



Summary of main changes in the key working assumptions used in the impairment assessment for June 30, 2019 compared to that for December 31, 2018



Changes compared to the impairment assessment of Pelephone for December 31, 2018

Description	NIS millions
Pelephone impairment assessment as at December 31, 2018	2,914
Pelephone impairment assessment as at June 30, 2019	1,214
% change	(58.3%)

Summary of the main changes in the key working assumptions used in the impairment assessment for June 30, 2019 compared to that for December 31, 2018:

Revenues from services

- **ARPU** - In the first half of 2019, the level of competition in the market continued to be extremely high and all competitors are continuing to implement aggressive pricing and market share policy. Therefore, our current projections for 2019 show further deterioration of the ARPU and a lack of observations that can indicate market recovery in the short term, and in view of the difference between Pelephone's ARPU and the selling prices on the market (marginal price), we lowered our short-term assessments, while the ARPU continues to align with the market prices. The long-term ARPU projection is based on estimations regarding the short-term ARPU and assumes a gradual increase compared to this base. However, a decrease in the short-term ARPU has a significant impact on its absolute long-term level.

Accordingly, in the valuation for June 30, 2019, we estimated the ARPU in the terminal year at NIS 62 compared to NIS 69 in the impairment assessment for December 31, 2018 (see p.29, 38-39 of the valuation).

- **Subscribers** - In the assessment for the periods under discussion (December 31, 2018 and June 30, 2019), we adopted the Company's projections regarding the net adds of subscribers with attention to the fact that the previous projections of Pelephone's management regarding the number of subscribers were a good approximation. Accordingly, the subscriber base in the assessment for June 30, 2019 is not materially different to our estimations for December 30, 2018 (decrease of 1% over the projection years compared to the previous assessment).

Revenues from the sale of end-user equipment

Pelephone's performance in the first half of 2019 indicates a negative deviation in revenue from the sale of end-user equipment between the projection for 2019 used for the assessment for December 31, 2018 and Pelephone's actual results for that period, and in this segment, the decline continued as a result of a change in the sales mix, a decrease in the volume of units sold and lengthening of the device replacement rate. Accordingly, we decreased our projections regarding the sales from end-user equipment and they include further deterioration in short-medium term revenue (until and including 2022). The assessment of the gross profit from the end-user equipment sales was affected by the projected revenue from the sale of end-user equipment as described above (quantity of units sold and sales mix) and resulted in a decrease in profits and profit margin from the sale of end-user equipment compared to our estimation in the impairment assessment for December 31, 2018.



Changes compared to the impairment assessment of Telephone for December 31, 2018 (contd.)

Salary expenses:

In the valuation for June 30, 2019, we estimated the Company's salary expenses in the terminal year at NIS 350 million (similar to our estimation in the impairment assessment for December 31, 2018 of NIS 346 million in the terminal year). Our estimations regarding the salary expenses derives, *inter alia*, from our estimations of partial implementation of the Company's restructuring plan, that does not even include efficiency improvements that amount to a restructuring (according to IAS36 and IAS37).

General and operating expenses

In the valuation, Telephone's general and operating expenses item comprises all Company expenses other than salary expenses, payments for leases (rental of sites and buildings, leasing of motor vehicles) and depreciation. We adopted the management's projection that the Company will be able to decrease its operating expenses (network maintenance, transmission expenses, rent, etc.) less streamlining for inter-company synergies that amount to a restructuring. The effect of the changes is NIS 28 million decrease in the terminal year compared to the projection for December 31, 2018. Following are the main working assumptions used to establish future development of these expenses (the working assumptions in the impairment assessment for December 31, 2018 and June 30, 2019 are the same, unless indicated otherwise):

Cost of sale of end-user equipment - a variable expense in line with the revenue trends.

Site and building maintenance - conforms with the number of sites and buildings.

Site transmission expenses - a decline in expenses as from 2022 was assumed (in line with the validity of the contracts and the same as the discount rates measured in the past upon termination of the transmission contracts).

Frequency fees - On July 14, 2019, the Ministry of Communications published a tender for 5th generation frequencies. As opposed to the estimations used in the impairment assessment for December 31, 2018 under which the Communications and Finance Ministries will act to reduce the frequency fees so that after winning and receiving additional frequencies, the frequency fees that Telephone pays will remain unchanged, under the terms of the tender that was published (if the Ministry of Finance accepts the Ministry of Communications' request for discounted frequency fees), the payments for the fees are expected to be the same as the previous estimations in the first four years. However, in later years, the tender terms include an additional cost compared to the earlier estimations.

Roaming expenses - a variable expense in line with the revenue trends.

Interconnect payments - a variable expense in line with the number of subscribers and traffic per subscriber.

Other operating revenue (expenses), net - costs for termination of employer-employee relationship, the result of our estimation regarding implementation of the restructuring plan for 2019-2021.



Changes compared to the impairment assessment of Telephone for December 31, 2018 (contd.)

CAPEX

The Company's CAPEX includes investments in the gradual establishment of a 5th generation network over several years as from 2020. In our assessment, we estimated the investment level in the terminal year according to the Company's average CAPEX margin in the last decade. The period for calculation of the average derived from the investment cycle in the telecom market (generation replacement among the technology companies and manufacturers is an expensive action that occurs once every 7-10 years). As at June 30, 2019, we estimated that the investment level in the terminal year is NIS 30 million lower than our estimations in our assessments for December 31, 2018. The changes in the investment level is due to an expected decline in capitalized salaries and commissions (the result of efficiency measures) and current investments in the network.

Sincerely,

Prometheus Financial Advisory Ltd.

Signed on December 1, 2019

By Gideon Peltz