May 20, 2015

Quarterly report for period ended March 31, 2015

- **Update to Chapter A (Description of Company Operations) of the Periodic Report for 2014**
- **Directors' Report on the State of the Company's Affairs for the period ended March 31, 2015**
- **Interim Financial Statements as at March 31, 2015**

bezeq

Update to Chapter A
(Description of Company Operations)
of the Periodic Report for 2014

bezeq

Update to Chapter A (Description of Company Operations) [1]
to the Periodic Report for 2014 ("Periodic Report")
of "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company")

1. General development of the Group's business

Section 1.3.3 - Dividend distribution

For information about a dividend distribution in the amount of NIS 844 million in respect of profits from the second half of 2014 that was approved by a general meeting of the Company's shareholders on May 6, 2015, see Note 6.2 to the Company's Financial Statements for the period ended March 31, 2015.

Outstanding, distributable profits at the reporting date - NIS 463 million[2] (surpluses accumulated over the last two years, after subtracting previous distributions, and excluding the Special Distribution).

Section 1.4.4 - Main results and operational data

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

	Q1 2015	Q4 2014	Q3 2014	Q2 2014	Q1 2014
Revenues (NIS million)	1,113	1,086	1,081	1,073	1,077
Operating profit (NIS million)	547	507	498	471	504
Depreciation and amortization (NIS million)	176	170	178	172	168
EBITDA (Operating profit before depreciation and amortization) (NIS million)(1)	723	677	676	643	672
Net profit (NIS million)	367	345	324	314	332
Cash flow from current operations (NIS million)	548	499	599	545	616
Payments for investments in property, plant & equipment and intangible assets (NIS million)	231	195	210	207	210
Proceeds from the sale of property, plant & equipment and intangible assets (NIS million)	12	82	69	42	28
Free cash flow (NIS million) (2)	329	386	458	380	434
Number of active subscriber lines at the end of the period (in thousands)(3)	2,208	2,205	2,205	2,205	2,214
Average monthly revenue per line (NIS) (ARPL)(4)	61	62	63	63	64
Number of outgoing minutes (in millions)	1,459	1,482	1,588	1,522	1,608
Number of incoming minutes (in millions)	1,428	1,440	1,498	1,424	1,467
Number of active subscriber lines at the end of the period (in thousands)(7)	1,390	1,364	1,335	1,308	1,289
Number of active subscriber lines at the end of the period (in thousands) – wholesale (7)	11	-	-	-	-
Average monthly revenue per Internet subscriber (NIS) - retail	87	85	85	84	82
Average bundle speed per Internet subscriber (Mbps)(5)	33.2	32.5	24.0	21.9	20.0
Churn rate (6)	2.4%	2.5%	2.8%	2.8%	3.0%

[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 2014 and refers to the section numbers in Chapter A (Description of Company Operations) in the said periodic report.

[2] Including revaluation profits in the amount of NIS 12 million due to increased control of DBS. In accordance with a resolution passed by the Company's Board of Directors' on February 10, 2015, these revaluation profits will be excluded from the dividend distribution policy and will not be distributed as a dividend.

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

(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 communication, internet services, services to communications operators and contractor and other works. Calculated according to average lines for the period.

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

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

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

B. Pelephone

	Q1 2015	Q4 2014	Q3 2014	Q2 2014	Q1 2014
Revenue from services (NIS million)	499	584	610	622	637
Revenues from sale of terminal equipment (NIS million)	228	251	214	221	280
Total revenue (NIS million)	727	835	824	843	917
Operating profit (NIS million)	32	74	122	127	126
Depreciation and amortization (NIS million)	104	111	108	105	106
EBITDA (Operating profit before depreciation and amortization) (NIS million)(1)	136	184	231	232	232
Net profit (NIS million)	36	59	100	106	108
Cash flow from current operations (NIS million)	351	158	286	420	349
Payments for investments in property, plant and equipment and intangible assets (NIS million)	72	80	83	85	73
Free cash flow (NIS million) (1)	279	78	203	335	276
Number of subscribers at end of the period (thousands) (2)	2,565	2,586	2,600	2,610	2,631
Average monthly revenue per subscriber (NIS) (ARPU) (3)	65	75	78	79	80
Churn rate (4)	6.5%	5.6%	7.3%	6.5%	7.5%

(1) Regarding the definition of EBITDA (Operating profit before depreciation and amortization) 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 one call / sent one SMS, performed no surfing activity on his phone or has not paid for Pelephone services. It is noted that a customer may have more than one subscriber number ("line").

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

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

C. Bezeq International

	Q1 2015	Q4 2014	Q3 2014	Q2 2014	Q1 2014
Revenues (NIS million)	393	398	385	366	355
Operating profit (NIS million)	61	57	59	58	58
Depreciation and amortization (NIS million)	32	33	32	33	32
Operating profit before depreciation and amortization (EBITDA) (NIS million)(1)	93	90	92	90	90
Net profit (NIS million)	44	39	42	41	42
Cash flow from current operations (NIS million)	62	71	71	95	74
Payments for investments in property, plant and equipment and intangible assets (NIS million) (2)	53	28	27	23	31
Free cash flow (NIS million) (1)	9	43	44	72	43
Churn rate (3)	4.1%	4.7%	4.5%	3.7%	4.0%

(1) Regarding the definition of EBITDA (Operating profit before depreciation and amortization) and cash flows, see comments (1) and (2) in the Bezeq Fixed Line table.

(2) The item also includes long term 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.

D. DBS

	Q1 2015	Q4 2014	Q3 2014	Q2 2014	Q1 2014
Revenues (NIS million)	440	440	428	432	424
Operating profit (NIS million)	59	57	67	76	73
Depreciation and amortization (NIS million)	76	78	74	75	70
Operating profit before depreciation and amortization (EBITDA) (NIS million)(1)	135	135	141	151	143
Net profit (loss) (NIS million)	(3)	(87)	(115)	(86)	(34)
Cash flow from current operations (NIS million)	149	122	106	101	113
Payments for investments in property, plant and equipment and intangible assets (NIS million)	65	94	68	64	78
Free cash flow (NIS million) (1)	84	27	38	38	35
Number of subscribers (at the end of the period, in thousands) (2)	634	632	613	623	607
Average monthly revenues per subscriber (ARPU) (NIS)(3)	232	234	234	233	234
Churn rate (4)	3.3%	2.9%	3.1%	3.2%	3.6%

(1) Regarding the definition of EBITDA (Operating profit before depreciation and amortization) and cash flows, see comments (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 1.6 - General environment and the influence of external factors on the Group's activity

Section 1.6.3 - Regulatory oversight and changes in the regulatory environment - wholesale market

As noted, on March 25, 2015, HCJ ruled that the Company and the State should hold a roundtable discussion, as a form of post hearing, to examine the Company's arguments (professional and technical arguments, including technical issues which the Company claims are impossible to implement) with the purpose of clarifying such issues wherever possible and making the necessary amendments, and after which the Company and the State must submit notice to the Court within 60 days. The Company and the Ministry of Communications therefore held discussions on the subject of the possible implementation of the wholesale telephony service and issues pertaining to the economic pricing model.

On April 20, 2015, the Company received a letter from the Director General of the Ministry of Communications on the subject of providing wholesale telephony service. According to the letter, further to the meetings between the Ministry and the Company pursuant to the above-mentioned HCJ ruling, it transpires that the Ministry is of the opinion that provision of the wholesale services on the Bezeq network is technically feasible, with slight adjustments, within a short period and at negligible cost. The letter also states that the Ministry believes there are several possible technological solutions to providing the service in accordance with the service portfolio on time, and the letter includes a summary of three of these solutions. The Ministry therefore expects Bezeq to prepare for providing the service on the scheduled date (May 17, 2015). To this end, by April 27, 2015 the Company was required to submit documents to the Ministry describing the computerized interface for this service, and the letter also stipulates that insofar as Bezeq fails to submit these documents on time, the Ministry will take the view that Bezeq has no intention of providing the wholesale telephony service in accordance with its license, and it will take every available course of action (a copy of the letter sent by the Director General of the Ministry of Communications is attached to the Company's immediate report dated April 20, 2015, included in this report by way of reference). On April 26, 2015, the Company submitted its comments on this letter, completely rejecting the allegation that it had used the argument of the unfeasibility of the implementation to avoid providing the telephony services, and that the "technological solutions" presented in the Ministry's letter do not resolve the problem of unfeasibility and make it impossible to provide wholesale telephony services on the Company's existing network; nor are they consistent with the format for providing the services as defined in the service portfolio (in this context, the Company even suggested appointing an independent expert to examine the feasibility of the options put forward by the Ministry of Communications). Furthermore, the Company noted that the documents relating to the computerized interface for the service cannot be prepared as long as the service itself is impossible to implement (or even, taking the Ministry's position, until the format for the service has been defined and, according to the Ministry, for which several options may be possible).

On May 7, 2015, the Minister of Communications, Minister of Finance and Ministry of Communications submitted an updated notice on the Company's aforementioned petition, whereby, after the Ministry of Communications held meetings with the Company subsequent to the HCJ decision, the Ministry concluded that the provision of wholesale telephony services by the Company was technically feasible and that had the Company made preparations in advance, there would have been no technical impediment to opening the wholesale market in this field on the scheduled date, May 17, 2015. As for the economic issues, the notice stated that the Ministry of Communications had concluded that the Company's arguments as to the unreasonableness of the tariffs are unacceptable. Nevertheless, after re-examining the Company's arguments, it had reached the conclusion that there was room to make certain changes in matters concerning the demand for data usage and requirements concerning the quality of the service as defined in the service portfolio (which the Ministry believes do not affect the tariffs), including the Ministry's intention to publish a preliminary hearing for the entire market and not to enforce requirements concerning the quality of the service at this stage. The notice included engineering and economic opinions prepared by the Ministry's experts. The Company rejects the findings in the updated notice and it intends to file its response over the next few days.

Until May 16, 2015, customers were transferred from a retail subscription to a wholesale subscription (wholesale BSA service) via a non-automated process (a manual process that requires the intervention of Company employees). Notably, the Ministry of Communications and some of the communications operators have complaints regarding the Company's work capacity at this stage. As of May 17, 2015, the transfer is made by means of an automated process that does not require human intervention

On May 11, 2015, the Company received notice from the Ministry of Communications of its intention to impose a monetary sanction in connection with the implementation of the broadband reform (the "Notice"), whereby, as detailed in the supervisory report attached to the Notice, the Ministry found that the Company was not in compliance with the directives prescribed in the service portfolio and that such course of conduct amounted to a violation under Item (5) of Section D of the Addendum to the Communications Law (Telecommunications and Broadcasting), 1982. The Ministry therefore intends to impose on the Company a monetary sanction of NIS 11,343,800, which is the maximum amount prescribed by the law. According to the Notice, the Ministry believes that the Company's conduct since the launching of the reform amounted, at the very least, to a violation of the provisions of the service portfolio in the following matters:

1. The Company conducted customer retention calls prior to completing the transition (to wholesale);
2. The Company did not enable implementation of a verbal transition process during the interim period until the establishment of an automated interface;
3. The Company did not comply with the timeframe prescribed for transferring an infrastructure subscriber from the Company to a service provider, and for transferring a subscriber between suppliers on the Company's infrastructure
4. The Company operated the service provider call center in a limited scope compared with the other centers, thereby discriminating between the different types of subscribers.

The explanations provided in the Notice stated, among other reasons, that the violation made it difficult to create competition in the market, assisted the Company in maintaining its monopolistic market share and the resulting high revenues, and that the Company's conduct could harm and even prevent an important and significant reform in the Israeli communications market, which was designed to ensure the public's interest, consumers' welfare and competition in various markets, including in the Internet and telephony sectors, and in the future in the commercial broadcasting and other sectors.

The Company rejects the Notice and intends to submit its counter arguments within the prescribed thirty-day period, inter alia, in light of the Company's complaints regarding the Ministry's unreasonable course of conduct and the updating of the service portfolio in excess of its authority, while disregarding the complexity of the non-automated processes and the time frame prescribed for them.

Section 1.6.4 - Regulatory oversight and changes in the regulatory environment - additional topics

Sub-section F - Enforcement and monetary penalties - the Ministry of Communications has recently made extensive use of the oversight powers and has issued notice of its intention to impose monetary sanctions on the Company regarding on-going regulatory matters as well as matters pertaining to implementation of the wholesale market. The Company submits its comments on these oversight reports and notice of the imposition of such penalties to the Ministry.

2. Bezeq ("the Company") - Domestic fixed-line communications

Section 2.7.4 – Real estate

Sub-section A - concerning the Company's right to receive a site in Sakia, further to the Company's talks with the planning authorities vis-a-vis exercising the Company's rights under the planning authorization contract between the Company and ILA - in April 2015, a detailed outline plan was submitted to the Regional Planning Committee and published for objections, which determined the purposes, uses, building rights and construction provisions for the zoning in the plan.

Section 2.11 – Working capital

See Section 1.3 of the Board of Directors' Report for information about the Company's working capital.

At March 31, 2015, the Company has a working capital surplus in the amount of NIS 80 million (this figure refers to the Company's separate financial statements. In the Company's consolidated financial statements as at March 31, 2015, there is a working capital surplus in the amount of NIS 684 million).

Section 2.13 - Financing

On April 2, 2015 and on May 6, 2015, the Company entered into agreements with banking institutions in which context the banks undertook to provide the Company with credit in 2016 to recycle future debt, in the aggregate amount of NIS 900 million. The undertaking is to provide credit to the Company in June 2016 with an average duration of 4.6 years (repayment in five, equal annual installments as of June 1, 2019 until June 1, 2023), at an aggregate interest rate of 3.7% (fixed, shekel non-linked interest). The terms of the undertakings and the loans to be provided thereunder, include terms that are similar to those given in relation to other loans provided to the Company, as detailed in Part C, Note 11.2.1 of the 2014 Periodic Report. These conditions include: an undertaking to refrain from creating additional liens over the Company's assets (under certain restrictions); an undertaking whereby, in the event the Company assumes an undertaking towards a particular party in connection with meeting financial covenants, the Company shall also assume an identical undertaking with respect to this credit (subject to certain exceptions), and also accepted terms for immediate repayment (such as breach events, insolvency, liquidation or receivership and so forth), and cross default (with certain restrictions), that will also apply, mutatis mutandis, with respect to the period of the undertaking to provide credit.

On April 21, 2015, Maalot affirmed a rating of ilAA/Stable for the Company. On this, see also Section 5 in the Directors' Report.

Section 2.15.3 – Permits

Concerning high-voltage facilities - at the date of this report, radiation permits for 27 HV facilities have been received. Two additional facilities are still in the process of obtaining such permits.

Section 2.16.8 – Antitrust Laws

Concerning sub-section G - negotiations with the Antitrust Commissioner whereby the Company abused its position as a monopoly and determined unfair purchase and sale prices of a service in a monopoly in a sales promotion campaign - on March 31, 2015, the Company appealed the decision to the Antitrust Court, and submitted the opinion and affidavit of an economic expert, in which the Company asked that the court instruct that the determination is nullified, and alternatively for its repeal. In this appeal, the Company also argued that there had been no negative margin, that the decision had ignored various tests of negative margin and margin squeeze, that under the circumstances there was no concern of harm to competition, that in practice competition had not been adversely affected and that there had been no breach of relevant sections of the Antitrust Law. The Company also pointed out that the Authority had been in breach of administrative obligations while formulating the decision and by its very publication, which should also lead to cancelling the decision.

Section 2.18 – Legal proceedings

Concerning sub-section J on an application to certify a claim as a derivative claim in the matter of a Company transaction for acquisition of all the holdings and shareholders' loans of Eurocom DBS in DBS - on April 2, 2015 an additional application was filed in the Tel Aviv District Court (Economics Department) to certify a derivative claim in the same matter by a private shareholder who owns 30 shares of the Company and a company under his full ownership that holds 1000 Company shares ("the Applicants"), against the Company and against Eurocom DBS and Shaul Elovitch (Chairman of the Company's Board of Directors and an indirect controlling shareholder of the Company and Eurocom), against members of the Company's Board of Directors who approved the transaction, against three other Company directors, as claimed, for their influence over the resolutions passed by the sub-committee of the Company's Board of Directors, and against Bank of America -Merrill Lynch for its professional liability and alleged negligence in estimation of the purchase price ("the Respondents"). The Applicants request, inter alia, that the court approve the filing of a derivative claim in the Company's name, in which Eurocom DBS and Shaul Elovitch will be required to return a total of NIS 518 million, which in the opinion of the Applicants and their economic expert, constitutes the "unfair surplus consideration" paid for acquiring the outstanding shares of Eurocom DBS, to determine the liability of the respondent directors and the liability of the Bank of America Merrill Lynch for contracting in the transaction, and to obligate them to pay the entire amount up to a total of NIS 518 million which shall not be returned to the Company's coffers, as noted above, or alternatively to obligate all the Respondents for payment of NIS 477 million which is the price obtained, according to the Applicants, on the assumption of credit of only 70% of the value of the synergies in favor of DBS (instead of 100%). It should be noted that the transaction to acquire the entire holdings of Eurocom DBS in DBS is still to be completed.

3. Mobile radio-telephone (cellular telephony) - Pelephone Communications Ltd. ("Pelephone")

Section 3.6.2 C - Infrastructure sharing

On March 24, 2015, the Antitrust Commissioner informed Pelephone and Cellcom that from its perspective, there is no impediment to their carrying out preparatory action to enter into agreement concerning the object of the exemption application: to formulate a list of potential bidders to provide the services and prepare a procedure to review the feasibility of passive infrastructure sharing, prior to the granting of the exemption required for the agreement.

On March 29, 2015, the Minister of Communications announced that the infrastructure sharing agreements between Cellcom and Golan Telecom must be changed significantly before the Ministry of Communications will begin to review the details. As far as Pelephone is aware, the companies are studying the repercussions of the required changes and are taking action to apply these changes in order to obtain the Minister's approval of the agreements.

On April 20, 2015, Partner and Hot Mobile announced that the Minister of Communications had approved the network sharing agreement between them. To the best of Pelephone's knowledge, the cellular network shared by the companies will operate through a joint venture of these two companies ("the Joint Venture"). The Joint Venture's entire operation is subject to obtaining a communications license for the venture and to the allocation of frequency bands in the 1800 MHz spectrum that Partner and Hot Mobile won as part of the 4G frequency tender.

Section 3.12.5 - Credit rating

On April 21, 2015, Maalot affirmed a rating of ilAA/Stable for the Company and a rating of ilAA for Debentures (Series C) of Pelephone.

Section 3.17 – Legal proceedings

In May 2015, an action was filed against Pelephone in the Tel Aviv District Court together with an application for its certification as a class action, on grounds that Pelephone had discriminated against customers who contracted with it by not providing them with the lowest price that is offered for such services; and that it discriminated against its new customers over existing customers who were awarded monetary benefits for joining Pelephone. This was allegedly contrary to Pelephone's obligation, as provided in its license and by law, to refrain from discriminatory practices with respect to the prices of the services it offers. Notably, in 2013, a claim was filed against Pelephone on similar grounds, and such claim is still pending in court (see Section 3.17.1(E) in Chapter A of the 2014 Periodic Report). The applicant seeks for Pelephone to reimburse the members of the class group for the difference between the price they paid for the services and the lowest price customers such as themselves could have paid for the same services. Additionally, the applicant asked the court to require Pelephone to offer all customers identical terms and to display them in its various advertisements. The applicant estimates the action at millions of shekels and even more.

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

Section 4.13.2 D - NEP license

On April 27, 2015, the Ministry of Communications extended the NEP license that had been granted to Bezeq International, until July 31, 2015.

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

Section 5.15.3 - Institutional financing

In April 2015, DBS issued additional Debentures (Series 2), by way of an expansion of the series, in the total amount of NIS 198 million.

May 20, 2015	
Date	Bezeq - The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Shaul Elovitch, Chairman of the Board of Directors

Stella Handler, Chief Executive Officer