operations based on an infrastructure sharing model will affect the costs of its network.

Section 3.6.2 D - MVNO - Mobile Virtual Network Operator

In June 2014, the Ministry of Communications announced that it is considering the publication of an administrative directive to determine that in hosting agreements drawn up between cellular operators and MVNOs, the cellular operators will not demand hosting tariffs that are higher than the lowest tariff given to business customers in cellular agreements. On July 22, 2014, Pelephone submitted its objection to this directive.

Section 3.7.1 - Infrastructures

In April 2014, Pelephone signed an agreement with L.M. Ericsson Israel Ltd. ("Ericsson") to upgrade the network center to support LTE, purchase and install radio equipment and to make additional adjustments to the network to support LTE. The equipment to be supplied to Pelephone will also support Advanced 4.5G LTE technology.

In connection with the anticipated costs of setting up the LTE network – the cost of establishing and expanding the network (payments to Ericsson and additional costs relating to the setting up and expansion of the network) is expected to reach approximately NIS 500 million, which is expected to be paid over the period 2014-2017, excluding the cost of purchasing the frequencies. Implementation of the full cost of the setting up and expansion of the network is subject to Pelephone winning the frequencies tender. See the update to Section 3.1.5A on the frequencies tender.

Pelephone's above-mentioned estimates concerning the costs of setting up the LTE network and payment period are forward-looking information, based on Pelephone's forecasts and assessments, in part, in connection with the speed of expansion of the network. It should be clarified that, as noted above, these costs do not take into account the costs of purchasing frequencies and they therefore do not reflect the full cost of setting up and expanding the network.

Section 3.15.2 - Pelephone's cellular license

Add sub-par. C - Hearing on required cover and quality obligation

On July 30, 2014, the Ministry of Communications published a hearing directed to general license holders that offer cellular services, including Pelephone ("the Operators"). The hearing discusses an amendment to the Operators licenses which will tighten the cover and quality requirements for public telecommunications systems that they operate using 2G and 3G technology with nationwide deployment and in the Administered Territories ("the Hearing"). The Operators may submit their comments on the draft amendment by August 31, 2014.

Pelephone is studying the draft amendment and at this stage is unable to quantify the effect on investments and expenses that will be required to comply with the conditions resulting from the change in the existing license, insofar as the proposed amendment is passed as is. Pelephone intends to object to the draft amendment and to voice its reservations over the change in the license conditions, which it considers are unreasonable. On this, see also the Company's Immediate Report dated July 31, 2014, included here by way of reference.

Section 3.15.3 – Site construction licensing

On July 24, 2014, Planning and Building (Work and Buildings that are Exempt of a Permit) Regulations, 2014 were published ("the Regulations"), which exempt certain small buildings from a building permit, including the addition of an antenna to a licensed broadcasting facility. The Regulations entered into force on August 1, 2014. Prior to their entering into force, a petition was filed in HCJ to abolish Regulation 34 of the Pergola Regulations, the subject of which is this exemption. The Company is a respondent in the petition together with the other cellular operators.

Section 3.17.1 – Legal proceedings

In sub-paragraph B in the matter of a claim and application for its certification as a class action which was filed against Pelephone and three other cellular operators on grounds pertaining to the non-ionizing radiation values of cellular handsets - on July 28, 2014, a judgment was given certifying a compromise arrangement which includes verifying and ascertaining certain matters relating to the claim as well as the sale of earphones to customers at a reduced price for a certain period.

In sub-paragraph G in the matter of an action together with an application for its certification as a class action alleging that Pelephone makes false representations to the public, according to which it provides a surfing experience on its network at extremely high speeds whereas in practice the surfing speed on its cellular network is lower than specified - on June 16, 2014 a ruling was given in the case confirming a settlement between Pelephone and the applicants at a cost of NIS 4.5 million to Pelephone.

4. Bezeq International – communications, Internet and NEP services - Bezeq International Ltd. ("Bezeq International")

Section 4.2 – Products and Services

In July 2014, Bezeq International launched activity in the small business and self-employed sector offering the "Bigger" service - a new digital platform for managing the business's marketing and advertising.

Section 4.8 – Human resources

In March 2014, Bezeq International received notice from the New Labor Federation ("the Histadrut") that more than one third of Bezeq International's employees had chosen to sign up as members of the Histadrut, and that it therefore constitutes a representative workers union of Bezeq International's employees. After inspecting the enrollment forms that it received, Bezeq International informed the Histadrut that it is inclined to recognize it as the representative workers union of Bezeq International. The parties have begun to negotiate a collective labor agreement.

Commencing May 15, 2014, Moti Elmaliach is the CEO of Bezeq International. This follows the announcement by the previous CEO of Bezeq International, Yitzhak Benbenisti, that he would be stepping down.

Section 4.13.2 - Licenses

On June 30, 2014, Bezeq International's special license to provide internet access services (ISP) was extended to April 30, 2019.

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

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

Section 5.4 – New products

In March 2014, DBS launched the YesGo Service.

Section 5.15.3 - Institutional financing

In April 2014, DBS issued additional debentures (Series 1) and (Series 2) by way of an expansion of the series, in the total amount of NIS 300 million.

Section 5.15.4 - S&P Maalot ratings for DBS and its debentures

On April 1, 2014, S&P Maalot issued an (ilA-) rating for additional debentures of up to NIS 250 million par value to be issued by DBS through a new issuance of debentures or an expansion of an existing series.

On April 30, 2014 S&P Maalot upgraded DBS to a rating of ilA (stable) and upgraded the debentures of DBS to a rating of (ilA), and placed DBS on a rating watch list with positive outlook.

Section 5.17.6 - Requirement to transmit channels

On July 20, 2014, HCJ dismissed DBS's petition without an order for costs.

Section 5.17.9 - Ownership of broadcast channels

In April 2014, DBS began to broadcast local news, in accordance with the Communications (Telecommunications and Broadcasts) Law (Amendment no. 59 and Temporary Provision), 2014 and a decision of the Council dated March 2014.

Section 5.17.13 - Regulation of the transmission of video content via media infrastructures

In February 2014, the Minister of Communications appointed a committee to review the regulation of commercial broadcasts, whose task is to review and compile recommendations, in part, in connection with the principles and standards that will apply to all companies involved in the distribution of audio-visual content. The committee was also asked to make recommendations as to the possible inclusion of advertising in the broadcasts of DBS and HOT. The committee was asked to formulate its recommendations by August 2014. Pursuant to a request from the committee, in April 2014, DBS submitted its position on the aforementioned subjects.

Section 5.19.1 - Legal proceedings

Sub-par. B - On May 22, 2014, a hearing took place on the motion to certify during which the applicants, at the court's recommendation, asked to abandon the request for certification. The court instructed that the abandonment affidavits be filed by May 29, 2014, and that after they have been received, the court will strike out the application for certification. On May 29, 2014, a ruling was given in which the court approved the application for abandonment and struck out the request for certification.

Sub-par. C - On June 9, 2014, the parties filed an agreed application to withdraw from the application for certification.

On June 10, 2014, a claim, together with an application for its certification as a class action, was filed in the Tel Aviv District Court alleging that residents of apartment buildings (customers and non-customers of DBS) had been charged for the use of electricity by satellite dishes and/or amplifiers and/or devices used by DBS that are positioned on the apartment buildings. The applicant petitioned the court, in part, with a request to obligate DBS to reimburse the group's members for the charge for use of the electricity, as noted above, and set the total amount of the claim at NIS 126 million.

On June 15, 2016, two representatives of apartment buildings in Haifa filed a claim against DBS, together with an application for its certification as a class action, on the same subject. The applicants in this motion set the amount of the claim at NIS 125 million, of which NIS 80 million is for financial and non-financial losses that were allegedly caused for the use of electricity by DBS's systems, and an amount of NIS 44.6 million for the cost of a mandamus to obligate DBS to install electricity meters for measuring the electricity consumption of DBS's systems.

August 6, 2014	
Date	Bezeq The Israel Telecommunication Corporation Ltd.

Names and titles of signatories:

Shaul Elovitch, Chairman of the Board of Directors

Stella Handler, CEO

Bezeq - The Israel Telecommunication Corporation Ltd.

The Board of Directors' Report on the State of the Company's Affairs for the Period Ended June 30, 2014

bezeq

We hereby present the Board of Directors' report on the state of affairs of "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company") and the consolidated Group companies (the Company and the consolidated companies, jointly - "the Group"), for the six months ended June 30, 2014 ("the Six Month Period") and the three months then ended ("the Quarter").

The Board of Directors' report includes a condensed review of its subject-matter, and was prepared assuming the Board of Directors' report of December 31, 2013 is also available to the reader.

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

1. **Domestic Fixed-Line Communications**
2. **Cellular Communications**
3. **International Communications, Internet and NEP Services**
4. **Multi-Channel Television (presented using the equity method)**

It is noted that the Company's financial statements include an "Others" segment, which comprises mainly online content, commerce and classified advertisement services (through Walla, Walla Shops, Yad2 and other websites) and contracted call center services (through "Bezeq Online"). The "Others" segment is immaterial at the Group level.

On May 20, 2014, the Company completed the sale of the entire share capital of Coral-Tell Ltd., which operates the 'Yad-2' website.

	1-6.2014	**1-6.2013**	**Increase (decrease)**		**4-6.2014**	**4-6.2013**	**Increase (decrease)**	
	NIS millions	**NIS millions**	**NIS millions**	**%**	**NIS millions**	**NIS millions**	**NIS millions**	**%**
Profit	**1,267**	**970**	297	30.6	**810**	**473**	337	71.2
EBITDA (operating profit before depreciation and amortization)	**2,555**	**2,159**	396	18.3	**1,553**	**1,070**	483	45.1

The results for the Six Month Period and the Quarter presented in comparison to the same six month and quarterly periods last year were mainly influenced by gains from the sale of all holdings in Coral-Tell Ltd. shares, by a provision for termination of employment by way of early retirement; and by gains on the sale of real estate, as detailed in Note 10 to the financial statements.

1. The Board of Directors' Explanations for the State of the Company's Affairs, the Results of its Operations, Equity, Cash Flows, and Additional Matters

1.1 Financial position

	30.6.2014 NIS millions	30.6.2013 NIS millions	Increase (decrease) NIS millions	%	Explanation
Cash and current investments	**2,398**	2,007	391	19.5	The increase was attributable to all Group segments.
Current and non-current trade and other receivables	**3,247**	4,014	(767)	(19.1)	This decrease was mainly attributable to a decrease in trade receivables in the Cellular Communications segment, as a result of a decrease in revenues from handsets sold in 36 installments, and a decrease in service revenues.
Other current assets	**113**	239	(126)	(52.7)	This decrease was attributable to a decrease in assets held for sale in the Domestic Fixed-Line Communications segment and a decrease in inventory in the Cellular Communications and the Domestic Fixed-Line Communications segments.
Intangible assets	**1,839**	2,135	(296)	(13.9)	The decrease was mainly attributable to the deconsolidation of Coral-Tell Ltd. (see Note 4.2 to the financial statements). Other Group segments also saw a decrease in this item.
Other non-current assets	**7,443**	7,383	60	0.8	The increase was attributable to an increase in property, plant and equipment in the Domestic Fixed-Line Communications segment, partially offset by a decrease in property, plant and equipment in the Cellular Communications sand International Communications, Internet, and NEP Services segment.
Total assets	**15,040**	15,778	(738)	(4.7)	
Debt to financial institutions and debenture holders	**9,349**	9,939	(590)	(5.9)	The decrease was attributable to repayment of loans and debentures in the Domestic Fixed-Line Communications and Cellular Communications segments. The decrease was partially offset by a debenture issue made in the fourth quarter of 2013 in the Domestic Fixed-Line Communications segment, and effected as an expansion of an existing series.
Other liabilities	**2,807**	3,268	(461)	(14.1)	The decrease was mainly attributable to the settlement of the Company's liability from a distribution not meeting the profit test.
Total liabilities	**12,156**	13,207	(1,051)	(8.0)	
Total equity	**2,884**	2,571	313	12.2	The increase in total equity was attributable to timing differences between accrual of earnings in the Company, and the distribution of such earnings as dividends. Equity comprises 19.2% of the balance sheet total, as compared to 16.3% of the balance sheet total on June 30, 2013.

1.2 Results of operations

1.2.1 Highlights

	1-6.2014	1-6.2013	Increase (decrease)		4-6.2014	4-6.2013	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Revenues	**4,561**	4,756	(195)	(4.1)	**2,250**	2,351	(101)	(4.3)	The decrease was attributable to service revenues in the Cellular Communications segment and fixed-line telephone revenues in the Domestic Fixed-Line Communications segment.
Depreciation and amortization	**633**	654	(21)	(3.2)	**319**	326	(7)	(2.1)	The decrease was attributable to the Cellular Communications segment.
Labor costs	**891**	967	(76)	(7.9)	**443**	468	(25)	(5.3)	The decrease was mainly attributable to the Domestic Fixed-Line Communications segment, and the Cellular Communications segment, mainly due to downsizing.
General and operating expenses	**1,691**	1,720	(29)	(1.7)	**822**	831	(9)	(1.1)	The decrease was attributable to the Domestic Fixed-Line Communications segment and was partially offset by an increase in the Cellular Communications and the International Communications, Internet and NEP Services segment.
Other operating income, net	**576**	90	486	-	**568**	18	550	-	The increase in income was attributable to the sale of all of Walla! Communications Ltd.'s holdings in the shares of Coral-Tell Ltd., for a pre-tax profit of NIS 582 million. This increase was partially offset by recognition of expenses from the termination of employment by way of early retirement in the Domestic Fixed-Line Communications Segment in the present quarter.
Operating profit	**1,922**	1,505	417	27.7	**1,234**	744	490	65.9	
Finance expenses, net	**74**	51	23	45.1	**32**	27	5	18.5	The increase in net finance expenses was attributable to a decrease in net finance income from the Cellular Communications segment.
Share in losses of investees	**98**	107	(9)	(8.4)	**79**	67	12	17.9	The decrease in the Six Month Period and the increase in the Quarter were attributable to changes in the losses of the Multi-Channel Television segment.
Income tax	**483**	377	106	28.1	**313**	177	136	76.8	The increase was attributable to an increase in income before taxes.
Profit for the period	**1,267**	970	297	30.6	**810**	473	337	71.2	

1.2.2 Operating segments

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

	1-6.2014		1-6.2013		4-6.2014		4-6.2013	
	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues
Revenues by operating segment								
Domestic Fixed-Line Communications	**2,150**	**47.1%**	2,250	47.3%	**1,073**	**47.7%**	1,121	47.7%
Cellular Communications	**1,760**	**38.6%**	1,879	39.5%	**843**	**37.5%**	915	38.9%
International Communications, Internet and NEP Services	**721**	**15.8%**	704	14.8%	**366**	**16.3%**	359	15.3%
Multi-Channel Television	**851**	**18.7%**	807	17.0%	**427**	**19.0%**	404	17.2%
Other and offsets*	**(921)**	**(20.2%)**	(884)	(18.6%)	**(459)**	**(20.4%)**	(448)	(19.1%)
Total	**4,561**	**100%**	4,756	100%	**2,250**	**100%**	2,351	100%

	1-6.2014		1-6.2013		4-6.2014		4-6.2013	
	NIS millions	% of segment revenues	NIS millions	% of segment revenues	NIS millions	% of segment revenues	NIS millions	% of segment revenues
Operating profit by segment								
Domestic Fixed-Line Communications	**975**	45.3%	1,045	46.4%	**471**	43.9%	510	45.5%
Cellular Communications	**253**	14.4%	360	19.2%	**127**	15.1%	186	20.3%
International Communications, Internet and NEP Services	**116**	16.1%	116	16.5%	**58**	15.8%	60	16.7%
Multi-Channel Television	**140**	16.5%	135	16.7%	**67**	15.7%	68	16.8%
Other and offsets*	**438**	-	(151)	-	**511**	-	(80)	-
Consolidated operating profit/ % of Group revenues	**1,922**	42.1%	1,505	31.6%	**1,234**	54.8%	744	31.6%

(*) Offsets are mainly attributable to the Multi-Channel Television segment, an associate company.

1.2.2. Operating segments

B Domestic Fixed-Line Communications Segment

	1-6.2014	1-6.2013	Increase (decrease)		4-6.2014	4-6.2013	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Fixed-line telephony	**841**	1,013	(172)	(17.0)	**415**	503	(88)	(17.5)	This decrease was mainly attributable to a decrease in ARPU, mainly due to the reduction in call termination rates to fixed-line networks starting December 1, 2013.
Internet - infrastructure	**677**	631	46	7.3	**345**	321	24	7.5	The increase was mainly attributable to growth in the number of internet subscribers. The increase was partially offset by a decrease in revenues from home router sales following the transition from a sales-based to a rental-based model.
Transmission, data communications and others	**632**	606	26	4.3	**313**	297	16	5.4	
Total revenues	**2,150**	2,250	(100)	(4.4)	**1,073**	1,121	(48)	(4.3)	
Depreciation and amortization	**340**	335	5	1.5	**172**	168	4	2.4	
Labor costs	**451**	512	(61)	(11.9)	**228**	242	(14)	(5.8)	This decrease was mainly attributable to a decrease in the number of positions, in share-based payments, and in the Six Month Period - in the annual bonus. The decrease was partially offset by wage increases.
General and operating expenses	**378**	448	(70)	(15.6)	**188**	218	(30)	(13.8)	This decrease was mainly attributable to a reduction in call completion fees and a reduction in terminal equipment costs following a transition from selling home network routers, to rental.
Other operating expenses (income), net	**6**	(90)	96	-	**14**	(17)	31	-	The transition from net income to net expenses was attributable to recognition of expenses from termination of employment by way of early retirement, to the amount of NIS 116.5 million in the present Quarter (see Note 6 to the financial statements). This increase in expenses was partially offset in the present Quarter by increased capital gains on real estate sales.
Operating profit	**975**	1,045	(70)	(6.7)	**471**	510	(39)	(7.6)	

1.2.2. Operating segments (contd.)

B. Domestic Fixed-Line Communications Segment (contd.)

	1-6.2014	1-6.2013	Increase (decrease)		4-6.2014	4-6.2013	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Finance expenses, net	**103**	105	(2)	(1.9)	**47**	53	(6)	(11.3)	The decrease was mainly attributable to a decrease in revaluation expenses on the obligation to distribute dividends not meeting the profit test following completion of the dividend payment. Results were also affected by a decrease in interest expenses following repayment of loans. The decrease in net finance expenses was mostly offset by a decrease in interest income on loans to investees following a reduction in the scope of these loans, a decrease in finance income from ongoing investments and an increase in interest expenses on debentures.
Income tax	**226**	241	(15)	(6.2)	**110**	106	4	3.8	In the Six Month Period and Quarter, income tax accounted for 25.9% of profit after net finance expenses, as compared to 25.6% and 23.2%, respectively, in the same periods last year. This increase was due to an increase in the corporate income tax rate in 2014. The increase was partially offset by an increase in the tax-deductible portion of share-based payments, and by non-deductible dividend revaluation expenses recognized in the same six month period last year.
Segment profit	**646**	699	(53)	(7.6)	**314**	351	(37)	(10.5)	

1.2.2 Operating segments (contd.)

C Cellular Communications segment

	1-6.2014	1-6.2013	Increase (decrease)		4-6.2014	4-6.2013	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Services	**1,259**	1,410	(151)	(10.7)	**622**	696	(74)	(10.6)	The decrease was due to market competition driving down rates and migration of existing customers to cheaper bundles at current market prices, both of which served to lower ARPU. Revenues were also down due to a decrease in the number of subscribers.
Terminal equipment sales	**501**	469	32	6.8	**221**	219	2	0.9	The increase in the Six Month Period was attributable mainly to higher sales volumes on data products such as tablets and laptops.
Total revenues	**1,760**	1,879	(119)	(6.3)	**843**	915	(72)	(7.9)	
Depreciation and amortization expenses	**211**	234	(23)	(9.8)	**105**	113	(8)	(7.1)	The decrease was mainly attributable to assets whose amortization period has ended, and from cessation of discounting subscriber acquisition costs starting 2012.
Salary expenses	**212**	223	(11)	(4.9)	**103**	109	(6)	(5.5)	The decrease was mainly attributable to a decrease in the number of positions, and in the Six Month Period was also attributable to a decrease in incentives and bonuses.
General and operating expenses	**1,084**	1,062	22	2.1	**508**	507	1	0.2	The change was mainly attributable to an increase in site rentals following a one-time decrease of NIS 30 million in the same quarter last year following an updated estimate of a liability, which was partially offset by a decrease in call completion fees following a decrease in interconnect fees. Furthermore, in the Six Month Period, terminal equipment sales costs were up, mainly due to an increase in the number of units sold, which was partially offset by a decrease in costs following a change in the sales mix. In the Quarter, terminal equipment sales costs were down, mainly due to a decrease in costs following changes in the sales mix, which was partially offset by an increase in the number of units sold.
Operating profit	**253**	360	(107)	(29.7)	**127**	186	(59)	(31.7)	
Finance income, net	**35**	59	(24)	(40.7)	**17**	30	(13)	(43.3)	The decrease in net finance income was mainly attributable to a decrease in credit on instalment-based terminal equipment sales, and an update to a one-time liability in the same quarter last year. The decrease was partially offset by a decrease in interest expenses following a reduction in the average debt.
Income tax	**74**	105	(31)	(29.5)	**38**	55	(17)	(30.9)	The decrease was attributable to the reduction in income before taxes.
Segment profit	**214**	314	(100)	(31.8)	**106**	161	(55)	(34.2)	

1.2.2 Operating segments (contd.)

D International Communications, Internet and NEP Services

	1-6.2014	1-6.2013	Increase (decrease)		4-6.2014	4-6.2013	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Revenues	**721**	704	17	2.4	**366**	359	7	1.9	This increase was mainly attributable to revenues from enterprise communication solutions (ICT), and higher internet revenues due to growth in the number of subscribers. This increase was partially offset by a decrease in revenues from outgoing calls, stemming mainly from cellular market migration to plans offering unlimited international calls.
Depreciation and amortization expenses	**65**	64	1	1.5	**33**	33	-	-	
Salary expenses	**148**	143	5	3.5	**73**	70	3	4.3	This increase was mainly attributable to an increase in the number of employees providing outsourced services in ICT operations.
General and operating expenses	**392**	381	11	2.9	**202**	196	6	3.1	This increase was attributable to an increase in ICT expenses, partially offset by a decrease in expenses for outgoing calls, along with the above revenues.
Operating profit	**116**	116	-	-	**58**	60	(2)	(3.3)	
Finance expenses, net	**5**	6	(1)	(16.7)	**3**	2	1	50	
Share in the earnings of associates	**1**	-	1	-	**-**	-	-	-	
Income tax	**29**	29	-	-	**14**	14	-	-	
Segment profit	**83**	81	2	2.5	**41**	44	(3)	(6.8)	

1.2.2 Operating segments (contd.)

E Multi-Channel Television

	1-6.2014	1-6.2013	Increase (decrease)		4-6.2014	4-6.2013	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Revenues	**851**	807	44	5.5	**427**	404	23	5.7	This increase was mainly attributable to subscriber growth.
Cost of revenues	**544**	519	25	4.8	**275**	261	14	5.4	This increase was mainly attributable to increased depreciation expenses and utilized broadcasting rights.
Sales, marketing, general and administrative expenses	**167**	153	14	9.2	**85**	75	10	13.3	This increase was mainly attributable to higher salary costs.
Operating profit	**140**	135	5	3.7	**67**	68	(1)	(1.5)	
Finance expenses, net	**288**	296	(8)	(2.7)	**181**	168	13	7.7	The decrease in the Six Month Period was mainly attributable to linkage differences on debentures, following a negative change in the CPI in the present Six Month Period, as compared to a positive CPI change in the same six month period last year. The increase in the Quarter was mainly attributable to an increase in finance expenses on shareholder loans.
Income tax	**1**	1	-	-	**1**	1	-	-	
Segment loss	**(149)**	(162)	13	(8.0)	**(115)**	(101)	(14)	13.9	

1.3 Cash flow

	1-6.2014	1-6.2013	Change		4-6.2014	4-6.2013	Change		Explanation
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%	
Net cash from operating activities	**2,107**	2,074	33	1.6	**1,064**	1,102	(38)	(3.4)	Cash flow from operating activities was affected by a decrease in working capital, which was offset by a decrease in net profit after adjustments (mainly adjustments to the net profit from the sale of Coral-Tell Ltd.'s shares).
Net cash used in investment activities	**(557)**	(774)	217	(28.0)	**(60)**	(99)	39	(39.4)	The decrease was attributable to the net proceeds on the sale of holdings in Coral-Tell Ltd.'s shares in the present Quarter, which was largely offset by a net increase in the purchase of held-for-trade financial assets, and an increase in the net acquisition of property, plant and equipment in the Domestic Fixed-Line Communications segment.
Net cash used in financing activities	**(1,487)**	(1,222)	(265)	21.7	**(1,380)**	(1,032)	(348)	33.7	The increase was due to the fact that in the same quarter last year, the Company raised debt through the issue of debentures in its Domestic Fixed-Line Communications segment. The increase was partially offset by a decrease in dividend payments from NIS 1,361 million in the same quarter last year, to NIS 802 million in the present Quarter.
Increase in cash	**63**	78	(15)	(19.2)	**(376)**	(29)	(347)	-	

Average volume in the reporting period:

Long-term liabilities (including current maturities) to financial institutions and debenture holders: NIS 9,653 million.

Supplier credit: NIS 651 million.

Short-term credit to customers: NIS 2,496 million. Long-term credit to customers: NIS 607 million.

1.3 Cash Flows (contd.)

As of June 30, 2014, the Group had a working capital surplus of NIS 1,245 million, as compared to a surplus of NIS 1,551 million on June 30, 2013.

This decrease was mainly attributable to a decrease in current assets following a decrease in trade receivables in the Cellular Communications segment, partially offset by an increase in cash and investment balances.

According to its separate financial statements, the Company had a working capital deficit of NIS 501 million as of June 30, 2014, as compared to a working capital surplus of NIS 70 million on June 30, 2013.

This change in working capital was due to an increase in current liabilities, mainly following an increase in the current debt to debenture holders and a subsidiary, which was partially offset by the completion of a distribution not meeting the profit test.

The Company's Board of Directors has reviewed the Company's resources and cash requirements at present and in the foreseeable future, has reviewed the Company's investment needs, and has examined the sources of financing and finance-raising options available to the Company. Based on its review of all the above, the Board of Directors determined that, despite the Company's working capital deficit (according to its separate financial statements), the Company does not face any liquidity problems. The Company can meet its cash requirements at present and in the foreseeable future, both by generating cash from operating activities, by receiving dividends from subsidiaries, and by raising debt from bank and non-banking sources, should the Company so wish.

The above information includes forward-looking information, based on the Company's assessments concerning its liquidity. Actual data may differ materially from these assessments if there is a change in any of the factors taken into account in making them.

2. Aspects of Corporate Governance

Disclosure concerning the financial statements' approval process

2.1 Committee

The Company's Financial Statements Review Committee is a separate committee which does not serve as the Audit Committee. The Committee comprises 4 members, as follows: Yitzhak Idelman, chairman (external director); Mordechai Keret (external director); Tali Simone (external director); and Dr. Yehoshua Rosenzweig (independent director). All Committee members have accounting and financial expertise. All Committee members have submitted a statement prior to their appointment. For more information concerning the directors serving on the Committee, see Chapter D of the Company's Periodic Report for 2013.

2.2 Financial statements approval process

A. The Financial Statements Review Committee discussed and finalized its recommendations to the Company's Board of Directors in its meetings of July 30, 2014, and August 5, 2014.

   The Committee's meeting of July 30, 2014, was attended by all Committee members and by the Chairman of the Board, Mr. Shaul Elovitch; Company CEO, Ms. Stella Handler; Deputy CEO and CFO, Mr. Dudu Mizrahi; Company Comptroller, Mr. Danny Oz; the Internal Auditor, Mr. Lior Segal; the Legal Counsel, Mr. Amir Nachlieli; Mr. Rami Nomkin - director; the external auditors; and other Company officers. The Committee's meeting of August 5, 2014, was attended by the above persons, with the exception of Dr. Yehoshua Rosenzweig, and with the addition of Company secretary, Mrs. Linor Yochelman.

B. The Committee reviewed, inter alia, the assessments and estimates made in connection with the financial statements; internal controls over financial reporting; full and proper disclosure in the financial statements; and the accounting policies adopted on material matters.

C. The Committee submitted its recommendations to the Company's Board of Directors in writing on August 5, 2014.

The Board of Directors discussed the Financial Statements Review Committee's recommendations and the financial statements on August 6, 2014.

D. The Company's Board of Directors believes that the Financial Statements Review Committee's recommendations were submitted a reasonable time prior to the Board meeting, considering the fact that the material to be discussed in the meeting was submitted three business days prior to the meeting, and taking into account the scope and complexity of these recommendations.

E. The Company's Board of Directors adopted the Financial Statements Review Committee's recommendations and resolved to approve the Company's financial statements for the second quarter of 2014.

3. Disclosure Concerning the Company's Financial Reporting

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

4. Details of Debt Certificate Series

4.1 Debentures (Series 5)

On June 1, 2014, the Company repaid NIS 397,827,674 par value in debentures.

As of June 30, 2014, the par value, revalued to the reporting date, was NIS 984,289,410.
The fair value and stock exchange value was 1,056,472,439.

4.2 On May 13, 2014, Standard & Poor's Maalot Ltd. ("Maalot") affirmed its ilAA/Stable rating for the Company's debentures (Series 5-8). For current and historical ratings data for the debentures, see the Company's (amended) immediate report of May 15, 2014 (ref. no. 2014-01-064836) (Maalot) and November 19, 2013 (ref. no. 2013-01-196218) (Midroog). The rating reports are included in this Board of Directors' Report by way of reference.

5. Miscellaneous

For information concerning the liabilities balances of the reporting corporation and those companies consolidated in its financial statements as of June 30, 2014, see the Company's reporting form on the MAGNA system, dated August 7, 2014.

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

Shaul Elovitch	Stella Handler
Chairman of the Board	CEO

Signed: August 6, 2014

Bezeq The Israel Telecommunication Corporation Limited

Condensed Consolidated Interim Financial Statements

June 30, 2014

(Unaudited)

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

Contents	**Page**

Auditors' Report	2
Condensed Consolidated Interim Financial Statements as at June 30, 2014 (Unaudited)	
Condensed Consolidated Interim Statements of Financial Position	3
Condensed Consolidated Interim Statements of Income	5
Condensed Consolidated Interim Statements of Comprehensive Income	6
Condensed Consolidated Interim Statements of Changes in Equity	7
Condensed Consolidated Interim Statements of Cash Flows	10
Notes to the Condensed Consolidated Interim Financial Statements	12

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Review Report to the Shareholders of
"Bezeq" -The Israel Telecommunication Corporation Ltd.

Introduction

We have reviewed the accompanying financial information of "Bezeq" -The Israel Telecommunication Corporation Ltd. and its subsidiaries (hereinafter – "the Group") comprising of the condensed consolidated interim statement of financial position as of June 30, 2014 and the related condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the six and three month periods then ended. The Board of Directors and Management are responsible for the preparation and presentation of interim financial information for these interim periods in accordance with IAS 34 "Interim Financial Reporting", and are also responsible for the preparation of financial information for these interim periods in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express a conclusion on interim financial information for these interim periods based on our review.

We did not review the condensed interim financial information of a certain consolidated subsidiary whose assets constitute 1% of the total consolidated assets as of June 30 2014, and whose revenues constitute 1.4% and 1.5% of the total consolidated revenues for the six and three month periods then ended, respectively. The condensed interim financial information of that company was reviewed by other auditors whose review report thereon was furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial information of that company, is based solely on the said review report of the other auditors.

Scope of Review

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

Conclusion

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

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

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

Somekh Chaikin
Certified Public Accountants (Isr.)

August 6, 2014

Condensed Consolidated Interim Statements of Financial Position

	June 30, 2014	June 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
Assets	NIS million	NIS million	NIS million
Cash and cash equivalents	**673**	544	610
Investments, including derivatives	**1,725**	1,463	1,132
Trade receivables	**2,335**	2,863	2,651
Other receivables	**325**	334	344
Inventory	**89**	142	117
Assets classified as held for sale	**24**	97	66
Total current assets	**5,171**	5,443	4,920
Trade and other receivables	**587**	817	652
Property, plant and equipment	**6,060**	5,948	5,973
Intangible assets	**1,839**	2,135	2,060
Deferred and other expenses	**254**	265	261
Investments in equity-accounted investees (mainly loans)	**1,014**	1,015	1,015
Investments	**80**	89	81
Deferred tax assets	**35**	66	60
Total non-current assets	**9,869**	10,335	10,102
Total assets	**15,040**	15,778	15,022

Condensed Consolidated Interim Statements of Financial Position (Contd.)

	June 30, 2014	June 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
Liabilities and equity	NIS million	NIS million	NIS million
Debentures, loans and borrowings	**1,534**	1,076	1,136
Trade payables	**638**	685	719
Other payables, including derivatives	**651**	646	707
Current tax liabilities	**591**	598	523
Provisions	**134**	124	125
Employee benefits	**378**	273	257
Dividend payable	**-**	490	-
Total current liabilities	**3,926**	3,892	3,467
Loans and debentures	**7,815**	8,863	8,691
Employee benefits	**229**	256	234
Provisions	**68**	67	68
Deferred tax liabilities	**10**	48	55
Other liabilities, including derivatives	**108**	81	84
Total non-current liabilities	**8,230**	9,315	9,132
Total liabilities	**12,156**	13,207	12,599
Total equity	**2,884**	2,571	2,423
Total liabilities and equity	**15,040**	15,778	15,022

Shaul Elovitch
Chairman of the Board of Directors

Stella Handler
CEO

David (Dudu) Mizrahi
Deputy CEO and CFO

Date of approval of the financial statements: August 6, 2014

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

Condensed Consolidated Interim Statements of Income

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues (Note 8)	**4,561**	4,756	**2,250**	2,351	9,563
Cost of activities					
Depreciation and amortization	**633**	654	**319**	326	1,311
Salaries	**891**	967	**443**	468	1,872
General and operating expenses (Note 9)	**1,691**	1,720	**822**	831	3,576
Other operating expenses (income), net (Note 10)	**(576)**	(90)	**(568)**	(18)	(15)
	2,639	3,251	**1,016**	1,607	6,744
Operating profit	**1,922**	1,505	**1,234**	744	2,819
Financing expenses (income)					
Financing expenses	**240**	284	**127**	144	573
Financing income	**(166)**	(233)	**(95)**	(117)	(428)
Financing expenses, net	**74**	51	**32**	27	145
Profit after financing expenses, net	**1,848**	1,454	**1,202**	717	2,674
Share in losses of equity-accounted investees	**(98)**	(107)	**(79)**	(67)	(252)
Profit before income tax	**1,750**	1,347	**1,123**	650	2,422
Income tax	**483**	377	**313**	177	651
Profit for the period	**1,267**	970	**810**	473	1,771
Earnings per share (NIS)					
Basic earnings per share	**0.46**	0.36	**0.30**	0.17	0.65
Diluted earnings per share	**0.46**	0.36	**0.29**	0.17	0.65

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

Condensed Consolidated Interim Statements of Comprehensive Income

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	**2013**	**2014**	**2013**	**2013**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Profit for the period	**1,267**	970	**810**	473	1,771
Items of other comprehensive income not transferred to profit or loss					
Actuarial gains, net of tax	**-**	-	**-**	-	22
Items of other comprehensive income (net of tax) to be transferred to profit or loss subsequent to initial recognition in comprehensive income	**(9)**	(10)	**(22)**	(17)	(16)
Total comprehensive income for the period	**1,258**	960	**788**	456	1,777

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

Condensed Consolidated Interim Statements of Changes in Equity

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for transactions between corporation and controlling shareholder	Other reserves	Deficit	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Six months ended June 30, 2014 (Unaudited):							
Balance as at January 1, 2014	**3,842**	**143**	**242**	**390**	**(67)**	**(2,127)**	**2,423**
Profit for the period	**-**	**-**	**-**	**-**	**-**	**1,267**	**1,267**
Other comprehensive income for the period, net of tax	**-**	**-**	**-**	**-**	**(9)**	**-**	**(9)**
Total comprehensive income for the period	**-**	**-**	**-**	**-**	**(9)**	**1,267**	**1,258**
Transactions with owners recognized directly in equity							
Dividends to Company shareholders (see Note 7)	**-**	**-**	**-**	**-**	**-**	**(802)**	**(802)**
Share-based payments	**-**	**-**	**(1)**	**-**	**-**	**-**	**(1)**
Exercise of options for shares	**6**	**55**	**(55)**	**-**	**-**	**-**	**6**
Balance as at June 30, 2014	**3,848**	**198**	**186**	**390**	**(76)**	**(1,662)**	**2,884**
Six months ended June 30, 2013 (Unaudited):							
Balance as at January 1, 2013	3,837	100	256	390	(38)	(2,090)	2,455
Profit for the period	-	-	-	-	-	970	970
Other comprehensive income for the period, net of tax	-	-	-	-	(10)	-	(10)
Total comprehensive income for the period	-	-	-	-	(10)	970	960
Transactions with owners recognized directly in equity							
Dividend to Company shareholders	-	-	-	-	-	(861)	(861)
Share-based payments	-	-	16	-	-	-	16
Exercise of options for shares	1	2	(2)	-	-	-	1
Balance as at June 30, 2013	3,838	102	270	390	(48)	(1,981)	2,571

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

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

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for transactions between corporation and controlling shareholder	Other reserves	Deficit	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Three months ended June 30, 2014 (Unaudited)							
Balance as at April 1, 2014	**3,844**	**161**	**223**	**390**	**(54)**	**(2,472)**	**2,092**
Profit for the period	**-**	**-**	**-**	**-**	**-**	**810**	**810**
Other comprehensive income for the period, net of tax	**-**	**-**	**-**	**-**	**(22)**	**-**	**(22)**
Total comprehensive income for the period	**-**	**-**	**-**	**-**	**(22)**	**810**	**788**
Transactions with owners recognized directly in equity							
Exercise of options for shares	**4**	**37**	**(37)**	**-**	**-**	**-**	**4**
Balance as at June 30, 2014	**3,848**	**198**	**186**	**390**	**(76)**	**(1,662)**	**2,884**
Three months ended June 30, 2013 (Unaudited)							
Balance as at April 1, 2013	3,837	100	264	390	(31)	(1,593)	2,967
Profit for the period	-	-	-	-	-	473	473
Other comprehensive income for the period, net of tax	-	-	-	-	(17)	-	(17)
Total comprehensive income for the period	-	-	-	-	(17)	473	456
Transactions with owners recognized directly in equity							
Dividend to Company shareholders	-	-	-	-	-	(861)	(861)
Share-based payments	-	-	8	-	-	-	8
Exercise of options for shares	1	2	(2)	-	-	-	1
Balance as at June 30, 2013	3,838	102	270	390	(48)	(1,981)	2,571

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

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for transactions between corporation and controlling shareholder	Other reserves	Deficit	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Year ended December 31, 2013 (Audited)							
Balance as at January 1, 2013	3,837	100	256	390	(38)	(2,090)	2,455
Profit in 2013	-	-	-	-	-	1,771	1,771
Other comprehensive income for the year, net of tax	-	-	-	-	(16)	22	6
Total comprehensive income for 2013	-	-	-	-	(16)	1,793	1,777
Transactions with owners recognized directly in equity							
Dividend to Company shareholders	-	-	-	-	-	(1,830)	(1,830)
Share-based payments	-	-	29	-	-	-	29
Exercise of options for shares	5	43	(43)	-	-	-	5
Increase in the rate of holding in a subsidiary	-	-	-	-	(13)	-	(13)
Balance as at December 31, 2013	3,842	143	242	390	(67)	(2,127)	2,423

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

Condensed Consolidated Interim Statements of Cash Flows

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	**2013**	**2014**	**2013**	**2013**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
Cash flows from operating activities					
Profit for the period	**1,267**	970	**810**	473	1,771
Adjustments:					
Depreciation and amortization	**633**	654	**319**	326	1,311
Profit from the sale of Coral Tell Ltd. shares (see Note 4.2)	**(582)**	-	**(582)**	-	-
Share in losses of equity-accounted investees	**98**	107	**79**	67	252
Financing expenses, net	**122**	129	**59**	61	278
Capital gain, net	**(121)**	(112)	**(104)**	(65)	(159)
Share-based payments	**(1)**	16	**-**	8	29
Income tax expenses	**483**	377	**313**	177	651
Miscellaneous	**2**	(10)	**5**	(6)	(22)
Change in inventory	**34**	(22)	**13**	6	9
Change in trade and other receivables	**387**	268	**224**	163	646
Change in trade and other payables	**(107)**	(77)	**(45)**	(71)	27
Change in provisions	**8**	(31)	**12**	(3)	(29)
Change in employee benefits	**117**	18	**104**	40	2
Change in other liabilities	**(8)**	-	**(8)**	-	11
Net income tax paid	**(225)**	(213)	**(135)**	(74)	(625)
Net cash from operating activities	**2,107**	2,074	**1,064**	1,102	4,152
Cash flow used for investing activities					
Net consideration for the sale of Coral Tell Ltd.	**596**	-	**596**	-	-
Investment in intangible assets and deferred expenses	**(90)**	(93)	**(42)**	(49)	(186)
Proceeds from the sale of property, plant and equipment	**75**	166	**46**	123	312
Acquisition of financial assets held for trading and others	**(686)**	(1,137)	**(476)**	(702)	(1,570)
Proceeds from the sale of financial assets held for trading and others	**94**	766	**94**	759	1,528
Purchase of property, plant and equipment	**(548)**	(497)	**(281)**	(252)	(1,042)
Proceeds from disposal of long-term investments	**(1)**	8	**2**	-	9
Miscellaneous	**3**	13	**1**	22	32
Net cash used for investing activities	**(557)**	(774)	**(60)**	(99)	(917)

Condensed Consolidated Interim Statements of Cash Flows (Contd.)

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	**2013**	**2014**	**2013**	**2013**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Cash flows used in financing activities					
Issue of debentures and receipt of loans	**-**	869	**-**	869	1,364
Repayment of debentures and loans	**(462)**	(488)	**(380)**	(332)	(1,120)
Dividends paid	**(802)**	(1,361)	**(802)**	(1,361)	(2,830)
Interest paid	**(219)**	(239)	**(192)**	(203)	(453)
Increase in the rate of holding in a subsidiary	**-**	-	**-**	-	(50)
Miscellaneous	**(4)**	(3)	**(6)**	(5)	(2)
Net cash used in financing activities	**(1,487)**	(1,222)	**(1,380)**	(1,032)	(3,091)
Increase (decrease) in cash and cash equivalents, net	**63**	78	**(376)**	(29)	144
Cash and cash equivalents at beginning of period	**610**	466	**1,049**	573	466
Cash and cash equivalents at end of period	**673**	544	**673**	544	610

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

Notes to the Financial Statements

1. Reporting Entity

Bezeq – The Israel Telecommunication Corporation Limited ("the Company") is a company registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The consolidated financial statements of the Company include those of the Company and its subsidiaries (together referred to as "the Group"), as well as the Group's interests in associates. The Group is a principal provider of communication services in Israel (see also Note 12 – Segment Reporting).

2. Basis of Preparation

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

2.2 The condensed consolidated interim financial statements do not contain all the information required in full annual financial statements, and should be reviewed in the context of the annual financial statements of the Company and its subsidiaries as at December 31, 2013 and the year then ended, and their accompanying notes ("the Annual Financial Statements"). The notes to the interim financial statements include only the material changes that have occurred from the date of the most recent Annual Financial Statements until the date of these consolidated interim financial statements.

2.3 The condensed consolidated interim financial statements were approved by the Board of Directors on August 6, 2014.

2.4 Use of estimates and judgment

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

The judgments made by management, when applying the Group's accounting policies and the key assumptions used in assessments that involve uncertainty, are consistent with those applied in the Annual Financial Statements.

3. Reporting Principles and Accounting Policy

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

3.2 As from January 1, 2014, the Group applies the amendment to IAS 32, Financial Instruments: Presentation, which refers to offsetting financial assets and financial liabilities. Application of the amendment to IAS 32 did not have a material effect on the Group's financial statements.

3.3 New standards and interpretations not yet adopted

3.1.1 IFRS 15, Revenues from Contracts with Customers, issued in May 2014 ("IFRS 15")

IFRS 15 replaces current guidelines for revenue recognition and presents a new model for recognition of revenues from contracts with customers. The model includes five steps for analyzing transactions to determine the timing and amount of revenue recognition. IFRS 15 also establishes new and more extensive disclosure requirements. IFRS 15 will be effective for annual periods starting from January 1, 2017. Early adoption is permitted. IFRS 15 includes various alternatives for the transition guidelines, so that companies may choose one alternative upon initial adoption. The Group is examining the effects of adopting IFRS 15 on the financial statements.

3.1.2 IFRS 9 (2014), Financial Instruments, issued in July 2014 ("IFRS 9")

IFRS 9 replaces the requirements included in IAS 39 regarding classification and measurement of financial assets and financial liabilities, hedge accounting, and impairment of financial instruments. IFRS 9 is effective for annual periods beginning on January 1, 2018. Early adoption is permitted, subject to the conditions set out in the Standard. The Standard is to be applied retrospectively other than in a number of exceptions as indicated in the transitional provisions included in the Standard. The Group is examining the effects of adopting IFRS 15 on the financial statements.

4. Group Entities

A detailed description of the Group entities appears in Note 10 to the Annual Financial Statements. Below is a description of the material changes that occurred in connection with the Group entities since publication of the Annual Financial Statements.

4.1. DBS Satellite Services (1998) Ltd. (an equity-accounted associate) ("DBS")

4.1.1 The Group attaches the condensed interim financial statements of DBS to these condensed consolidated interim financial statements.

4.1.2 Further to Note 10.1.2 to the Annual Financial Statements regarding publication of the terms for the Antitrust Commissioner's approval of the merger between the Company and DBS, on March 26, 2014, the Antitrust Commissioner informed the Company that on fulfillment of the terms, the restrictions imposed on Eurocom Group for its continued holding of DBS will be removed and the Company will be allowed to merge with DBS ("the Merger").

Through a subcommittee of the Board of Directors established to address the issue, the Company is advancing, with the assistance of external consultants appointed by the committee, the assessment of the viability of the merger and the available options in view of this decision and its conditions, including acquisition of DBS shares held by Eurocom and other options. As part of these assessments, the Company is carrying out due diligence for DBS, with the assistance of external consultants.

4.1.3 Since starting its operations, DBS has accumulated considerable losses. The loss of DBS in 2013 amounted to NIS 381 million, and its loss in the six months ended June 30, 2014, amounted to NIS 149 million. As a result of these losses, as of June 30, 2014, DBS had an equity deficit and a working capital deficit of NIS 4,492 million and NIS 431 million, respectively.

4.1.4 As of June 30, 2014, DBS complied with the financial covenants established under its financing and debenture agreements. As of June 30, 2014, DBS complied with the debt/EBITDA ratio covenant established in Deed of Trust B (the debt/EBITDA ratio of DBS as of June 30, 2014, was 2.9). Furthermore, DBS complied with the debt//EBITDA ratio covenant specified by the 2012 Debentures (as of June 30, 2014, the debt/EBITDA ratio of DBS was 2.7), and the debt/(E-C) ratio covenant specified by the 2012 Debentures (as of June 30, 2014, the debt/(E-C) ratio was 7.4).

4.1.5 On April 1, 2014, S&P Maalot announced a rating of -ilA for additional debentures to be issued by DBS up to a total par value of NIS 250 million by a new debenture issue or expansion of an existing series.

In April 2014, DBS issued additional debentures (Series A) by expanding the series by a total of NIS 253 million, and issued additional debentures (Series B) by expanding the series by a total of NIS 47 million. For information about the terms of the debentures, see note 10.1.6 to the Annual Financial Statements.

On April 30, 2014, S&P Maalot upgraded its rating for DBS and its debentures to ilA (stable), and placed the rating on the Credit Watch list with a positive outlook.

4.1.6 DBS management estimates that the financing resources available to DBS, which include, among other things, the working capital deficit and its potential debt raising activities, will be sufficient for the operating needs of DBS in the coming year, based on the forecasted cash flows approved by the Board of Directors of DBS. Should additional resources be required to meet the operating needs of DBS in the coming year, DBS will adjust its operations so as not to require additional resources beyond those currently at its disposal.

4.2. Coral Tell Ltd. (a previously consolidated company)

On May 20, 2014, the sale of the entire share capital of Coral Tell Ltd. was completed for NIS 805 million. Coral Tell Ltd. is wholly-owned indirectly by Walla! Communications Ltd. ("Walla"), which operates Yad2. The sale agreement includes an undertaking by Walla and the Company to refrain from engaging in Coral Tell's fields of activity for 24 months. The pre-tax profit arising from the sale amounted to NIS 582 million, and the profit net of tax amounted to NIS 437 million.

Following the sale, intangible assets and goodwill amounting to NIS 187 million were derecognized.

5. Contingent Liabilities

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

In the opinion of the managements of the Group companies, based, *inter alia*, on legal opinions as to the likelihood of success of the legal claims, the financial statements include appropriate provisions of NIS 121 million, where provisions are required to cover the exposure arising from such legal claims.

In the opinion of the managements of the Group companies, the additional exposure (beyond these provisions) as at June 30, 2014 for claims filed against Group companies on various matters and which are unlikely to be realized, amounted to NIS 7.1 billion. There is also additional exposure of NIS 850 million for claims, the chances of which cannot yet be assessed.

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

This amount and all the amounts of the additional exposure in this note are linked to the CPI and are stated net of interest. For updates subsequent to the reporting date, see section 5.2 below.

5.1 Following is a detailed description of the Group's contingent liabilities as at June 30, 2014, classified into groups with similar characteristics:

Claims group	Nature of the claims	Provision	Additional exposure	Exposure for claims that cannot yet be assessed
		NIS million		
Claims of employees and former employees of Group companies	Mainly collective and individual claims filed by employees and former employees of the Company in respect of recognition of various salary components as components for calculation of payments to Company employees, some of which have wide ramifications in the Company.	**63**	**77**	**1**
Customer claims	Mainly motions for certification of class actions concerning contentions of unlawful collection of payment and impairment of the service provided by the Group companies.	**30**	**2,755**	**822**
Supplier and communication provider claims	Claims filed by suppliers of goods and/or services to Group companies or by communications providers that the Group companies supply goods and/or services to or receive goods and/or services from These claims are usually for compensation for alleged damage as a result of the supply of the service and/or the product.	**-**	**128**	**2**
Claims for punitive damages, real estate and infrastructure	Claims for alleged physical damage or damage to property caused seemingly by Group companies (including in relation to environmental quality and radiation) and regarding real estate and infrastructure. The additional amount of exposure for punitive damages does not include claims for which the insurance coverage is not disputed.	**1**	**4,036**	**25**
Claims by enterprises and companies	Claims alleging liability of the Group companies in respect of their activities and/or the investments made in various projects.	**11**	**48**	**-**
Claims by the State and authorities	Various claims by the State of Israel, government institutions and authorities (“the Authorities”). These are mainly procedures related to regulations relevant to the Group companies and financial disputes concerning monies paid by the Group companies to the authorities (including property taxes) or by the authorities to the Group companies.	**16**	**48**	**-**
Total legal claims against the Company and subsidiaries		**121**	**7,092**	**850**
Contingent liabilities for legal claims against associates		**8**	**164**	**323**

5.2 Subsequent to the reporting date, claims amounting to NIS 202 million were filed against Group companies. At the approval date of the financial statements, the exposure for these claims cannot yet be assessed. In addition, claims with exposure of NIS 3.7 billion came to an end. The costs to the Group companies for these claims are insignificant.

6. Employee Benefits

Further to Note 14.5 to the Annual Financial Statements, on May 15, 2014, the Company's Board of Directors approved a provision of NIS 116.5 million for the voluntary redundancy of 101 employees, in accordance with the terms of the collective agreement of December 2006, as amended in December 2010. The Board of Directors also approved the voluntary redundancy of additional employees in an increased compensation track, in accordance with the Company's needs. In view of the above, the Company included a provision of NIS 116.5 million in its financial statements for the second quarter of 2014.

7. Equity and Share-based Payments

7.1 Below are details of the Company's equity:

Registered			Issued and paid up		
June 30, 2014	June 30, 2013	December 31, 2013	June 30, 2014	June 30, 2013	December 31, 2013
(Unaudited)	(Unaudited)	(Audited)	(Unaudited)	(Unaudited)	(Audited)
Number of shares	Number of shares	Number of shares	Number of shares	Number of shares	Number of shares
2,825,000,000	2,825,000,000	2,825,000,000	**2,735,918,334**	2,725,589,079	2,730,129,689

7.2 On March 27, 2014, the general meeting of the Company's shareholders approved the recommendation of the Company's Board of Directors of March 5, 2014 to distribute a cash dividend to the shareholders of the Company in the amount of NIS 802 million (representing NIS 0.2936509 per share on the ex-date). The dividend was paid in cash on April 23, 2014.

7.3 The balance of the distributable profits as at the reporting date (subject to fulfillment of the distribution tests) amounts to NIS 1,267 million (surpluses accumulated in the last two years after deducting prior distributions).

7.4 On August 6, 2014, the Company's Board of Directors resolved to recommend to the general meeting of the Company's shareholders (which is summoned for September 3, 2014) the distribution of a cash dividend to the shareholders in the amount of NIS 1,267 million. The record date for the distribution is September 15, 2014 and the payment date is October 2, 2014.

8. Revenues

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Domestic fixed-line communication					
Fixed-line telephony	**824**	979	**407**	484	1,908
Internet - infrastructure	**677**	631	**345**	323	1,283
Transmission and data communication	**408**	394	**201**	194	794
Other services	**112**	111	**55**	52	220
	2,021	2,115	**1,008**	1,053	4,205
Cellular telephony					
Cellular services and terminal equipment	**1,232**	1,377	**609**	680	2,744
Sale of terminal equipment	**500**	469	**220**	219	1,000
	1,732	1,846	**829**	899	3,744
International communications, internet and NEP services	**689**	676	**357**	340	1,367
Other	**119**	119	**56**	59	247
	4,561	4,756	**2,250**	2,351	9,563

9. General and Operating Expenses

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	**2013**	**2014**	**2013**	**2013**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Terminal equipment and materials	**474**	505	**212**	247	1,071
Interconnectivity and payments to domestic and international operators	**414**	452	**208**	228	905
Maintenance of buildings and sites	**312**	288	**156**	127	607
Marketing and general	**281**	266	**142**	126	563
Services and maintenance by sub-contractors	**78**	74	**38**	36	162
Vehicle maintenance	**77**	75	**40**	38	152
Content services	**30**	34	**15**	17	65
Collection fees	**25**	26	**11**	12	51
	1,691	1,720	**822**	831	3,576

10. Other Operating Expenses (Income), Net

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	**2013**	**2014**	**2013**	**2013**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Profit from the sale of Coral Tell Ltd. shares (see Note 4.2)	**(582)**	-	**(582)**	-	-
Capital gain from sale of property, plant and equipment (mainly real estate)	**(114)**	(75)	**(102)**	(41)	(120)
Profit from copper sales	**(7)**	(34)	**(2)**	(22)	(40)
Provision for early retirement	**125**	35	**117**	49	90
Expenses for collective agreement at Pelephone	**-**	-	**-**	-	61
Others	**2**	(16)	**1**	(4)	(6)
	(576)	(90)	**(568)**	(18)	(15)

11. Financial Instruments

11.1. Fair value

11.1.1 Financial instruments at fair value for disclosure purposes only

The carrying amounts of certain financial assets and liabilities, including cash and cash equivalents, trade receivables, other receivables, short-term investments, deposits, derivatives, some of the loans and credit, trade payables, other payables and declared dividend are the same or proximate to their fair value. The table below shows the differences between the carrying amount and the fair value of financial liabilities.

The methods used to estimate the fair values of financial instruments are described in Note 28.7 to the Annual Financial Statements.

	June 30, 2014		**June 30, 2013**		**December 31, 2013**	
	Carrying amount (including accrued interest)	**Fair value**	**Carrying amount (including accrued interest)**	**Fair value**	**Carrying amount (including accrued interest)**	**Fair value**
	(Unaudited)		**(Unaudited)**		**(Audited)**	
	NIS million		**NIS million**		**NIS million**	
Bank loans (unlinked)	**2,101**	**2,246**	2,378	2,491	2,086	2,203
Debentures issued to the public (CPI-linked)	**2,796**	**3,026**	2,613	2,787	3,132	3,347
Debentures issued to the public (unlinked)	**1,335**	**1,438**	1,335	1,461	1,335	1,449
Debentures issued to financial institutions (unlinked)	**403**	**455**	403	442	403	444
	6,635	**7,165**	6,729	7,181	6,956	7,443

11.1.2 Fair value hierarchy

The table below presents an analysis of the financial instruments measured at fair value, with details of the evaluation method. The methods used to estimate the fair values of financial instruments are described in Note 28.7 to the Annual Financial Statements.

	June 30, 2014	**June 30, 2013**	**December 31, 2013**
	NIS million	**NIS million**	**NIS million**
Level 1: investment in exchange-traded funds and financial funds	**1,629**	1,408	1,099
Level 2: forward contracts	**(47)**	(12)	(25)
Level 3: investment in non-marketable shares	**9**	19	12
	1,591	1,415	1,086

12. Segment Reporting

12.1. Operating segments

	Six months ended June 30, 2014 (Unaudited):						
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi-channel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	2,017	1,730	685	851	119	(851)	4,551
Inter-segment revenues	133	30	36	-	7	(196)	10
Total revenues	2,150	1,760	721	851	126	(1,047)	4,561
Depreciation and amortization	340	211	65	144	13	(140)	633
Segment results – operating profit	975	253	116	140	638*	(200)	1,922
Financing expenses	230	9	9	299	1	(308)	240
Financing income	(127)	(44)	(4)	(11)	-	20	(166)
Total financing expenses (income), net	103	(35)	5	288	1	(288)	74
Segment profit (loss) after financing expenses, net	872	288	111	(148)	637	88	1,848
Share in profits (losses) of associates	-	-	1	-	(3)	(96)	(98)
Segment profit (loss) before income tax	872	288	112	(148)	634	(8)	1,750
Income tax	226	74	29	1	154	(1)	483
Segment results – net profit (loss)	646	214	83	(149)	480	(7)	1,267

* Including profit from the sale of Coral Tell Ltd. shares amounting to NIS 582 million

12. Segment Reporting (Contd.)

12.1 Operating segments (contd.)

	Six months ended June 30, 2013 (Unaudited):						
	Domestic fixed-line communication	**Cellular communications**	**International communications and internet services**	**Multi-channel television**	**Other**	**Adjustments**	**Consolidated**
	NIS million	**NIS million**	**NIS million**	**NIS million**	**NIS million**	**NIS million**	**NIS million**
Revenues from external sources	2,112	1,844	675	806	117	(806)	4,748
Inter-segment revenues	138	35	29	1	10	(205)	8
Total revenues	2,250	1,879	704	807	127	(1,011)	4,756
Depreciation and amortization	335	234	64	126	15	(120)	654
Segment results – operating profit	1,045	360	116	135	(10)	(141)	1,505
Financing expenses	264	26	11	301	4	(322)	284
Financing income	(159)	(85)	(5)	(5)	(1)	22	(233)
Total financing expenses (income), net	105	(59)	6	296	3	(300)	51
Segment profit (loss) after financing expenses, net	940	419	110	(161)	(13)	159	1,454
Share in losses of associates	-	-	-	-	-	(107)	(107)
Segment profit (loss) before income tax	940	419	110	(161)	(13)	52	1,347
Income tax	241	105	29	1	2	(1)	377
Segment results – net profit (loss)	699	314	81	(162)	(15)	53	970

12. Segment Reporting (Contd.)

12.1 Operating segments (contd.)

	Three months ended June 30, 2014 (Unaudited):						
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi-channel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	1,006	828	354	427	57	(427)	2,245
Inter-segment revenues	67	15	12	-	2	(91)	5
Total revenues	1,073	843	366	427	59	(518)	2,250
Depreciation and amortization	172	105	33	74	6	(71)	319
Segment results – operating profit	471	127	58	67	637*	(126)	1,234
Financing expenses	124	3	4	187	(1)	(190)	127
Financing income	(77)	(20)	(1)	(6)	-	9	(95)
Total financing expenses (income), net	47	(17)	3	181	(1)	(181)	32
Segment profit (loss) after financing expenses, net	424	144	55	(114)	638	55	1,202
Share in losses of associates	-	-	-	-	(3)	(76)	(79)
Segment profit (loss) before income tax	424	144	55	(114)	635	(21)	1,123
Income tax	110	38	14	1	151	(1)	313
Segment results – net profit (loss)	314	106	41	(115)	484	(20)	810

* Including profit from the sale of Coral Tell Ltd. shares amounting to NIS 582 million

12. Segment Reporting (Contd.)

12.1 Operating segments (contd.)

	Three months ended June 30, 2013 (Unaudited):						
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi-channel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	1,053	898	339	404	59	(404)	2,349
Inter-segment revenues	68	17	20	-	4	(107)	2
Total revenues	1,121	915	359	404	63	(511)	2,351
Depreciation and amortization	168	113	33	64	8	(60)	326
Segment results – operating profit	510	186	60	68	(9)	(71)	744
Financing expenses	135	14	4	170	1	(180)	144
Financing income	(82)	(44)	(2)	(2)	-	13	(117)
Total financing expenses (income), net	53	(30)	2	168	1	(167)	27
Segment profit (loss) after financing expenses, net	457	216	58	(100)	(10)	96	717
Share in losses of associates	-	-	-	-	-	(67)	(67)
Segment profit (loss) before income tax	457	216	58	(100)	(10)	29	650
Income tax	106	55	14	1	4	(3)	177
Segment results – net profit (loss)	351	161	44	(101)	(14)	32	473

12. Segment Reporting (Contd.)

12.1 Operating segments (contd.)

	Year ended December 31, 2013 (Audited)						
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi-channel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	4,198	3,741	1,365	1,633	241	(1,633)	9,545
Inter-segment revenues	280	68	68	2	21	(421)	18
Total revenues	4,478	3,809	1,433	1,635	262	(2,054)	9,563
Depreciation and amortization	683	458	130	263	31	(254)	1,311
Segment results – operating profit	1,998	608	227	268	(4)	(278)	2,819
Financing expenses	534	46	23	654	6	(690)	573
Financing income	(317)	(137)	(9)	(7)	-	42	(428)
Total financing expenses (income), net	217	(91)	14	647	6	(648)	145
Segment profit (loss) after financing expenses, net	1,781	699	213	(379)	(10)	370	2,674
Share in profits (losses) of associates	-	-	1	-	-	(253)	(252)
Segment profit (loss) before income tax	1,781	699	214	(379)	(10)	117	2,422
Income tax	410	178	56	2	5	-	651
Segment results – net profit (loss)	1,371	521	158	(381)	(15)	117	1,771

12. Segment Reporting (Contd.)

12.2. Adjustment of profit or loss for reporting segments

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Operating profit for reporting segments	**1,484**	1,656	**723**	824	3,101
Cancellation of results for a segment classified as an associate	**(140)**	(135)	**(67)**	(68)	(268)
Financing expenses, net	**(74)**	(51)	**(32)**	(27)	(145)
Share in losses of associates	**(98)**	(107)	**(79)**	(67)	(252)
Other adjustments	**578***	(16)	**578***	(12)	(14)
	1,750	1,347	**1,123**	650	2,422

* Including profit from the sale of Coral Tell Ltd. shares amounting to NIS 582 million

13. Condensed Financial Statements of Pelephone Communications Ltd. and Bezeq International Ltd.

13.1. Pelephone Communications Ltd.

Selected data from the statement of financial position

	June 30, 2014	June 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	**1,775**	2,214	2,073
Non-current assets	**1,962**	2,215	2,053
	3,737	4,429	4,126
Current liabilities	**735**	891	1,037
Long-term liabilities	**105**	546	205
Total liabilities	840	**1,437**	**1,242**
Equity	**2,897**	2,992	2,884
	3,737	4,429	4,126

Selected data from the statement of income

	Six months ended June 30		Three months ended June 30		Year ended
	2014	2013	2014	2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from services	**1,259**	1,410	**622**	696	2,808
Revenues from sales of terminal equipment	**501**	469	**221**	219	1,001
Total revenues from services and sales	**1,760**	1,879	**843**	915	3,809
Cost of services and sales	**1,293**	1,303	**612**	627	2,711
Gross profit	**467**	576	**231**	288	1,098
Selling and marketing expenses	**159**	161	**76**	75	320
General and administrative expenses	**55**	55	**28**	27	109
Other operating expenses	**-**	-	**-**	-	61
	214	216	**104**	102	490
Operating profit	**253**	360	**127**	186	608
Financing expenses	**9**	26	**3**	14	46
Financing income	**(44)**	(85)	**(20)**	(44)	(137)
Financing income, net	**(35)**	(59)	**(17)**	(30)	(91)
Profit before income tax	**288**	419	**144**	216	699
Income tax	**74**	105	**38**	55	178
Profit for the period	**214**	314	**106**	161	521

13.2. Bezeq International Ltd.

Selected data from the statement of financial position

	June 30, 2014	June 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	**497**	483	494
Non-current assets	**746**	801	763
	1,243	1,284	1,257
Current liabilities	**299**	293	311
Long-term liabilities	**121**	171	129
Total liabilities	420	**464**	**440**
Equity	**823**	820	817
	1,243	1,284	1,257

Selected data from the statement of income

	Six months ended June 30		Three months ended June 30		Year ended
	2014	2013	2014	2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from services	**721**	704	**366**	359	1,433
Operating expenses	**447**	426	**229**	219	879
Gross profit	**274**	278	**137**	140	554
Selling and marketing expenses	**100**	101	**50**	50	205
General and administrative expenses	**58**	61	**29**	30	119
Other expenses, net	**-**	-	**-**	-	3
	158	162	**79**	80	327
Operating profit	**116**	116	**58**	60	227
Financing expenses	**9**	11	**4**	4	23
Financing income	**(4)**	(5)	**(1)**	(2)	(9)
Financing expenses, net	**5**	6	**3**	2	14
Share in profits of equity-accounted associates	**1**	-	**-**	-	1
Profit before income tax	**112**	110	**55**	58	214
Income tax	**29**	29	**14**	14	56
Profit for the period	**83**	81	**41**	44	158

D.B.S. Satellite Services (1998) Ltd.

Condensed Interim Financial Statements as of June 30, 2014

Table of Contents

Table of Contents	Page
Auditors' Review Report	2
Condensed Interim Statements of Financial Position	3
Condensed Interim Statements of Income	5
Condensed Interim Statements of Comprehensive Income	6
Condensed Interim Statements of Changes in Equity	7
Condensed Interim Statements of Cash Flows	10
Notes to the Condensed Interim Financial Statements	12

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Review Report to the Shareholders of
D.B.S. Satellite Services (1998) Ltd.

Introduction

We have reviewed the accompanying financial information of D.B.S. Satellite Services (1998) Ltd. (hereinafter- "the Company") comprising of the condensed interim statement of financial position as of June 30, 2014 and the related condensed interim statements of income, comprehensive income, changes in equity and cash flows for the six and threemonth periods then ended. The Board of Directors and Management are responsible for the preparation and presentation of interim financial information for these interim periods in accordance with IAS 34 "Interim Financial Reporting", and are also responsible for the preparation of financial information for these interim periods in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express a conclusion on interim financial information for these interim periods based on our review.

Scope of Review

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

Conclusion

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

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

Without qualifying our above conclusion, we draw attention to Note 4 regarding the financial condition of the Company.

Somekh Chaikin
Certified Public Accountants (Isr.)

August 3, 2014

Condensed Interim Statements of Financial Position as of

	June 30, 2014	June 30, 2013	December 31 2013
	(unaudited)	(unaudited)	(audited)
	NIS Thousands	NIS Thousands	NIS Thousands
Assets			
Cash and cash equivalents	**386,477**	-	125,263
Trade receivables	**166,516**	160,813	164,277
Other receivables	**5,231**	4,745	1,615
Total current assets	**558,224**	165,558	291,155
Broadcasting rights - net of exercised rights	**427,293**	396,290	416,598
Property, plant and equipment, net	**783,314**	757,123	775,131
Intangible assets, net	**139,898**	109,327	133,728
Total non-current assets	**1,350,505**	1,262,740	1,325,457
Total assets	**1,908,729**	1,428,298	1,616,612

The notes to the condensed interim financial statements are an integral part thereof.

Condensed Interim Statements of Financial Position as of

	June 30, 2014 (unaudited) NIS Thousands	June 30, 2013 (unaudited) NIS Thousands	December 31 2013 (audited) NIS Thousands
Liabilities			
Credit from banks	**18,461**	2,469	35,785
Current maturities on debentures	**354,507**	189,534	292,168
Trade payables	**441,794**	406,455	467,929
Other payables	**165,481**	146,007	161,318
Provisions	**8,915**	11,356	12,360
Total current liabilities	**989,158**	755,821	969,560
Debentures and bank loans	**1,586,138**	1,428,455	1,387,616
Loans from shareholders	**3,797,810**	3,310,267	3,571,900
Other long-term liabilities	**22,407**	52,245	24,931
Employee benefits	**5,490**	4,817	5,779
Total non-current liabilities	**5,411,845**	4,795,784	4,990,226
Total liabilities	**6,401,003**	5,551,605	5,959,786
Equity deficit			
Share capital	**29**	29	29
Share premium	**85,557**	85,557	85,557
Options	**48,219**	48,219	48,219
Capital reserves	**1,537,271**	1,537,271	1,537,271
Capital reserve for share-based payments	**10,280**	10,280	10,280
Retained losses	**(6,173,630)**	(5,804,663)	(6,024,530)
Total equity deficit	**(4,492,274)**	(4,123,307)	(4,343,174)
Total liabilities and equity	**1,908,729**	1,428,298	1,616,612

David Efrati
Authorized to sign as Chairman of the Board
(See Note 8)

Ron Eilon
CEO

Micky Neiman
CFO

Financial statements approval date: August 3, 2014

The notes to the condensed interim financial statements are an integral part thereof.

Condensed Interim Statements of Income

	For the six months ended		For the three months ended		For the year ended
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	December 31, 2013
	(unaudited)		(unaudited)		(audited)
	NIS Thousands		NIS Thousands		NIS Thousands
Revenues	**851,357**	807,381	**427,633**	403,840	1,635,216
Cost of revenues	**544,005**	518,995	**275,255**	260,881	1,051,618
Gross profit	**307,352**	288,386	**152,378**	142,959	583,598
Sales and marketing expenses	**79,784**	75,348	**40,170**	36,229	153,712
General and administrative expenses	**87,856**	78,025	**45,378**	39,146	162,372
Operating profit	**139,712**	135,013	**66,830**	67,584	267,514
Finance expenses	**73,098**	76,497	**50,770**	44,745	167,677
Finance income	**(10,665)**	(4,844)	**(5,892)**	(2,183)	(6,979)
Finance expenses for shareholder loans, net	**225,910**	224,525	**137,004**	125,678	486,158
Finance expenses, net	**288,343**	296,178	**181,882**	168,240	646,856
Loss before income tax	**(148,631)**	(161,165)	**(115,052)**	(100,656)	(379,342)
Income tax	**469**	474	**283**	282	1,352
Loss for the period	**(149,100)**	(161,639)	**(115,335)**	(100,938)	(380,694)

Basic and diluted loss per share (NIS)	**4,987**	5,407	**3,858**	3,377	12,734

The notes to the condensed interim financial statements are an integral part thereof.

Condensed Interim Statements of Comprehensive Income

	For the six months ended		For the three months ended		For the year ended
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	December 31, 2013
	(unaudited)		(unaudited)		(audited)
	NIS Thousands		NIS Thousands		NIS Thousands
Loss for the period	**(149,100)**	(161,639)	**(115,335)**	(100,938)	(380,694)
Items of other comprehensive income that will not be transferred to profit or loss					
Actuarial gains (losses) on a defined benefit plan	**-**	166	**-**	-	(646)
Total other comprehensive income (loss) for the period that will not be transferred to profit or loss	**-**	166	**-**	-	(646)
Total comprehensive loss for the period	**(149,100)**	(161,473)	**(115,335)**	(100,938)	(381,340)

The notes to the condensed interim financial statements are an integral part thereof.

Condensed Interim Statements of Changes in Equity Deficit

	Share capital	Share premium	Options	Capital reserve	Capital reserve for share-based payments	Retained losses	Total
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
For the six months ended June 30, 2014 (unaudited)							
Balance as of January 1, 2014 (audited)	**29**	**85,557**	**48,219**	**1,537,271**	**10,280**	**(6,024,530)**	**(4,343,174)**
Total comprehensive loss for the period							
Loss for the period	**-**	**-**	**-**	**-**	**-**	**(149,100)**	**(149,100)**
Other comprehensive income for the period	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total comprehensive loss for the period	**-**	**-**	**-**	**-**	**-**	**(149,100)**	**(149,100)**
Balance as of June 30, 2014 (unaudited)	**29**	**85,557**	**48,219**	**1,537,271**	**10,280**	**(6,173,630)**	**(4,492,274)**
For the six months ended June 30, 2013 (unaudited)							
Balance as of January 1, 2013 (audited)	29	85,557	48,219	1,537,271	10,280	(5,643,190)	(3,961,834)
Total comprehensive loss for the period							
Loss for the period	-	-	-	-	-	(161,639)	(161,639)
Other comprehensive income for the period	-	-	-	-	-	166	166
Total comprehensive loss for the period	-	-	-	-	-	(161,473)	(161,473)
Balance as of June 30, 2013 (unaudited)	29	85,557	48,219	1,537,271	10,280	(5,804,663)	(4,123,307)

The notes to the condensed interim financial statements are an integral part thereof.

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

	Share capital	Share premium	Options	Capital reserve	Capital reserve for share-based payments	Retained losses	Total
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
For the three months ended June 30, 2014 (unaudited)							
Balance as of April 1, 2014 (unaudited)	**29**	**85,557**	**48,219**	**1,537,271**	**10,280**	**(6,058,295)**	**(4,376,939)**
Total comprehensive loss for the period							
Loss for the period	**-**	**-**	**-**	**-**	**-**	**(115,335)**	**(115,335)**
Other comprehensive loss for the period	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total comprehensive loss for the period	**-**	**-**	**-**	**-**	**-**	**(115,335)**	**(115,335)**
Balance as of June 30, 2014 (unaudited)	**29**	**85,557**	**48,219**	**1,537,271**	**10,280**	**(6,173,630)**	**(4,492,274)**
For the three months ended June 30, 2013 (unaudited)							
Balance as of April 1, 2013 (unaudited)	29	85,557	48,219	1,537,271	10,280	(5,703,725)	(4,022,369)
Total comprehensive loss for the period							
Loss for the period	-	-	-	-	-	(100,938)	(100,938)
Other comprehensive loss for the period	-	-	-	-	-	-	-
Total comprehensive loss for the period	-	-	-	-	-	(100,938)	(100,938)
Balance as of June 30, 2013 (unaudited)	29	85,557	48,219	1,537,271	10,280	(5,804,663)	(4,123,307)

The notes to the condensed interim financial statements are an integral part thereof.

Condensed Interim Statements of Changes in Equity (Contd.)

	Share capital	Share premium	Options	Capital reserves	Capital reserve for share-based payments	Retained losses	Total
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
For the year ended December 31, 2013 (audited)							
Balance as of January 1, 2013 (audited)	29	85,557	48,219	1,537,271	10,280	(5,643,190)	(3,961,834)
Total comprehensive loss for the year							
Loss for the year	-	-	-	-	-	(380,694)	(380,694)
Other comprehensive loss for the year	-	-	-	-	-	(646)	(646)
Total comprehensive loss for the year	-	-	-	-	-	(381,340)	(381,340)
Balance as of December 31, 2013 (audited)	29	85,557	48,219	1,537,271	10,280	(6,024,530)	(4,343,174)

The notes to the condensed interim financial statements are an integral part thereof..

Condensed Interim Statements of Cash Flows

	For the six months ended		For the three months ended		For the year ended
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	December 31, 2013
	(unaudited)		(unaudited)		(audited)
	NIS Thousands		NIS Thousands		NIS Thousands
Cash flows from operating activities					
Loss for the period	**(149,100)**	(161,639)	**(115,335)**	(100,938)	(380,694)
Adjustments:					
Depreciation and amortization	**143,560**	126,058	**73,829**	64,105	262,735
Finance expenses, net	**285,809**	293,475	**178,397**	170,232	633,376
Losses (gains) from sale of property, plant and equipment	**334**	724	**(22)**	(76)	320
Income tax expenses	**469**	474	**283**	282	1,352
Change in trade receivables	**(2,239)**	2,230	**(724)**	(1,263)	(1,234)
Change in other receivables	**(3,615)**	(3,071)	**(2)**	(127)	59
Change in broadcasting rights	**(10,696)**	(18,941)	**(6,878)**	(4,839)	(39,249)
Change in trade and other payables	**(45,308)**	(6,200)	**(23,833)**	(16,255)	16,076
Change in employee benefits	**(289)**	(854)	**70**	(638)	(704)
Subtotal	**368,025**	393,895	**221,120**	211,421	872,731
Income taxes paid	**(545)**	(474)	**(273)**	(282)	(1,550)
Net cash from operating activities	**218,380**	231,782	**105,512**	110,201	490,487
Cash flows from investing activities					
Proceeds from the sale of property, plant and equipment	**115**	117	**48**	82	474
Purchase of property, plant and equipment	**(121,827)**	(144,107)	**(57,210)**	(68,451)	(260,110)
Payments for software and licenses	**(24,002)**	(30,267)	**(10,811)**	(16,277)	(63,638)
Net cash used in investing activities	**(145,714)**	(174,257)	**(67,973)**	(84,646)	(323,274)

The notes to the condensed interim financial statements are an integral part thereof.

Condensed Interim Statements of Cash Flows (Contd.)

	For the six months ended		For the three months ended		For the year ended
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	December 31, 2013
	(unaudited)		(unaudited)		(audited)
	NIS Thousands		NIS Thousands		NIS Thousands
Cash flows from financing activities					
Repayment of debenture principal	**(32,074)**	(31,695)	**(32,074)**	(31,695)	(223,355)
Short-term bank credit and loans, net	**(14,022)**	(66,853)	**4,575**	(59,784)	(33,537)
Payment for finance lease liabilities	**(2,215)**	(741)	**(1,142)**	(741)	(2,766)
Interest paid	**(62,053)**	(57,385)	**(39,758)**	(33,367)	(121,352)
Debenture issues, net	**298,912**	99,149	**298,912**	27,033	339,060
Net cash from (used in) financing activities	**188,548**	(57,525)	**230,513**	(98,554)	(41,950)
Increase in cash and cash equivalents	**261,214**	-	**268,052**	72,999	125,263
Cash and cash equivalents at the beginning of the year	**125,263**	-	**118,425**	(72,999)	-
Cash and cash equivalents at the end of the year	**386,477**	-	**386,477**	-	125,263

The notes to the condensed interim financial statements are an integral part thereof.

NOTE 1 - THE REPORTING ENTITY

D.B.S. Satellite Services (1998) Ltd. ("the Company") was incorporated in Israel in 1998 and has its main offices in 6 HaYozma Street, Kfar Saba.

The Company holds a Ministry of Communications license for satellite television broadcasts ("the License"). The License is valid until January 2017, and may be extended for additional six-year periods, subject to certain conditions. The Company's operations are subject, inter alia, to the Communications (Telecommunications and Broadcasts) Law, 1982 ("the Communications Law") and the regulations and rules enacted thereunder, and to the terms of the License.

Bezeq - The Israel Telecommunication Corporation Ltd. ("Bezeq") holds 49.78% of the Company's issued capital, and options for an additional 8.6% of the Company's issued capital, which Bezeq may exercise subject to Bezeq and the Company meeting the terms of the merger specified by the Antitrust Authority. The Company's remaining shares are held by Eurocom DBS Ltd. Voting rights granted by these shares are held by a trustee, under an irrevocable letter of appointment and authorization, and pursuant to the Antitrust Commissioner's decision stating, inter alia, that he must use the shares as an owner.

On March 26, 2014, Bezeq received the Antitrust Authority's decision, whereby, subject to certain conditions, the restrictions imposed on the Eurocom Group concerning its continued holding of the Company would be repealed, and the merger between the Company and Bezeq will be permitted.

NOTE 2 - BASIS OF PREPARATION

A. Statement of Compliance

The condensed interim financial statements were prepared in accordance with IAS 34 - Interim Financial Reporting, and does not include all the information required to be presented in the full annual financial statements. These condensed statements should be read in conjunction with the financial statements for the year ended December 31, 2013 ("the Annual Statements"). In addition, these statements were prepared in accordance with Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970.
The condensed interim financial statements were approved by the Board of Directors on August 3, 2014.

B. Use of estimates and judgment

In preparing these condensed financial statements according to IFRS, Management is required to exercise judgment and use assessments, estimates, and assumptions which affect the application of accounting policies and the reported amounts of assets and liabilities, revenues and expenses. It is clarified that actual results may differ from these estimates.

Management's judgment in applying the Company's accounting policies and the key assumptions used in assessments involving uncertainty, are consistent with those applied in preparing the annual financial statements.

NOTE 3 - PRINCIPAL ACCOUNTING POLICIES

Principal accounting policies were applied in these interim financial statements in a manner that is consistent with their application in the Annual Statements for the year ended December 31, 2013, except for the following:

First-time application of new standards

Starting January 1, 2014, the Company applies IAS 32 - *Financial Instruments: Presentation*, concerning the offsetting of financial assets and liabilities. Application of the amended standard did not materially affect the Company's financial statements.

New standards and interpretations not yet adopted

Integrated amendments to IAS 16 - *Property, Plant and Equipment*, and IAS 38 - *Intangible Assets*, published in May 2014 ("the Amendment").

The Amendment clarifies acceptable methods of depreciation and amortization. Application of the Amendments is mandatory starting with the financial statements for annual periods starting on or after January 1, 2016, on a prospective basis. Early adoption of the Amendment is possible, subject to disclosure requirements. The Company will study the effects of the Standard's adoption on its financial statements.

IFRS 15 - *Revenue From Contracts with Customers*, published in May 2014 ("the Standard").
The Standard supersedes existing guidelines concerning the recognition of revenue, and presents a new model for recognizing revenue from contracts with customers. The model includes a five-step approach to analyzing transactions, in order to determine when revenue is to be recognized, and to what amount. The Standard also establishes new and broader disclosure requirements as compared to current guidelines.
The Standard is to be applied for annual periods starting from January 1, 2017, and earlier adoption is permitted. The Standards includes various alternative transitional provisions, so that companies may choose one of the following alternatives upon first-time application: Full retrospective application; full retrospective application with practical expedients; or application from the date of first-time application, while adjusting the retained earnings balances on that date for uncompleted transactions. The Company is examining the effects of the Standard on its financial statements.

IFRS 9 (2014) - *Financial Instruments*, published in July 2014 ("the Standard").
The Standard supersedes the requirements of IAS 39 concerning the classification and measurement of financial assets and financial liabilities hedge accounting, and the measurement of impairment on financial instruments. The Standard is to be applied to annual periods starting January 1, 2018. Earlier application is permitted subject to certain conditions set forth in the Standard. The Standard will be applied retrospectively, except for certain allowances, as set forth in the Standard's transitional provisions. The Company is examining the effects of the Standard's adoption on its financial statements.

NOTE 4 - THE COMPANY'S FINANCIAL POSITION

A. Since starting its operations, the Company has accumulated considerable losses. The Company's loss in 2013 amounted to NIS 381 million, and its loss in the six months ended June 30, 2014, amounted to NIS 149 million. As a result of these losses, as of June 30, 2014, the Company had an equity deficit and a working capital deficit of NIS 4,492 million and NIS 431 million, respectively.

B. 1. As of June 30, 2014, the Company complied with the financial covenants established under its financing and debenture agreements. As of June 30, 2014, the Company complied with the debt/EBITDA ratio covenant established in Deed of Trust B (the Company's debt/EBITDA ratio as of June 30, 2014, was 2.9). Furthermore, the Company complied with the debt//EBITDA ratio covenant specified by the 2012 Debentures (as of June 30, 2014, the Company's debt/EBITDA ratio was 2.7), and the debt/(E-C) ratio covenant specified by the 2012 Debentures (as of June 30, 2014, the debt/(E-C) ratio was 7.4).

2. For information concerning additional debt raising in the reporting period, see Note 7 below.

3. For information concerning the upgrade of the Company's rating in the reporting period, see Note 7 below.

4. Management estimates that the financing resources available to the Company, which include, inter alia, the working capital deficit and potential capital raising, will be sufficient for the Company's operating needs in the coming year, based on the forecasted cash flows approved by the Company's Board of Directors. Should additional resources be required to meet the Company's operating needs in the coming year, the Company will adjust its operations so as not to require additional resources beyond those currently at its disposal.

NOTE 5 - CONTINGENT LIABILITIES

Legal actions

Various legal actions have been filed or are pending against the Company (in this section: "Legal Actions").

Based, *inter alia*, on the opinion of its legal counsel concerning the chances for success of these Legal Actions, Management believes that adequate provisions have been included in the financial statements, where such provisions are required, to cover the Company's exposure from the said Legal Actions.

As of June 30, 2014, the Company's exposure to Legal Actions brought against the Company on various matters, totalled NIS 429,754,000, of which NIS 270,233,000 were from customer claims whose chances of success cannot be estimated at this time. These amounts and all claimed amounts presented in this Note do not include linkage and interest.

Below are details of material claims pending against the Company as of June 30, 2014, classified into groups with similar characteristics.

A. Employee claims

In the normal course of business, collective and individual Legal Actions have been filed against the Company by its employees and former employees. These claims primarily concern allegations of non-payment of salary components and delay in salary payments. As of June 30, 2014, these claims totaled NIS 84,066,000. Based on the opinion of its legal counsel concerning the chances of success of these claims, Management believes that adequate provisions have been included in the financial statements, to the amount of NIS 1,939,000, where provisions are required to cover the Company's exposure to such claims.

NOTE 5 - CONTINGENT LIABILITIES (CONTD.)

Legal actions (contd.)

B. Customer claims

In the normal course of business, Legal Actions have been filed against the Company by its customers. These are mainly applications for approval as class actions (and subsequent actions) which usually concern claims of unlawful charges and complaints concerning services provided by the Company. As of June 30, 2014, these claims totaled NIS 344,698,000. Based, among other things, on the opinion of its legal counsel concerning the chances of success of these claims, Management believes that adequate provisions have been included in the financial statements, to the amount of NIS 6,334,000, where provisions are required to cover the Company's exposure to such claims.

C. Supplier and communication provider claims

In the normal course of business, various Legal Actions have been brought against the Company by suppliers of goods and/or services to the Company. As of June 30, 2014, these claims totaled NIS 990,000. Based, among other things, on the opinion of its legal counsel concerning the chances of success of these claims, Management believes that adequate provisions have been included in the financial statements, to the amount of NIS 40,000, where provisions are required to cover the Company's exposure to such claims.

NOTE 6 - FINANCIAL INSTRUMENTS

Fair value

A. Fair value vs. carrying amount

The carrying amount of certain financial assets and financial liabilities including cash and cash equivalents, trade receivables, other receivables, deposits, derivatives, bank credit, long- and short-term loans and credit, trade payables, other payables, matches or is near their fair value. The fair value of other financial assets and financial liabilities and their respective carrying amounts presented in the statement of financial position, are as follows:

	June 30, 2014	
	Carrying amount	**Fair value**
	NIS Thousands	
Debentures, including accrued interest and bank loans	**1,983,789**	**2,186,105**

	June 30, 2013	
	Carrying amount	**Fair value**
	NIS Thousands	
Debentures, including accrued interest	1,665,410	1,819,972

	December 31, 2013	
	Carrying amount	**Fair value**
	NIS Thousands	
Debentures, including accrued interest	1,712,923	1,933,242

B. Fair value hierarchy

The fair value of financial instruments measured at fair value is assessed according to the fair value level in the hierarchy.
The various levels are defined as follows:

- Level 1: Quoted (non-adjusted) prices on an active market for identical instruments.
- Level 2: Directly or indirectly observed data, not included in Level 1 as aforesaid.
- Level 3: Data not based on observed market data.

C. Data concerning Level 2 fair value measurement

As of June 30, 2014, the Company has made a number of forward transactions to reduce its exposure to fluctuations in the USD exchange rate. The fair value of these forward transactions was determined by using market-observed data. The net fair value of these forward transactions as of June 30, 2014 (liability) totaled NIS 5.1 million.

NOTE 7 - EVENTS IN THE REPORTING PERIOD

A. On April 1, 2014, S&P Maalot set an -ilA rating for additional debentures to be issued by the Company up to a total par value amount of NIS 250 million. This issue will be effected as a new debenture issue or as an expansion of an existing series.

B. In April 2014, the Company carried out an additional issue of Debentures (Series A), effected as an expansion of the series by a total of NIS 253 million, and an additional issue of Debentures (Series B), effected as an expansion of the series by a total of NIS 47 million. For information concerning the terms of these debentures, see Note 14 to the financial statements for December 31, 2013.

C. On April 30, 2014, S&P Maalot upgraded its rating for the Company and the Company's debentures to ilA (stable), and put this rating on its watch list with a positive outlook.

NOTE 8 - APPOINTMENT OF A CHAIRPERSON FOR THE FINANCIAL STATEMENTS APPROVAL MEETING

On the financial statements approval date, the Company's Board of Directors does not have an incumbent Chairperson. Consequently, on August 3, 2014, the Company's Board of Directors authorized David Efrati, a director in the Company, to chair the Board of Directors meeting in which the financial statements were approved, and to sign the Company's financial statements for June 30, 2014.

Bezeq - The Israel Telecommunication Corporation Ltd.

Condensed Separate Interim Financial Information as at June 30, 2014

(Unaudited)

bezeq

Contents	**Page**

Auditors' Report	2
Condensed Separate Interim Financial Information as at June 30, 2014 (unaudited)	
Condensed interim information of Financial Position	3
Condensed interim information of Statement of Income	5
Condensed interim information of Comprehensive Income	5
Condensed interim information of Cash Flows	6
Notes to the condensed separate interim financial information	8

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

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

Introduction

We have reviewed the separate interim financial information presented in accordance with Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970 of “Bezeq”- The Israel Telecommunication Corporation Ltd. (hereinafter – “the Company”) as of June 30, 2014 and for the six and three month periods then ended. The separate interim financial information is the responsibility of the Company’s Board of Directors and of its Management. Our responsibility is to express a conclusion on the separate interim financial information based on our review.

We did not review the separate interim financial information of an investee company the investment in which amounted to NIS 581 million as of June 30, 2014, and the profit from this investee company amounted to NIS 422 million and NIS 428 million for the six and three month periods then ended, respectively. The financial statements of that company were reviewed by other auditors whose review report thereon was furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial statements of that company, is based solely on the said review report of the other auditors.

Scope of Review

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

Conclusion

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

Without qualifying our abovementioned conclusion, we draw attention to lawsuits filed against the Company which cannot yet be assessed or the exposure in respect thereof cannot yet be estimated, as set forth in Note 4.

Somekh Chaikin
Certified Public Accountants (Isr.)

August 6, 2014

Condensed interim information of Financial Position

	June 30, 2014	June 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Assets			
Cash and cash equivalents	**207**	206	237
Investments, including derivatives	**1,659**	1,414	1,129
Trade receivables	**727**	757	738
Other receivables	**216**	191	166
Inventories	**6**	20	7
Loans provided to investees	**262**	385	498
Assets classified as held for sale	**24**	97	66
Total current assets	**3,101**	3,070	2,841
Investments	**69**	70	67
Trade and other receivables	**36**	103	61
Property, plant and equipment	**4,563**	4,356	4,426
Intangible assets	**314**	344	334
Investment in investees	**6,328**	6,053	5,890
Loans provided to investees	**311**	815	555
Deferred tax assets	**40**	55	50
Total non-current assets	**11,661**	11,796	11,383
Total assets	**14,762**	14,866	14,224

Condensed interim information of Financial Position (contd.)

	June 30, 2014	June 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Liabilities			
Debentures, loans and borrowings	**1,555**	1,068	1,127
Loan from an investee	**434**	-	-
Trade payables	**127**	105	129
Other payables, including derivatives	**465**	399	484
Current tax liabilities	**574**	597	522
Provisions (Note 4)	**107**	107	109
Employee benefits	**340**	234	222
Dividend payable	**-**	490	-
Total current liabilities	**3,602**	3,000	2,593
Debentures and loans	**7,975**	9,003	8,926
Employee benefits	**195**	216	201
Other liabilities, including derivatives	**106**	76	81
Total non-current liabilities	**8,276**	9,295	9,208
Total liabilities	**11,878**	12,295	11,801
Equity			
Share capital	**3,848**	3,838	3,842
Share premium	**198**	102	143
Reserves	**500**	612	565
Deficit	**(1,662)**	(1,981)	(2,127)
Total equity attributable to equity holders of the Company	**2,884**	2,571	2,423
Total liabilities and equity	**14,762**	14,866	14,224

Shaul Elovitch
Chairman of the Board of Directors

Stella Handler
CEO

David (Dudu) Mizrahi
Deputy CEO and CFO

Date of approval of the financial statements: August 6, 2014

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

Condensed interim information of Statement of Income

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues (Note 2)	**2,150**	2,250	**1,073**	1,121	4,478
Cost of Activities					
Depreciation and amortization	**340**	335	**172**	168	683
Salaries	**451**	512	**228**	242	980
Operating and general expenses (Note 3)	**378**	448	**188**	218	895
Other operating expenses (income), net	**6**	(90)	**14**	(17)	(78)
Cost of Activities	**1,175**	1,205	**602**	611	2,480
Operating profit	**975**	1,045	**471**	510	1,998
Financing expenses (income)					
Financing expenses	**230**	264	**124**	135	534
Financing income	**(127)**	(159)	**(77)**	(82)	(317)
Financing expenses, net	**103**	105	**47**	53	217
Profit after financing expenses, net	**872**	940	**424**	457	1,781
Share in earnings of investees, net	**621**	271	**496**	122	400
Profit before income tax	**1,493**	1,211	**920**	579	2,181
Income tax	**226**	241	**110**	106	410
Profit for the period attributable to equity holders of the Company	**1,267**	970	**810**	473	1,771

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

Condensed Interim Statement of Comprehensive Income

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Profit for the period	**1,267**	970	**810**	473	1,771
Items of other comprehensive income					
Actuarial gains (losses) net of tax	**-**	-	**-**	-	17
Other items of other comprehensive income (loss) for the period, net of tax	**(9)**	(10)	**(22)**	(17)	(11)
Other comprehensive income (loss), net of tax	**(9)**	(10)	**(22)**	(17)	6
Total comprehensive income for the period attributable to equity holders of the Company	**1,258**	960	**788**	456	1,777

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

Condensed interim information of Cash Flows

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Cash flows from operating activities					
Profit for the period	**1,267**	970	**810**	473	1,771
Adjustments:					
Depreciation and amortization	**340**	335	**172**	168	683
Share in the profits of equity-accounted investees, net	**(621)**	(271)	**(496)**	(122)	(400)
Financing expenses, net	**105**	136	**44**	48	267
Capital gain, net	**(120)**	(112)	**(103)**	(65)	(161)
Share-based payment transactions	**(1)**	16	**-**	8	29
Income tax expenses	**226**	241	**110**	106	410
Sundries	**-**	(10)	**-**	(6)	(7)
Change in inventory	**1**	(7)	**-**	5	6
Change in trade and other receivables	**47**	(34)	**53**	(1)	25
Change in trade and other payables	**(15)**	(46)	**(72)**	(97)	40
Change in provisions	**(3)**	(33)	**1**	(3)	(29)
Change in employee benefits	**113**	15	**107**	40	3
Net cash (used in) from operating activities due to transactions with investees	**(6)**	(13)	**(2)**	12	(35)
Net income tax paid	**(172)**	(70)	**(79)**	(10)	(328)
Net cash flows from operating activities	**1,161**	1,117	**545**	556	2,274

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

Condensed Interim Statements of Cash Flows (cont.)

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	2013	2014	2014	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Cash flows from investing activities					
Investment in intangible assets	**(39)**	(41)	**(20)**	(20)	(86)
Proceeds from the sale of property, plant and equipment	**70**	166	**42**	124	304
Acquisition of financial assets held for trading and others	**(620)**	(1,091)	**(410)**	(659)	(1,486)
Proceeds from the sale of financial assets held for trading and others	**94**	759	**94**	759	1,441
Purchase of property, plant and equipment	**(378)**	(328)	**(187)**	(166)	(703)
Sundries	**2**	13	**3**	12	23
Net cash from investment activities due to transactions with investees	**589**	509	**345**	447	1,080
Net cash (used in) provided by investment activities	**(282)**	(13)	**(133)**	497	573
Cash flow from finance activities					
Issue of debentures and receipt of loans	**-**	869	**-**	869	1,360
Repayment of debentures and loans	**(323)**	(394)	**(323)**	(319)	(928)
Dividend paid	**(802)**	(1,361)	**(802)**	(1,361)	(2,830)
Interest paid	**(213)**	(228)	**(191)**	(201)	(433)
Sundries	**(5)**	(5)	**(7)**	(5)	-
Loan received from an investee	**434**	-	**434**	-	-
Net cash used for financing activities	**(909)**	(1,119)	**(889)**	(1,017)	(2,831)
Increase (decrease) in cash and cash equivalents	**(30)**	(15)	**(477)**	36	16
Cash and cash equivalents at beginning of period	**237**	221	**684**	170	221
Cash and cash equivalents at the end of the period	**207**	206	**207**	206	237

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

Notes to the condensed separate interim financial information

1. Manner of Preparing Financial Information

1.1. Definitions

The Company: Bezeq The Israel Telecommunication Corporation Limited.

"Investee", the "Group", "Subsidiary”: as these terms are defined in the Company's consolidated financial statements for 2013.

1.2. Principles used for preparing financial information

The condensed separate interim financial information is presented in accordance with Regulation 38(D) of the Securities Regulations (Periodic and Immediate Reports), 1970 ("the Regulation") and the Tenth Addendum of the Securities Regulations (Periodic and Immediate Reports),1970 ("the Tenth Addendum") with respect to the separate interim financial information of the corporation. They should be read in conjunction with the separate financial information for the year ended December 31, 2013 and in conjunction with the condensed interim consolidated financial statements as at June 30, 2014 ("the Consolidated Financial Statements").

The accounting policies used in these condensed separate interim financial information are in accordance with the accounting policies set out in the separate financial information as of and for the year ended December 31, 2013.

2. Revenues

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	2013	2014	2014	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Fixed-line telephony	**841**	1,013	**415**	503	1,971
Internet - infrastructure	**677**	631	**345**	321	1,287
Transmission and data communication	**514**	488	**255**	241	990
Other services	**118**	118	**58**	56	230
	2,150	2,250	**1,073**	1,121	4,478

3. Operating and General Expenses

	Six months ended June 30		Three months ended June 30		Year ended December 31
	2014	2013	2014	2014	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Maintenance of buildings and sites	**108**	114	**53**	55	233
Interconnectivity and payments to communications operators	**81**	115	**39**	58	220
Sales and marketing	**87**	85	**45**	41	186
Terminal equipment and materials	**22**	50	**10**	23	90
Services and maintenance by sub-contractors	**31**	32	**15**	16	64
Vehicle maintenance	**36**	39	**19**	19	76
Collection commissions	**13**	13	**7**	6	26
	378	448	**188**	218	895

4. Contingent Liabilities

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

In the opinion of the Company's management, based, *inter alia*, on legal opinions as to the likelihood of success of these litigations, the financial statements include appropriate provisions in the amount of NIS 107 million, where provisions are required to cover the exposure arising from such litigation.

In the Company's opinion, the additional exposure (exceeding the foregoing provisions), as of June 30, 2014 due to legal claims filed against the Company on various matters, which are unlikely to be realized, amounts to a total of NIS 1.2 billion. Of this amount, NIS 374 million is for a claim filed against the Company and other associates without specifying the portion of the amount claimed from each of the plaintiffs. In addition, there is further exposure in the amount of NIS 254 million for claims, the success of which cannot be assessed at this stage. All the foregoing amounts are linked to the consumer price index and are before the addition of interest.

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

For further information concerning contingent liabilities see Note 5 to the Consolidated Financial Statements, Contingent Claims.

5. Material agreements and transactions with Investees during and subsequent to the reporting period

5.1 In May 2014, Pelephone Communications Ltd. paid a cash dividend to the Company, which was announced in February 2014, in the amount of NIS 206 million.

5.2 In May 2014, Bezeq International Ltd. paid a cash dividend to the Company, which was announced in February 2014, in the amount of NIS 77 million.

5.3 On May 21, 2014, Walla! Communications Ltd. (Walla) repaid the balance of the loans it received from the Company in an amount of NIS 58 million. In addition, Walla granted a loan to the Company in the amount of NIS 434 million, bearing annual interest of 4.31%, which is repayable by September 2014.

5.4 In July 2014 the board of directors of Pelephone decided to distribute a dividend to the Company in the amount of NIS 213 million in October 2014.

5.5 In July 2014 the board of directors of Bezeq International decided to distribute a dividend to the Company in the amount of NIS 82 million in October 2014.