

PARTNER COMMUNICATIONS CO LTD
Form 20-F
March 29, 2018

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
ANNUAL REPORT
FILED PURSUANT TO SECTION 12, 13 or 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

As filed with the Securities and Exchange Commission on March 29, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2017

OR

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

For the transition period from _____ to _____

OR

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

Date of event requiring this shell company report _____

Commission file number 1-14968

PARTNER COMMUNICATIONS COMPANY LTD.
(Exact Name of Registrant as Specified in its Charter)

ISRAEL
(Jurisdiction of Incorporation or Organization)

8 AMAL STREET
AFEQ INDUSTRIAL PARK
ROSH-HA'AYIN 48103
ISRAEL

(Address of Principal Executive Offices)

Hadar Vismunski-Weinberg
ExecutiveOffices@partner.co.il

(Name, Telephone, E-mail and/or facsimile Number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing one ordinary share, nominal value NIS 0.01 per share	The NASDAQ Global Select Market
Ordinary Shares, nominal value NIS 0.01 per share*	The NASDAQ Global Select Market

* Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities Registered Pursuant to Section 12(g) of the Act:

NONE

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

NONE

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

ORDINARY SHARES OF NIS 0.01 EACH 168,243,913

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

YES NO

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

YES NO

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

YES NO

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

YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

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

ITEM 17

ITEM 18

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

YES

NO

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INTRODUCTION

As used herein, references to “we,” “our,” “us,” the “Group,” “Partner” or the “Company” are references to Partner Communications Company Ltd. and its wholly-owned subsidiaries, Partner Future Communications 2000 Ltd., Partner Land-Line Communications Solutions LP, Partner Business Communications Solutions LP, Partner Communication Products 2016 LP, 012 Smile Telecom Ltd. (“012 Smile”) and 012 Smile's wholly-owned subsidiary, 012 Telecom Ltd., except as the context otherwise requires. Partner Future Communications 2000 Ltd. serves as the general partner and the Company serves as the limited partner of each of the limited partnerships.

Pursuant to a 15-year Network Sharing Agreement that the Company entered into with HOT Mobile Ltd. (“HOT Mobile”) in November 2013, the parties created a 50-50 limited partnership, P.H.I. Networks (2015) Limited Partnership (“PHI”). See “Item 4B.8 OUR NETWORK ”.

In the context of cellular services, references to “our network” refer to Partner's cellular telecommunications network which includes our core network, as well as the shared radio access network with HOT Mobile which is operated by PHI and any other Company infrastructure which enables our cellular service.

In addition, references to our “financial statements” are to our consolidated financial statements, unless the context requires otherwise.

The Company currently provides telecommunications services in the following two segments: (1) cellular telecommunications services (“Cellular Services”) and (2) fixed-line communication services (“Fixed-Line Services”), which include: (a) Internet services including access to the internet through both fiber optics and wholesale broadband access; internet services provider (“ISP”) services; internet Value Added Services (“VAS”) such as cyber protection, anti-virus and anti-spam filtering; and fixed-line voice communication services provided through Voice Over Broadband (“VOB”); (b) Business solutions including SIP voice trunks and Network Termination Point Services (“NTP”) – under which the Group supplies, installs, operates and maintains endpoint network equipment and solutions, including providing and installing equipment and cabling, within a subscriber's place of business or premises, hosting services, transmission services, Primary Rate Interface (“PRI”) and other fixed-line communications solution services; (c) International Long Distance services (“ILD”): outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services; and, as from 2017, (d) Television services over the Internet (“TV”). Sales of equipment include sales and leasing of telecommunications, audio visual and related devices including cellular handsets, phones, tablets, laptops, modems, data cards, domestic routers, servers, audio-visual devices and related peripherals, equipment and integration projects. Unless the context indicates otherwise, expressions such as “our business,” “Partner’s business” and “the Company’s business” or “industry” refer to both Cellular and Fixed-Line Services.

In this document, references to “\$,” “US\$,” “US dollars,” “USD” and “dollars” are to United States dollars, and references to “NIS” and “shekels” are to New Israeli Shekels. We maintain our financial books and records in shekels. This annual report contains translations of NIS amounts into US dollars at specified rates solely for the convenience of the reader. No representation is made that the amounts referred to in this annual report as convenience translations could have been or could be converted from NIS into US dollars at these rates, at any particular rate or at all. The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the exchange rate on December 31, 2017, of NIS 3.467 = US\$1.00 as published by the Bank of Israel, unless otherwise specified. See “Item 3A. Key Information – Selected Financial Data – Exchange Rate Data”.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

Our financial statements included in this annual report are prepared in accordance with International Financial Reporting Standards (“IFRS”) published by the International Accounting Standards Board (“IASB”). See “Item 18. Financial Statements” and “Item 5A. Operating and Financial Review and Prospects – Operating Results”.

FORWARD-LOOKING STATEMENTS

This annual report includes forward-looking statements within the meaning of Section 27A of the US Securities Act of 1933, as amended, Section 21E of the US Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the US Private Securities Litigation Reform Act of 1995. Words such as “believe,” “anticipate,” “expect,” “intend,” “seek,” “will,” “plan,” “could,” “may,” “project,” “goal,” “target” and similar expressions often identify forward-looking statements but are not the only way we identify these statements. All statements other than statements of historical fact included in this annual report, including the statements in the sections of this annual report entitled “Item 3D. Key Information – Risk Factors,” “Item 4. Information on the Company” and “Item 5. Operating and Financial Review and Prospects” and elsewhere in this annual report regarding our future performance, revenues or margins, market share or reduction of expenses, regulatory developments, and any statements regarding other future events or our future prospects, are forward-looking statements.

We have based these forward-looking statements on our current knowledge and our present beliefs and expectations regarding possible future events. These forward-looking statements are subject to risks, uncertainties and assumptions about Partner, consumer habits and preferences in cellular and fixed-line telephone usage, trends in the Israeli telecommunications industry in general, the impact of current global economic conditions and possible regulatory and legal developments. For a description of some of the risks see “Item 3D Risk Factors,” “Item 4 Information On The Company”, “Item 5 Operating And Financial Review And Prospects,” “Item 8A.1 Legal And Administrative Proceedings” and “Item 11 Quantitative And Qualitative Disclosures About Market Risk”. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this annual report might not occur, and actual results may differ materially from the results anticipated. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

3A. Selected Financial Data

Our consolidated financial statements for the years ended December 31, 2013, 2014, 2015, 2016 and 2017, have been prepared in accordance with the International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The tables below at and for the years ended December 31, 2013, 2014, 2015, 2016 and 2017, set forth selected consolidated financial data under IFRS. The selected financial information is derived from our consolidated financial statements, which have been audited by Kesselman & Kesselman, our independent registered public accounting firm in Israel and a member of PricewaterhouseCoopers International Limited. The audited consolidated financial statements at December 31, 2016 and 2017 and for the years ended December 31, 2015, 2016 and 2017, appear at the end of this report.

	Year ended December 31,					2017*
	2013	2014	2015	2016	2017*	2017*
	New Israeli Shekels in millions (except per share data)					US\$ in millions(1)
Consolidated Statement of Income Data						
Revenues, net	4,519	4,400	4,111	3,544	3,268	943
Cost of revenues	3,510	3,419	3,472	2,924	2,627	758
Gross profit	1,009	981	639	620	641	185
Selling and marketing expenses	462	438	417	426	269	78
General and administrative expenses	217	193	223	263	196	56
Income with respect to Settlement agreement with Orange	-	-	61	217	108	31
Other income, net	79	50	47	45	31	9
Operating profit	409	400	107	193	315	91
Finance income	29	3	13	13	4	1
Finance expenses	240	162	156	118	184	53
Finance costs, net	211	159	143	105	180	52
Profit (loss) before income tax	198	241	(36)	88	135	39

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Income tax expenses	63	79	4	36	21	6
Profit (loss) for the year	135	162	(40)	52	114	33
Earnings (loss) per ordinary share and per ADS						
Basic:	0.87	1.04	(0.26)	0.33	0.70	0.20
Diluted:	0.86	1.04	(0.26)	0.33	0.69	0.20
Weighted average number of shares outstanding (in thousands)						
Basic:	155,687	155,802	156,081	156,268	162,733	162,733
Diluted (for calculation above):	156,199	156,400	156,081	158,096	164,537	164,537

(*) The results at and for the year ended December 31, 2017, include the impact of the adoption of IFRS 15 with effect as of January 1, 2017. See "Item 5A.1j Early adoption of IFRS 15 Revenue from Contracts with Customers – change in accounting policy".

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	Year ended December 31,					2017*
	2013	2014	2015	2016	2017*	2017*
	New Israeli Shekels in millions (except per share data)					US\$ in millions (1)
Other Financial Data						
Capital expenditures (2)	413	434	271	202	417	120
Adjusted EBITDA (3)	1,114	1,096	876	834	917	264
Statement of Cash Flow Data						
Net cash provided by operating activities	1,539	951	922	945	973	280
Net cash used in investing activities	(498)	(431)	(356)	(639)	(72)	(20)
Net cash used in financing activities	(1,108)	(338)	(303)	(516)	(750)	(217)
Balance Sheet Data (at year end)						
Current assets	1,703	1,817	2,185	2,339	2,009	579
Non current assets	3,784	3,679	3,341	2,858	2,709	782
Property and equipment	1,791	1,661	1,414	1,207	1,180	340
License and other intangible assets	1,167	1,079	956	793	697	201
Goodwill	407	407	407	407	407	117
Deferred income tax asset	12	14	49	41	55	17
Total assets	5,487	5,496	5,526	5,197	4,718	1,361
Current liabilities (4)	1,374	1,385	1,765	1,607	1,811	522
Long-term liabilities (4)	3,239	3,072	2,741	2,479	1,473	425
Total liabilities	4,613	4,457	4,506	4,086	3,284	947
Shareholders' equity	874	1,039	1,020	1,111	1,434	414
Total liabilities and shareholders' equity	5,487	5,496	5,526	5,197	4,718	1,361

(*) The results at and for the year ended December 31, 2017, include the impact of the adoption of IFRS 15 with effect as of January 1, 2017. See "Item 5A.1j Early adoption of IFRS 15 Revenue from Contracts with Customers – change in accounting policy".

The NIS figures at December 31, 2017, and for the period then ended have been translated throughout this annual report into dollars using the representative exchange rate of the dollar at December 31, 2017 (USD 1 = NIS 3.467).

- (1) The translation was made solely for convenience, is supplementary information, and is distinguished from the financial statements. The translated dollar figures should not be construed as a representation that the Israeli currency amounts actually represent, or could be converted into, dollars. See also “Item 3A. Key Information – Selected Financial Data – Exchange Rate Data”.

- (2) Capital Expenditures represent additions to property and equipment (see note 10 to our consolidated financial statements) and intangible assets (see note 11 to our consolidated financial statements).

Adjusted EBITDA as reviewed by the CODM represents Earnings Before Interest (finance costs, net), Taxes, Depreciation and Amortization (including amortization of intangible assets, deferred expenses-right of use and impairment charges) and Other expenses (mainly amortization of share based compensation). Adjusted EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. Adjusted EBITDA may not be indicative of the Group's historic operating results nor is it meant to be predictive of potential future results. The usage of the term "Adjusted EBITDA" is to highlight the fact that the Amortization includes amortization of deferred expenses – right of use and amortization of employee share based compensation and impairment charges; it is fully comparable to EBITDA information which has been previously provided for prior periods.

- (4) See note 15 to the consolidated financial statements for information regarding long-term liabilities and current maturities of long-term borrowings and notes payable.

The tables below at and for the years ended December 31, 2013, 2014, 2015, 2016 and 2017, set forth a reconciliation between Profit (Loss) and Adjusted EBITDA.

	Year ended December 31,					
	2013	2014	2015	2016	2017*	2017*
	New Israeli Shekels in millions					US\$ in millions
						(1)
Reconciliation Between Profit (Loss) and Adjusted EBITDA						
Profit (Loss)	135	162	(40)	52	114	33
Depreciation and amortization expenses	700	689	753	595	580	168
Finance costs, net	211	159	143	105	180	52
Income tax expenses	63	79	4	36	21	6
Other (**)	5	7	16	46	22	5
Adjusted EBITDA (2)	1,114	1,096	876	834	917	264

The results at and for the year ended December 31, 2017, include the impact of the adoption of IFRS 15 with effect (*) as of January 1, 2017. See "Item 5A.1j Early adoption of IFRS 15 Revenue from Contracts with Customers – change in accounting policy".

(**) Mainly amortization of employee share based compensation.

The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the (1) exchange rate on December 31, 2017, of NIS 3.467 = US\$1.00 as published by the Bank of Israel, unless otherwise specified. See "Item 3A. Key Information – Selected Financial Data – Exchange Rate Data".

(2) Adjusted EBITDA as reviewed by the CODM represents Earnings Before Interest (finance costs, net), Taxes, Depreciation and Amortization (including amortization of intangible assets, deferred expenses-right of use and impairment charges) and Other expenses (mainly amortization of share based compensation). Adjusted EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. Adjusted EBITDA may not be indicative of the Group's historic operating results nor is it meant to be predictive of potential future results. The usage of the term "Adjusted EBITDA" is to highlight the fact that the Amortization includes amortization of deferred expenses – right of use and amortization of employee share based

compensation and impairment charges; it is fully comparable to EBITDA information which has been previously provided for prior periods.

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At December 31,
2015 2016 2017

Cellular Industry Data

Estimated population of Israel (in millions) (1)	8.5	8.6	8.8
Estimated Israeli cellular telephone subscribers (in millions) (2)	10.5	10.3	10.4
Estimated Israeli cellular telephone penetration (3)	124 %	120 %	120 %

	Year ended December 31,				
	2013	2014	2015	2016	2017
Partner Data					
Cellular subscribers (000's) (at period end) (4)	2,956	2,837	2,718	2,686	2,674
Pre-paid cellular subscribers (000's) (at period end) (4)	823	705	562	445	354
Post-paid cellular subscribers (000's) (at period end) (4)	2,133	2,132	2,156	2,241	2,320
Share of total Israeli cellular subscribers (at period end) (5)	29 %	28 %	27 %	26 %	25 %
Average monthly revenue per cellular subscriber including roaming ("ARPU") (NIS) (6)	83	75	69	65	62
Churn rate for cellular subscribers (7)	39 %	47 %	46 %	40 %	38 %
Number of TV households (000's) (at period end) (8)					43
Estimated cellular coverage of Israeli population (at period end) (9)	99 %	99 %	99 %	99 %	99 %
Number of employees (full time equivalent) (at period end) (10)	4,045	3,575	2,882	2,686	2,797

(1) The population estimates are as published by the Central Bureau of Statistics in Israel as of December 31, 2017.

We have estimated the total number of Israeli cellular telephone subscribers based on Partner subscriber data as (2) well as information contained in published reports and public statements issued by operators and data regarding the number of subscribers porting between operators.

(3) Total number of estimated Israeli cellular telephone subscribers expressed as a percentage of the estimated population of Israel. The total number of estimated cellular telephone subscribers includes dormant subscribers as well as other subscribers who are not included in the Israeli population figures, such as Palestinians, visitors, and foreign workers.

(4) In accordance with general practice in the cellular telephone industry, we use the term “subscriber”, unless the context otherwise requires, to indicate a telephone or a data or video device, rather than either a bill-paying network customer, who may have a number of telephones connected to the network, or a cellular telephone user who may share a single telephone with a number of other users. “Subscriber” includes our pre-paid customers. A pre-paid subscriber is recognized as such only following the actual use of his pre-paid SIM card and only once they have generated revenues in the amount of at least one shekel (excluding VAT).

References to the number of subscribers are stated net of subscribers who leave or are disconnected from the network, or who have not generated revenue for the Company for a period of over six consecutive months ending at a reporting date.

(5) Total number of Partner subscribers expressed as a percentage of the estimated total number of Israeli cellular subscribers.

(6) We have calculated our average monthly revenue per cellular subscriber by (i) dividing, for each month in the relevant year, the total cellular segment service revenues during the month by the average number of our cellular subscribers during that month, and (ii) dividing the sum of all such results by the number of months in the relevant period.

(7) We define the “churn rate” as the total number of cellular subscribers who disconnect from our network, either involuntarily or voluntarily, in a given period expressed as a percentage of the average of the number of our subscribers at the beginning and end of such period. Our churn rate includes subscribers who have not generated revenue for us for a period of the last six consecutive months ending at a reporting date. This includes cellular subscribers who have generated minute revenues only from incoming calls directed to their voice mail. Involuntary churn includes disconnections due to non-payment of bills or suspected fraudulent use, and voluntary churn includes disconnections due to subscribers terminating their use of our services.

(8) Number of active TV households. The Company launched its TV services in 2017.

(9) We measure cellular coverage using computerized models of our network, radio propagation characteristics and topographic information to predict signal levels at two meters above ground level in areas where we operate a network site. According to these coverage results, we estimate the population serviced by our network and divide this by the estimated total population of Israel. Population estimates are published by the Central Bureau of Statistics in Israel.

(10) A full-time employee is contracted to work a standard 186 hours per month. Part-time employees are converted to full-time equivalents by dividing their contracted hours per month by the full-time standard. The result is added to the number of full-time employees to determine the number of employees on a full-time equivalent basis.

Exchange Rate Data

The following table sets forth, for the years indicated, exchange rates between the shekel and the US dollar, expressed as shekels per US dollar and based upon the daily representative rate of exchange on the last day of each year as published by the Bank of Israel.

	Year ended December 31,				
	2013	2014	2015	2016	2017
Average (1)	3.609	3.577	3.884	3.841	3.600
High	3.791	3.994	4.053	3.983	3.860
Low	3.471	3.402	3.761	3.746	3.467
End of period	3.471	3.889	3.902	3.845	3.467

(1) Calculated based on the average of the daily exchange rates during the relevant period.

	September	October	November	December	January	February	March
	2017	2017	2017	2017	2018	2018	2018
High	3.584	3.542	3.544	3.550	3.460	3.535	3.495
Low	3.504	3.491	3.499	3.467	3.388	3.427	3.431

On December 31, 2017, the exchange rate was NIS 3.467 per US\$1.00 as published by the Bank of Israel. Changes in the exchange rate between the shekel and the US dollar could materially affect our financial results.

3B. Capitalization and Indebtedness

Not applicable.

3C. Reasons for the Offer and Use of Proceeds

Not applicable.

3D. Risk Factors

You should carefully consider the risks described below and the other information in this annual report. Depending on the extent to which any of the following risks materializes, our business, financial condition, cash flow or results of operations could suffer, and the market price of our shares may be negatively affected. The risks below are not the only ones we face, and other risks currently not affecting our business or industry, or which are currently deemed insignificant, may arise.

3D.1 RISKS RELATING TO THE REGULATION OF OUR INDUSTRY

We operate in a highly regulated telecommunications market in which the regulator imposes substantial limitations on our flexibility in managing our business and continues to seek to increase industry competition. At the same time, the regulator limits our ability to compete by, among other measures, giving preference to new competitors, and limits our ability to expand our business and develop our network. Such measures may continue to increase our costs, decrease our revenues and adversely affect our business and results of operations.

3D.1a If the Ministry of Communications fails to enforce its fixed-line wholesale market reforms on Bezeq and HOT Telecom, or if it fails to prevent Bezeq or HOT Telecom from lowering their retail prices for fixed-line services and thereby narrowing our margin in these services, our business and results of operations may be materially adversely affected.

In the past, the Ministry of Communications (the "MoC") has failed to enforce its fixed-line wholesale market reforms ("Wholesale Market Reform") on Bezeq-The Israel Telecommunication Corp., Ltd. ("Bezeq") and HOT Telecom LP ("HOT Telecom"), the two largest wireline infrastructure operators in Israel. See "Item 3D.2f Competition resulting from the full service offers by telecommunications groups and additional entrants into the mobile telecommunications market, as well as other actual and potential changes in the competitive environment and communications technologies, may continue to cause a further decrease in tariffs, an increase in subscriber acquisition and retention costs, and may continue to reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations." and "Item 4B.12e - iv The Ministry of Communications policy regarding the fixed-line telecommunications sector".

MoC policy and decisions regarding the Wholesale Market Reform (Bit Stream Access (BSA), fixed-line telephony and passive infrastructures, see "Item 4B.12e - iv The Ministry of Communications policy regarding the fixed-line telecommunications sector") have not been effectively enforced by the MoC since May 2015. If the MoC fails to enforce the most important components of its wholesale market reform, or if it rolls back (partially or in-whole), or fails to enforce, its decisions regarding wholesale access to HOT Telecom's network, or adopts other regulation unfavorable to companies, such as Partner, which must rely on the two wholesale suppliers, such actions may negatively affect our business and results of operations.

For further information regarding this risk, see "Item 4B.12e - iv The Ministry of Communications policy regarding the fixed-line telecommunications sector".

In addition, the infrastructure owners (Bezeq and HOT Telecom) may lower their infrastructure retail prices thereby narrowing the margin between their retail prices and the wholesale price we are required to pay them to use their fixed-line infrastructure. This may erode our margin to the point of eradicating the economic feasibility of continuing such operations. If the MoC fails to prevent such conduct by the infrastructure owners, this may adversely affect our business and results of operations.

3D.1b The MoC might require us to terminate the use of certain spectrum ranges which have been allocated to us, limit our use of such spectrum or fail to respond to our demands for the allocation of additional spectrum. Such eventualities may adversely affect our business and results of operations.

The MoC might prevent us from using some of our existing spectrum, may limit our ability to use such spectrum (whether by demanding we share such use with others or placing other limits on such use) or may fail to respond to our demands for the allocation of additional spectrum or for the refarming of our existing spectrum (the conversion of existing frequencies to a different technology). Such actions may interfere with our ability to effectively manage our licensed spectrum, reduce our ability to adequately provide services to our subscribers and place us at a competitive disadvantage. These possible eventualities may adversely affect our business and results of operations.

3D.1c If the structural separation provisions (which apply to Bezeq and HOT) are not enforced or are removed before we have established ourselves in the fixed-line and TV markets, this would adversely affect our business and results of operations.

The current structural separation limitations require Bezeq to equally market all ISPs (internet service providers) when selling service bundles which include its infrastructure services and ISP services. Since the launch of the Wholesale Market Reform, Bezeq has launched a bundle which includes its services and the services of certain ISPs and does not market all ISPs equally. If the MoC continues to fail to effectively enforce this requirement, it may continue to erode

our market share in the internet segment.

The MoC has also announced that it intends to cancel the regulations requiring Bezeq to maintain a “structural separation” between its fixed-line telephony, ILD, mobile telecommunications, internet infrastructure and services and TV operations. In the past, the MoC has published official announcements which indicate its satisfaction with the implementation of the Wholesale Market Reform. The MoC also provided Bezeq with a letter in which it announced it is promoting the removal of corporate separation provisions which currently apply to the Bezeq group. We strongly oppose the factual descriptions and the conclusions in these announcements. If the MoC removes the structural separation provisions based on its above-mentioned announcements before we have firmly established ourselves in the fixed-line telecommunications services market (in both fixed-line telephony, passive infrastructures and broadband) and the multi-channel TV market, Bezeq and HOT may be able to offer bundled services more effectively than we, and thereby gain a competitive advantage which could adversely affect our results of operations.

For further information regarding this risk, see “Item “4B.12e - iv The Ministry of Communications policy regarding the fixed-line telecommunications sector”.

3D.1d The Network Sharing Agreement we entered into with HOT Mobile may be terminated earlier than we expected due to regulatory intervention. In such case we will be required to split the shared network with HOT Mobile, and the resources, time and expense it may take us to have our own network on a nation-wide coverage may be substantial and could also materially harm our business and the results of operations at such time. Network sharing and similar agreements entered into by our competitors may place us at a competitive disadvantage.

In November 2013, we entered into a 15-year network sharing agreement ("Network Sharing Agreement") with HOT Mobile pursuant to which the parties created a limited partnership, under the name P.H.I. Networks (2015) Limited Partnership ("PHI"). The purpose of PHI is to operate and develop a radio access network to be shared by both parties.

In May 2014, the Anti-Trust Commissioner resolved to approve the Network Sharing Agreement, subject to a number of conditions ("Anti-Trust Commissioner Approval") and in April 2015, the Ministry of Communications resolved to approve the Network Sharing Agreement, subject to a number of conditions as well ("MoU Approval").

However, the Network Sharing Agreement may terminate or expire prior to the lapse of the said 15-year period due to regulatory intervention in one of the following circumstances:

Pursuant to the Anti-Trust Commissioner Approval - as of April 22, 2021, the Anti-Trust Commissioner will be entitled to notify Partner and HOT Mobile that the network sharing is terminated, if at that time the Anti-Trust Commissioner will be of the opinion that PHI or its activities may adversely affect competition, in which case the parties will be required to cease sharing the active part of the shared network within two years and the passive parts within five years from the Anti-Trust Commissioner's notice to that effect;

In the event we are found to be in breach of any of the conditions set out in the Anti-Trust Commissioner Approval 2) or in the MoU's Approval, the Anti-Trust Commissioner Approval or the MoU Approval might be terminated, which could create significant uncertainty as to the management of the shared radio access network;

PHI is operating under a special license granted by the Ministry of Communications on August 9, 2015. The term of 3) the license is 10 years from the grant thereof. If the term of the license will not be extended we may not be able to continue sharing the network.

If and when the network sharing will end, we will need to split the shared network with HOT Mobile and the resources, time and expense it may take to have our own network on a nation-wide coverage, may be substantial and could materially harm our business and results of operations at such time. See also "Item 3D.2e If the network sharing agreement entered into with HOT Mobile is unilaterally terminated by HOT Mobile earlier than we expect, we will be required to split the shared network with HOT Mobile and the resources, time and expense it may take us to have our own network in a nationwide coverage, would be substantial and could also materially harm our business and the results of operations at such time." and "Item 4B.8a Overview - Cellular Network Sharing Agreement".

Network sharing and similar agreements entered into by our competitors

In January 2017, Cellcom Israel Ltd. ("Cellcom") announced that it had reached an agreement with Electra Consumer Products Ltd. ("Electra") for 3G and 4G network sharing and 2G hosting services. According to Cellcom's report, Electra simultaneously entered into an agreement with Golan Telecom and its shareholders to purchase Golan Telecom's share capital. These agreements were approved by the Israeli Anti-Trust Commissioner, subject to certain conditions. In March 2017, Cellcom reported that the agreements were approved by the Ministry of Communications. Our knowledge of the content of these agreements is based on partial publications including reports filed by Cellcom, Electra and the IDB Development Company Ltd. However, if these agreements or any future network sharing agreement receive regulatory approval under conditions that are more lenient than those imposed on us, this would place us at a competitive disadvantage compared to our competitors. As a result, our business and results of operations may be negatively impacted.

3D.1e New regulatory initiatives may continue to increase the regulatory burden and intensify competition, which could negatively affect our business and results of operations.

The implementation of the Telecommunications Law, 1982, ("Telecommunications Law"), the Wireless Telegraph Ordinance [New Version], 1972 ("Wireless Telegraph Ordinance") and other laws and regulations, as well as the provisions of our licenses, are all subject to interpretation and change. New laws, regulations or government policies, changes to current regulations, or a change to the interpretation thereof, may be adopted or implemented in a manner which damages our business and operating results. Such measures may include new limits on our ability to market our services, new safety and health related requirements, new limits on the construction and operation of cell towers, new requirements, standards, consumer protection provisions, privacy provisions, coverage term and other conditions or limits applicable to the services we provide. Such measures may negatively affect our business and results of operations. Furthermore, if such measures would benefit our competitors or are applied only to us (and not to our competitors), we may be placed at a competitive disadvantage. For information regarding the principal regulations and regulatory developments affecting our business, see "Item 4B.12e Regulatory Developments".

3D.1f The State may impose regulations on TV content services provided over the Internet, which may negatively affect our business and results of operations.

The state (through the MoC and/or the Council for Cable and Satellite Broadcasting) may impose regulations on nascent TV content services which are provided over the Internet ("OTT") and which are currently unregulated. If such regulations are set (including a requirement to invest in original productions), this will increase our costs, raise the cost of operations in this segment and, if applied only to Israeli OTT providers, place us at a competitive disadvantage, in each case with potential negative effects on our business and results of operations.

3D.1g The deployment of our fiber-optic based infrastructure is dependent on effective enforcement by the Ministry of Communications of its reform enabling us to use a competitor's cable ducts.

The deployment of a fiber-optic based infrastructure is part of our overall strategy to become a comprehensive telecommunications group.

Currently, the majority of our deployment is performed based on the MoC's reform which enables us to use Bezeq's existing cable ducts in order to deploy our fiber optic cables, see "Item 4B.12e - iv- The Ministry of Communications policy regarding the fixed-line telecommunications sector".

Bezeq has not abided by some of its main obligations under the relevant MoC reform. For example, Bezeq does not allow us to use the manholes that are situated in front of buildings, thus making it difficult and more expensive to enter the buildings with our fiber optic cables. Bezeq has attempted to overcharge for actions it has performed for us (during the period in which it lay down fiber-optic cables for us) and has also attempted to charge us fees for actions

which the relevant MoC decision expressly states are to be performed at no charge. If the MoC fails to effectively enforce its reform in this matter against Bezeq, the future progress of this project and our business and results of operations may be materially and adversely affected.

3D.1h We are subject to monitoring and enforcement measures by the Ministry of Communications and other relevant authorities, which may adversely affect our business and results of operations.

Although we believe that we are currently in compliance with all material requirements of the relevant legislation and our licenses, disagreements have arisen and may arise in the future between the MoC and us regarding the interpretation and application of the requirements set out in relevant legislation and our licenses. The MoC is authorized to levy significant fines on us for breaches of the Telecommunications Law, relevant regulations and our licenses. Our operations are also subject to the regulatory and supervisory authority of other Israeli regulators which have the authority to impose criminal and administrative sanctions against us.

We may not always be successful in our defense, and should we be found in violation of these regulations, we and our management may be subject to civil or criminal penalties, including the loss of our operating license as well as administrative sanctions. All such enforcement measures may adversely affect our financial condition or results of operations. For information regarding on-going litigation and legal proceedings, see "Item 8A.1 Legal and Administrative Proceedings".

3D.1i Potential future regulation of roaming services may decrease our roaming revenues and negatively affect our income.

In August 2014, the Ministry of Communications published a hearing aimed at increasing competition in roaming services abroad and which suggested adopting various measures intended to improve transparency and limit subscriber payments for roaming services. Adoption of such measures might decrease our roaming revenues and negatively affect our income. See "4B.12e - iii Hearings and Examinations".

3D.1j We have had difficulties obtaining some of the building and environmental permits required for the erection and operation of our cellular network sites, and some building permits have not been applied for or may not be fully complied with. These difficulties could have an adverse effect on the coverage, quality and capacity of our network. Operating network sites without building or other required permits, or in a manner that deviates from the applicable permit, may result in criminal or civil liability to us or to our officers and directors.

Our ability to maintain and improve the extent, quality and capacity of our cellular network coverage depends in part on our ability to obtain appropriate sites and approvals to install our network infrastructure, including network sites. The erection and operation of most of these network sites require building permits from local or regional planning and building authorities, as well as a number of additional permits from other governmental and regulatory authorities. In addition, as part of our network build-out and expansion, we are erecting additional network sites and making modifications to our existing network sites for which we may be required to obtain new consents and approvals.

For the reasons described in further detail below, we have had difficulties obtaining some of the building permits required for the erection and operation of our network sites. As of December 31, 2017, less than 10% of our network sites were operating without local building permits or exemptions which, in our opinion, are applicable. In addition, some of our network sites are not built in full compliance with the applicable building permits.

Network site operation without required permits or that deviates from the permit has in some cases resulted in the filing of criminal charges and civil proceedings against us and our officers and directors, and monetary penalties against the Company, as well as demolition orders. See "Item 8A.1 Legal and Administrative Proceedings". In the future, we may face additional demolition orders, monetary penalties (including compensation for loss of property value) and criminal charges. The prosecutor's office has a national unit that enforces planning and building laws. The unit has stiffened the punishments regarding violations of planning and building laws, particularly against commercial companies and its directors. If we continue to experience difficulties in obtaining approvals for the erection and operation of network sites and other network infrastructure, this could have an adverse effect on the extent, coverage and capacity of our network, thus impacting the quality of our cellular voice and data services, and on our ability to

continue to market our products and services effectively. In addition, as we seek to improve the range and quality of our services, we need to further expand our network, and difficulties in obtaining required permits may delay, increase the costs or prevent us from achieving these goals in full. Our inability to resolve these issues could prevent us from maintaining the quality requirements contained in our license.

Uncertainties under National Building Plan 36. Since June 2002, following the approval of the National Building Plan 36 (the “Plan”), which regulates network site construction and operation, building permits for our network sites (where required) have been issued in reliance on the Plan. Several local planning and building authorities have questioned the ability of Israeli cellular operators to receive building permits, in reliance on the Plan, for network sites operating in frequencies not specifically detailed in the frequency charts attached to the Plan. In a number of cases, these authorities have refused to grant building permits for network sites, claiming that frequencies are not included in the Plan. There has been no judicial ruling at this stage. If a future court ruling determines that building permits cannot be issued for network sites operating in frequencies not specifically detailed in the frequency charts attached to the Plan, this could have a material adverse effect both on our ability to erect new sites as well as on our existing sites.

The Plan is in the process of being changed. See “Item 4B.12h Network Site Permits”.

Uncertainties regarding the validity of exemptions for wireless access devices. We have set up several hundred small communications devices, called wireless access devices, pursuant to a provision in the Telecommunications Law which exempts such devices from the need to obtain a building permit. A claim was raised that the exemption does not apply to cellular communications devices and the matter reached first instance courts a number of times, resulting in conflicting decisions. This claim is included in an application to certify a class action filed against the three principal Israeli cellular operators. In May 2008, a district court ruling adopted the position that the exemption does not apply to wireless access devices. We, as well as our competitors, filed a request to appeal this ruling to the Supreme Court. In May 2008, the Attorney General filed an opinion regarding this matter stating that the exemption does apply to wireless radio access devices under certain conditions. Two petitions were filed with the High Court of Justice in opposition to the Attorney General’s opinion. The matter is still pending before the Supreme Court and the High Court of Justice. See “Item 4B.12h Network Site Permits”. In December 2017, the Knesset Economics Committee discussed a new version of the regulations passed by the Minister of Finance in coordination with the other relevant government ministries. The Economics Committee has not concluded its discussion of all the regulations clauses and therefore has clarified that a follow-up discussion of the regulations would be scheduled. The proposed text was recommended for approval by the National Planning and Building Council. Insofar as the wording is approved in the format submitted to the Economics Committee, it will be very difficult to transfer existing wireless access devices from place to place and also to make changes to existing access devices.

If a definitive court judgment holds that the exemption does not apply to cellular devices at all, we may be required to remove the existing devices. As a result, our network capacity and coverage would be negatively impacted, which could have an adverse effect on our revenue and results of operations.

Uncertainties regarding requirements for repeaters and other small devices. We, like the other cellular operators in Israel, provide repeaters, also known as bi-directional amplifiers, to subscribers seeking an interim solution to weak signal reception within specific indoor locations. In light of the lack of a clear policy of the local planning and building authorities, and in light of the practice of the other cellular operators, we have not requested permits under the Planning and Building Law, 1965 (“Planning and Building Law”) for the repeaters. However, we have received an approval to connect the repeaters to our communications network from the Ministry of Communications and have received from the Ministry of Environmental Protection permit types for all our repeaters. If the local planning and building authorities determine that permits under the Planning and Building Law are also necessary for the installation of these devices, or any other receptors that we believe do not require a building permit, it could have a negative impact on our ability to obtain permits for our repeaters.

In addition, we construct and operate microwave links as part of our transmission network. The various types of microwave links receive permits from the Ministry of Environmental Protection in respect of their radiation level. Based on an exemption in the Telecommunications Law, we believe that building permits are not required for the installation of most of these microwave links on rooftops, but to the best of our knowledge, there is not yet a determinative ruling on this issue by the Israeli courts. If the courts determine that building permits are necessary for the installation of these sites, it could have a negative impact on our ability to obtain environmental permits for these

sites and to deploy additional microwave links, and could hinder the coverage, quality and capacity of our transmission network.

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3D.1k In connection with some building permits, we may also be required to indemnify planning committees in respect of claims against them relating to the depreciation of property values that result from the granting of permits for network sites.

Under the Planning and Building Law, local planning committees may be held liable for the depreciation of the value of nearby properties as a result of approving a building plan. Under the Non-Ionizing Radiation Law, 2006 (the "Non-Ionizing Radiation Law") the National Council for Planning and Building requires indemnification undertakings from cellular companies as a precondition for obtaining a building permit for new or existing network sites. The National Council has decided that until the Plan is amended to reflect a different indemnification amount, cellular companies will be required to undertake to indemnify the committees in full against all losses resulting from claims against a committee for reductions in property values as a result of granting a permit to the network site. On June 1, 2010, the National Council for Planning and Building approved the National Building Plan No. 36/A/1 version that incorporates all of the amendments to the Plan (the "Amended Plan"). The Amended Plan sets forth the indemnification amounts as a percentage of the value of the depreciated property claims in accordance with the manner in which the licenses were granted. See "Item 4B.12h Network Site Permits". The Amended Plan is subject to governmental approval, in accordance with the Planning and Building Law. It is unknown when the government intends to approve the Amended Plan.

As of December 31, 2017, we have provided local authorities with 488 indemnification undertakings. These indemnifications expose us to risks which are difficult to quantify or mitigate and which may have a material adverse effect on our financial conditions and results of operations, if we are required to make substantial payments in connection therewith. In addition, the requirement to provide indemnification in connection with new building permits may impede our ability to obtain building permits for existing network sites or to expand our network with the erection of new network sites. The indemnification requirement may also cause us to change the location of our network sites to less suitable locations or to dismantle existing network sites, which may have an adverse effect on the quality and capacity of our network coverage.

In 2007, the Israeli Ministry of Interior Affairs extended the limitation period within which depreciation claims may be brought under the Planning and Building Law from three years from approval of the building plan to the later of one year from receiving a building permit for a network site under the Plan and six months from the construction of a network site. The Ministry retains the general authority to extend such period further. This extension of the limitation period increased our potential exposure to depreciation claims.

3D.11 Potential future regulation of the ILD market may decrease our revenues from international calls and adversely affect our income.

In October 2013, the Ministry of Communications published a hearing regarding proposed new regulations for the ILD market which would allow all general licensees to provide international call services (under certain conditions). The MoC also proposed that general licensees (such as cellular operators) would no longer be allowed to charge interconnect fees for outgoing international calls and that some international calls would be preceded with a voice message stating the tariff of such call and allowing the subscriber to disconnect without being charged. Such regulation if adopted, may decrease our revenues from international calls and adversely affect our income. See "Item 4B.12e - iii Hearings and Examinations".

3D.1m The Ministry of Communications has indicated its intent to reduce mobile interconnection charges, which would negatively affect our income.

An MoC economic opinion published in February 2013, included a recommendation for a further reduction of cellular call and SMS interconnect tariffs towards the end of 2016. Such a reduction may negatively affect our business and results of operations. In February 2017, the MoC notified the cellular companies that due to other priorities, it does not intend to pursue this task at this time.

3D.1n We can only operate our business for as long as we have licenses from the Ministry of Communications.

We conduct our operations pursuant to licenses granted to us by the Ministry of Communications, which may be extended for additional periods upon our request to the Ministry of Communications and confirmation from the Ministry that we have met certain performance requirements. We cannot be certain that our licenses will not be revoked, will be extended when necessary, or, if extended, on what terms an extension may be granted. See “Item 4B.12f Our Mobile Telephone License”.

3D.1o Our mobile telephone license imposes certain obligations on our shareholders and restrictions on who can own our shares. Ensuring compliance with these obligations and restrictions may be outside our control, and may limit our ability to raise new equity capital. If the obligations or restrictions are not respected by our shareholders, we could lose our license.

As with other companies engaged in the telecommunications business in Israel, our license requires that a minimum economic and voting interest in, and other defined means of control of our company be held by Israeli citizens and residents or entities under their control. If this requirement is not complied with, we could be found to be in breach of our license, even though ensuring compliance with this restriction may be beyond our control. See “Item 4B.12f Our Mobile Telephone License”.

Our general mobile telephone license requires that our "founding shareholders or their approved substitutes", as defined in the license, hold at least 26% of the means of control in the Company, including 5% which must be held by Israeli founding shareholders (Israeli citizens and residents), who were approved as such by the Minister of Communications. If the Company decides to raise capital, it may face significant difficulty to do so since the current holdings of Israeli entities (as defined in the license) holdings are approximately 5% and any equity offering to the public or to the Company's employees and office holders will require an equivalent equity offering of shares to Israeli entities, in a manner in which the total Israeli entities founding shareholders' holdings will not be less than 5% of the total issued share capital. Since the transfer of these Israeli entity shares requires pre-approval of the MoC to determine that the receiving shareholder is eligible to be an Israeli entity, they are limited in their capability of transfer to another shareholder. The Company may need to grant a significant discount in an equity offering of these Israeli entity shares. If the Company were required to raise capital and this issue prevented it from doing so, our business could be adversely impacted (e.g., reduction in sales with long term credit arrangements and/or reduction in capital investments). The license also requires that these Israeli founding shareholders appoint at least 10% of our Board of Directors. In 2006, our Israeli founding shareholders sold substantially all of their shares in the Company to Israeli institutional investors, who were approved as substitutes. Since then, there were additional share sales to Israeli institutional investors that were approved as substitutes by the Minister of Communications.

In addition, according to our license, no transfer or acquisition of 10% or more of any of such means of control, or the acquisition of control of our company, may be made without the consent of the Minister of Communications. Nevertheless, under certain licenses granted, directly or indirectly, to Partner, approval of, or notice to, the Minister of Communications may be required for holding of 5% or more of Partner's means of control. Our license also restricts cross-ownership and cross-control among competing mobile telephone operators, including the ownership of 5% or more of the means of control of both our company and a competing operator, without the consent of the Minister of Communications, which may limit certain persons from acquiring our shares. Shareholdings in breach of these restrictions relating to transfers or acquisitions of means of control or control of Partner could result in the following consequences: the shares will be converted into “dormant” shares as defined in the Israeli Companies Law, 1999 (“Israeli Companies Law”), with no rights other than the right to receive dividends or other distributions to shareholders, and to participate in rights offerings until such time as the consent of the Minister of Communications has been obtained and our license may be revoked. In addition, under certain licenses of the Company's subsidiaries, approval of, or notice to, the Minister of Communications may be required for holding of less than 5% of means of control. Because of this lack of consistency, Partner may be in breach of its licenses in this regard.

3D.2 RISKS RELATING TO OUR BUSINESS OPERATIONS

3D.2a As a result of substantial and continuing changes in our regulatory and business environment, our operating results and profitability have decreased significantly in the past five years, with a loss for 2015. In 2017 we earned profits of NIS 114 million (US\$ 33 million). Profit without the impact of the early adoption of IFRS 15 in 2017 would have been NIS 61 million (US\$ 18 million), and profit in 2016 was NIS 52 million. Our operating results may again decline in 2018 and beyond, which may adversely affect our financial condition.

Our revenues in 2017 were NIS 3,268 million (US\$ 943 million), a decrease of 8% from NIS 3,544 million in 2016 and a decrease of 21% from NIS 4,111 million in 2015. The Company recorded a profit in 2017 of NIS 114 million (US\$ 33 million). Profit without the impact of the early adoption of IFRS 15 in 2017 would have been NIS 61 million (US\$ 18 million), compared with a profit in 2016 of NIS 52 million. The principal factor leading to the continued decline in operating results over the past several years has been the intense competition resulting largely from regulatory developments intended to enhance competition in the Israeli telecommunications market. These developments have caused, over the past several years, (i) significant price erosion in cellular services due to heightened competition from new entrants (since 2012) in the Israeli cellular market, (ii) a decrease in our cellular subscriber base and market share, and (iii) a significant decrease in gross profits from equipment sales. Service revenues and gross profits from equipment sales may decrease further in 2018.

Because the regulatory and business environment continues to evolve, generally with the objective of further increasing competition in the various markets in which we operate, depending on past and future regulatory and market developments, these factors may continue to negatively impact our business through 2018 and beyond, which may adversely affect our financial condition by, among other things, increasing the risk of a substantial impairment in the value of our telecommunications assets. See also “Item 5D.2 Outlook”.

3D.2b Our level of indebtedness could adversely affect our business, profits and liquidity. Furthermore, difficulties in generating sustainable cash flow may impair our ability to repay our debt and reduce the level of indebtedness.

As of December 31, 2017, total borrowings and notes payables amounted to NIS 1,923 million (US\$ 555 million), compared to NIS 2,694 million as of December 31, 2016. See also “Item 5B.4 Total net financial debt”. The terms of the Company’s borrowings require the Company to comply with financial covenants and other stipulations for existing borrowings. The existing borrowing agreements allow the lenders to demand an immediate repayment of the borrowings in certain events (events of default), including, among others, a material adverse change in the Company’s business and non-compliance with the financial covenants set in those agreements. Furthermore, although the Company has entered into agreements for deferred borrowing commitments in a total amount of NIS 376.75 million (US\$ 109 million), these agreements allow the lenders to not provide the borrowings should any of the events of default defined for our existing borrowings occur prior to the date for providing the deferred borrowings. These events of default include non-compliance with the financial covenants, as well as other customary terms. See “Item 5B.2 Long-Term Borrowings”.

In addition, our need for cash to service our substantial existing debt may in the future restrict our ability to continue offering long-term installment plans to promote sales of equipment. As a result, our ability to continue benefiting from one of the current contributors to total Company profits may be limited. (See also “ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS” and specifically “Item 5D.2 Outlook”);

Our substantial indebtedness could also adversely affect our financial condition and profitability by, among other things:

• requiring us to dedicate a substantial portion of our cash flow from operations to service our debt, thereby reducing the funds available for financing ongoing operating expenses and future business development;

- limiting our flexibility in planning for, or reacting to, changes in our industry and business as well as in the economy generally;
- increasing the likelihood of a downgrade in the rating of our Notes by the rating company;
- increasing the risk of a substantial impairment in the value of our telecommunications assets; and
- limiting our ability to obtain the additional financing we may need to serve our debt, operate, develop and expand our business on acceptable terms or at all.

If our financial condition is affected to such an extent that our future cash flows are not sufficient to allow us to pay principal and interest on our debt, we might not be able to satisfy our financial and other covenants, and may be required to refinance all or part of our existing debt, use existing cash balances or issue additional equity or other securities. We cannot be sure that we will be able to do so on commercially reasonable terms, if at all.

3D.2c Our recent entry into the television services market entails risks and costs, without expectations of profitability in the short term.

Our entry into the television services market in June 2017 necessarily entails costs, including capital and operating expenditures related to the establishment of the infrastructure of our technological content management system, which supports our TV service, and costs of wholesale access to fixed-line infrastructure, TV technicians, the content management team, service and sales, licensing and distribution rights and the purchase of other equipment (e.g. Set top boxes).

Entry into the television services market also requires access to premium content. If we fail to secure and maintain the rights to premium content, our ability to continue to expand our customer base may be limited and our results of operations may be negatively affected.

Our TV services are provided over the internet. Due to the fact that most of our TV subscribers are also subscribers to our wholesale internet infrastructure service, any growth in the volume of data such TV subscribers (as well as ISP and wholesale market subscribers) consume during peak hours translates into an increase in the payment we have to pay to the infrastructure holders for access to their infrastructure. If such growth exceeds our estimations this may increase our costs and negatively affect our results of operations.

As is typical when entering a new market, we do not expect to achieve profitability in the short term.

In addition, our recent entry into a market which is controlled by two dominant competitors, as well as the competition we face from additional existing and potential competitors, may cause us unexpected increased costs in content, sales and marketing, as part of our goal to continue to expand our customer base for TV services.

Such an increase in our costs would have a further negative impact on our EBITDA and results of operations.

3D.2d Our revenues from the pre-paid subscriber base have decreased over the last few years and may continue to decrease as a result of the increased competition in the market.

Over the last few years, our revenues from cellular pre-paid subscriber base have decreased. Service revenues from cellular pre-paid subscribers totaled NIS 146 million (US\$ 42 million) in 2017 compared with NIS 180 million in 2016, a decrease of 19%, and compared with NIS 230 million in 2015. The principal factors leading to this continued decline over the past few years have been the decline in pricing of unlimited post-paid plans and therefore the relative attractiveness of those plans compared to the pre-paid plans as well as increased competition due to the entrance of new operators into the pre-paid market. If this trend continues, revenues from pre-paid subscribers will continue to decline.

3D.2e If the network sharing agreement entered into with HOT Mobile is unilaterally terminated by HOT Mobile earlier than we expect, we will be required to split the shared network with HOT Mobile and the resources, time and expense it may take us to have our own network in a nationwide coverage, would be substantial and could also materially harm our business and the results of operations at such time.

Pursuant to the terms of the Network Sharing Agreement that we entered into with HOT Mobile as of April 2023, either party is entitled to terminate the Network Sharing Agreement for convenience by notifying the other party to that effect two years in advance. See "Item 3D.1d The Network Sharing Agreement we entered into with HOT Mobile may be terminated earlier than we expected due to regulatory intervention. In such case we will be required to split the shared network with HOT Mobile, and the resources, time and expense it may take us to have our own network on a nation-wide coverage may be substantial and could also materially harm our business and the results of operations at such time. Network sharing and similar agreements entered into by our competitors may place us at a competitive disadvantage."

If and when the network sharing will end, we will need to split the shared network with HOT Mobile and the resources, time and expense it may take to have our own network on a nation-wide coverage, would be substantial and could materially harm our business and results of operations at such time.

3D.2f Competition resulting from the full service offers by telecommunications groups and additional entrants into the mobile telecommunications market, as well as other actual and potential changes in the competitive environment and communications technologies, may continue to cause a further decrease in tariffs and an increase in subscriber acquisition and retention costs, and may continue to reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations.

Competition by Golan Telecom and HOT Mobile. HOT Mobile and Golan Telecom, which entered the market in May 2012, were awarded various benefits and leniencies by the MoC. These leniencies include a waiver of HOT Mobile and Golan Telecom's obligation to build an independent network subject to their commitment to invest in a shared network with another operator the same amount that they have committed to invest in their UMTS network. Such leniencies and benefits place us at a substantial competitive disadvantage, which may negatively affect our results of operations.

Entrance of the sixth facility-based operator. Following the 4G tender results, Marathon 018 Xfone Ltd. ("Xfone") gained one band of 5 MHz in the 1800 range, allowing it to share its frequencies with other operators and share their network (as part of a network sharing agreement). Cellcom, Golan and Xfone have reached a network sharing agreement which has been approved by the Anti-Trust Commissioner and the Ministry of Communications. This agreement will enable Xfone to enter the market as the sixth facility based operator, which may further increase competition levels in the cellular market and cause further rate decreases, thus negatively affecting our results of operations.

The acquisition of Golan Telecom by Electra, which was approved by the Anti-Trust Commissioner under certain conditions and by the MoC, might increase competition in the cellular market. Electra's retail business allows it access to a wide customer base and distribution network and may enable it to offer attractive package prices to their customers. Furthermore, the terms under which the acquisition of Golan by Electra has been approved by the relevant regulators may also affect our ability to compete. See "Item 3D.1d- Network sharing and similar agreements entered into by our competitors".

Network sharing and national roaming agreements entered into by our competitors. Our knowledge of the content of the network sharing and national roaming agreements entered into by our competitors is based on partial publications, including reports filed by Cellcom, Electra and the IDB Development Company Ltd. However, if such agreements (or any such future agreements) have been approved under conditions that are more lenient than those imposed on us, or if such conditions are not effectively enforced by the relevant authorities, this would place us at a competitive

disadvantage compared to our competitors. As a result, our business and results of operations may be negatively impacted. See "Item 3D.1d The Network Sharing Agreement we entered into with HOT Mobile may be terminated earlier than we expected due to regulatory intervention. In such case we will be required to split the shared network with HOT Mobile, and the resources, time and expense it may take us to have our own network on a nation-wide coverage may be substantial and could also materially harm our business and the results of operations at such time. Network sharing and similar agreements entered into by our competitors may place us at a competitive disadvantage."

Entrance of additional MVNOs. The entrance of additional Mobile Virtual Network Operators (“MVNOs”) may further increase competition in the cellular market. Some MVNOs are retailers with a wide customer base and distribution network that allows them to offer attractive package prices to their customers. See “Item 4B.9a Competitors in the Cellular Services market”.

Competitive advantages of the two fixed-line infrastructure groups. The Bezeq Group and the HOT Group are the only Israeli telecommunications providers that have their own nationwide fixed-line telecommunications infrastructures. See "Item 3D.1c If the structural separation provisions (which apply to Bezeq and HOT) are not enforced or are removed before we have established ourselves in the fixed-line and TV markets, this would adversely affect our business and results of operations."

Because the Bezeq Group and the HOT Group operate their own broadband internet access and transmission infrastructures, they do not depend on any third party for broadband internet access. Partner and other telecommunications services providers who do not have their own independent broadband internet access infrastructure are unable to provide some of these services, and are dependent on Bezeq and HOT in providing some of these services, substantially limiting their ability to compete.

Entry into the fixed-line infrastructure market. In August 2017, we announced the commencement of the commercial phase and acceleration of our independent fixed-line infrastructure deployment using fiber optics. Entry into this market entails significant long-term investments associated with infrastructure deployment, for which a positive return on capital is not expected in the short term. As a result, our results of operations may be adversely affected. In addition, our entrance into this market may accelerate the entry of additional competitors, deploying their own competitive infrastructures and operating existing ones, all of which might reduce or limit our market penetration.

Furthermore, entry into new markets (e.g. television services, fixed-line infrastructure) may further intensify price competition in the cellular and fixed-line markets which may have an adverse effect on our results of operations.

Israel Broadband Company (IBC). In August 2013, the Minister of Communications granted Israel Broadband Company (2013) Ltd. (“IBC”), a general license for the provision of fixed-line telecom services (infrastructure) and for the establishment of a nationwide optic fiber network using the Israeli Electric Company’s infrastructure. IBC has launched a web portal in which it offers ISP services to end-users (through agreements with selected ISPs). The variety of suppliers, immediate choice, and ability to quickly switch suppliers may commoditize the ISP segment and negatively impact our revenues and profits. IBC was also granted a special license for the provision of domestic fixed-line data communication. According to local media reports, IBC is permitted under its special license to provide its services to large business customers. Entry of IBC into the large business segment of the ISP market may increase competition in this segment and erode our market share and may affect our results of operation. IBC has retained Rothschild Bank in its attempt to find a strategic investor. Partner is examining the feasibility of such investment, as are other entities. In November of 2017, the MoC informed Partner that IBC had requested that its universal deployment obligation be "substantially reduced". If the MoC decides to grant IBC such leniencies and not treat other competitors (such as Partner) equally by providing them with the NIS 150 million grant that was paid to IBC by the State, this may place us at a competitive disadvantage and adversely effect on our results of operations.

Sale of handsets and other equipment. Competition in the market for handsets and other equipment including tablets, laptops, audio-visual devices and other related equipment sold by the Company is high and may increase, which may affect our results of operation.

Competition in Roaming Services. Some of our competitors may be able to obtain lower roaming rates than us either since they have larger call volumes or through their affiliations with other international cellular operators. Some competing service providers use alternative technologies for roaming that bypass the existing method of providing roaming services. Further competition in roaming services (both inbound and outbound) has arisen and may arise in the future from other telecommunication operators and new technologies that allow subscribers to use global SIM cards and pure internet-based services such as Skype, Viber and WhatsApp, as well as other operators' products which use VoIP applications. In addition, some cellular operators market plans that, in addition to calls, SMS and internet, include roaming services to set lists of countries.

Reliance on other service providers for roaming. We rely on agreements to provide roaming capability to our subscribers in many areas outside Israel. However, we cannot control the quality of the service that other telecommunication companies provide or whether they will be able to provide the services at all, and it may be inferior to our quality of service. Our subscribers also may not be able to use some of the advanced features that they enjoy when making calls on our network. As a result, we may lose some of our customers' roaming traffic to other roaming solutions, which would negatively impact our results of operations from this important source of earnings.

3D.2g Significant expansion in the capacity for international connectivity between Israel and Western Europe and increased competition in the ISP market resulted in sharp price decreases in these markets in 2011 and, as a result, caused us, and may in the future cause us, to recognize substantial impairment in the value of our fixed-line telecommunications assets.

Beginning in December 2011, total capacity available in international connectivity between Israel and Western Europe increased significantly as a result of the entry into operation of new underwater cables, and international connectivity services experienced a sharp decline in prices. In addition, we face increased competition in the retail ISP market, mainly since the launch of HOT-NET in the beginning of 2012. We therefore performed, with the assistance of an independent appraisal an impairment test on assets that belong to the VOB/ISP Cash Generating Unit ("CGU") of our fixed-line segment. As a result of the testing, impairment charges in a total amount of NIS 235 million were recognized for the fixed-line business at December 31, 2011. In addition, the Company's management performed, as required, its annual impairment review of goodwill, which resulted in an impairment charge to goodwill in 2011 in an amount of NIS 87 million with respect to the VOB/ISP and ILD group of CGUs of the fixed line segment.

At December 31, 2015, we recorded further asset impairment of NIS 98 million for the fixed-line business in the ISP/VOB CGU. See "Item 5A.1f Impairment of Fixed-Line Assets and Goodwill".

Continued increases in the level of competition for international connectivity and ISP services may bring further downward pressure on prices, and as a result, we may be required to perform further impairment tests of our fixed-line telecommunications assets in the future. Such impairment tests may lead to recording additional significant impairment charges, which could have a material negative impact on our operating and net profit.

In addition, continued increases in the level of competition for cellular, fixed-line and data transmission services may bring further downward pressure on prices which may require us to perform further impairment tests of our assets. Such impairment tests may lead to recording additional significant impairment charges, which could have a material negative impact on our operating and net profit.

3D.2h The unionization of our employees has negatively affected and may continue to negatively affect our financial results.

We signed a collective employment agreement with the employees' representatives and the Histadrut, the labor union representing the Company's employees, on March 13, 2016. The agreement includes an organizational chapter that is valid for a period of three years (2016-2018) and an economic chapter that was valid until December 30, 2016, and on December 12, 2016, we signed a new economic chapter that is valid for the years 2017 and 2018. The organizational

chapter includes, among others, provisions regarding manning and changing of positions, termination of employment and tenure. The new economic chapter includes, among others, provisions regarding terms of employment, benefits and welfare. See "Item 6D Employees".

As a result, management attention that would otherwise be available for our ongoing business must be directed towards the implementation of the collective employment agreement and other matters involving the unionization. The unionization of our employees has limited management's flexibility to efficiently run our business and adjust operations to market conditions, including the ability to execute organizational and personnel changes. It has resulted in increased costs and negatively affected our financial results, and may continue to do so in the future.

The Company is expected to begin negotiations during the last quarter of 2018 to renew the collective employment agreement. If the Company reaches understandings with the employee representatives and the Histadrut, the Company may incur further expenses which could increase operating expenses and reduce profitability. Failure to reach an understanding with the employee representatives, may lead to disruptions in our operations or cause work stoppages.

3D.2i Our purchase commitments pursuant to our non-exclusive agreement with Apple for the purchase and resale of iPhone handsets in Israel may adversely affect our financial results.

Following the expiration of our previous agreement in 2016 and pursuant to a non-exclusive agreement we entered into in June 2016 with Apple Distribution International for the purchase and resale of iPhone handsets in Israel, we agreed to purchase a minimum quantity of iPhone handsets per year, for a period of three years. These purchases represent a significant portion of our expected handset purchases over that period. If we fail to meet the minimum quantities and do not reach an agreement with Apple regarding this matter, we may be in breach of the agreement which may involve payment of damages, which would increase our costs.

3D.2j We depend on a limited number of suppliers and vendors for key equipment and services. Our results of operations could be adversely affected if our suppliers and vendors fail to provide us with needed services and adequate supplies of network equipment, handsets and other devices or maintenance support on a timely basis.

Network suppliers. We purchased our network equipment, such as switching equipment, base station controllers and base transceiver stations and network software, from Ericsson. In October 2010, we entered into an agreement with Ericsson for the upgrade and modernization of our networks and the deployment of our fourth generation network in Israel. The initial term of the agreement ended on December 31, 2014. We extended, with certain modifications, the maintenance period by additional periods until the end of 2018. See "Item 4B.8g Suppliers". We are therefore, as a practical matter, materially dependent on Ericsson as our sole vendor for our UMTS and LTE networks.

Handset and other equipment suppliers. We purchase the majority of our handsets and other equipment from a limited number of suppliers.

TV equipment and services. We purchase our TV set top boxes and the rights to distribute sports content each from a single supplier.

We cannot be certain that we will be able to obtain contracted services, equipment or handsets from one or more alternative suppliers on a timely basis in the event that any of our suppliers is unable to satisfy our requirements for services, equipment or handsets, or that the equipment provided by such alternative supplier or suppliers will be compatible with our existing equipment. Our handset and equipment suppliers may experience inventory shortages from time to time.

Our results of operations could be adversely affected if any of our key suppliers fails to provide us with contracted services or adequate supplies of handsets, equipment, as well as ongoing maintenance and upgrade support, in a timely manner. In addition, our results of operations could be adversely affected if the price of network equipment rises significantly. In our experience, suppliers from time to time extend delivery times, limit supplies and increase the prices of supplies due to their supply limitations and other factors. If the availability of handsets and other equipment furnished by our suppliers is insufficient to meet our customers' demands, we may lose opportunities to benefit from demand for this product, and our unserved customers may purchase the equipment independently which

may adversely affect our revenues. In addition, the constant development of new handsets and other equipment can render existing handsets and other equipment obsolete resulting in high levels of slow moving inventory.

3D.2k Unanticipated growth in subscriber demand for cellular data may require us to make additional investments and to modify certain products or services.

As a diversified multi-service communications and media service provider, we have developed services and successfully encouraged subscriber demand for internet access and content and data consumption using cellular phones, smartphones, tablets, data cards and ISP Services. However, in the event subscriber demand for data increases more rapidly than expected, we may need to develop strategies to avoid data traffic overloading the capacity of the network. Such strategies may include modifying certain products or services or undertaking significant additional investments. In addition, regulatory developments seeking to ensure “fair usage” of the internet for all persons may impose changes on the terms and conditions of certain of our current or future services. In the event of substantial, rapid growth in data consumption by our subscribers and the public generally, we may be obliged to undertake significant investments and to adjust our product offerings or, both of which could have a material adverse effect on our financial condition or results of operations.

3D.2l We could be subject to legal claims due to the inability of our information systems to fully support our tariff plans.

In order to attract and retain the maximum number of subscribers in our highly competitive market, we design specific tariff plans to suit the preferences of various subscriber groups. We require sophisticated information systems to record accurately subscriber usage pursuant to the particular terms of each subscriber plan, as well as accurate database management and operation of a very large number of tariff plans. From time to time, we have detected some discrepancies between certain tariff plans and the information processed by our internal information systems, such as applying an incorrect rebate or applying an incorrect tariff to a service, resulting in a higher or lower charge. We have invested substantial resources to refine and improve our information and control systems and ensure that our tariff plans are appropriately processed by our information systems. We have also taken steps to remedy the identified discrepancies. Despite our investments, we may experience discrepancies in the future due to the multiplicity of our plans and the scope of the processing tasks. Further, while we invest substantial efforts in monitoring our employees and third-party distributors and dealers that market our services, it is possible that some of our employees, distributors or dealers may offer terms and make (or fail to make) representations to existing and prospective subscribers that do not fully conform to applicable law, our license or the terms of our tariff plans. As a result of these discrepancies, we may be subject to subscribers’ claims, including class action claims, and substantial sanctions for breach of our license that may materially adversely affect our results of operations.

3D.2m Actual and alleged health risks related to network sites and the use of mobile telecommunications devices, including handsets, could have a material adverse effect on our business, operations and financial condition.

A number of studies have been conducted to examine the health effects of wireless phone use and network sites, and some of these studies have been construed as indicating that radiation from wireless phone use causes adverse health effects. Media reports have suggested that radio frequency emissions from network sites, wireless handsets and other mobile telecommunication devices may raise various health concerns.

The Ministry of Health published in July 2008 recommendations regarding precautionary measures when using cellular handsets. The Ministry of Health indicated that although the findings of an international study on whether cellular phone usage increases the risk of developing certain tumors were not yet finalized, partial results of several of the studies were published, and a relationship between prolonged cellular phone usage and tumor development was observed in some of these studies. These studies, as well as the precautionary recommendations published by the Ministry of Health, have increased concerns of the Israeli public with regards to the connection between cellular phone exposure and illnesses.

In May 2011, the International Agency for Research on Cancer (“IARC”), which is part of the World Health Organization (“WHO”), published a press release according to which it classified radiofrequency electromagnetic fields as possibly carcinogenic to humans based on an increased risk for adverse health effects associated with wireless phone use.

In June 2011, WHO published a fact sheet (no. 193) in which it was noted that “A large number of studies have been performed over the last two decades to assess whether mobile phones pose a potential health risk. To date, no adverse health effects have been established as being caused by mobile phone use”. It was also noted by WHO that “While an increased risk of brain tumors is not established, the increasing use of mobile phones and the lack of data for mobile phone use over time periods longer than 15 years warrant further research of mobile phone use and brain cancer risk in particular, with the popularity of mobile phone use among younger people, and therefore a potentially longer lifetime of exposure”. WHO notified that in response to public and governmental concern it will conduct a formal risk assessment of all studied health outcomes from radio frequency fields exposure by 2014. We are not aware that such an assessment has been published.

We have complied and are committed to continue to comply with the rules of the authorized governmental institutions with respect to the precautionary rules regarding the use of cellular telephones. We refer our customers to the precautionary rules that have been recommended by the Ministry of Health, as may be amended from time to time.

While, to the best of our knowledge, the handsets that we market comply with the applicable laws that relate to acceptable Specific Absorption Rate (“SAR”) levels, we rely on the SAR levels published by the manufacturers of these handsets and do not perform independent inspections of the SAR levels of these handsets. As the manufacturers’ approvals refer to a prototype handset, and not for each and every handset, we have no information as to the actual level of SAR of the handsets along the lifecycle of the handsets, including in the case of repaired handsets. See also “Item 4B.12g Other Licenses”. Furthermore, our network sites comply with the International Council on Non-Ionizing Radiation Protection standard, a part of the World Health Organization, which has been adopted by the Israeli Ministry of Environmental Protection.

Several lawsuits have been filed in the past against operators and other participants in the wireless industry alleging adverse health effects and other claims relating to radio frequency transmissions from sites, handsets and other mobile telecommunications devices, including lawsuits against us.

A class action was filed against us and three other operators alleging, among other things, that health effects were caused due to a lack of cell sites, resulting in elevated levels of radiation, mainly from handsets. The plaintiffs stressed that health damages are not a part of the claim. Another class action was also filed against us and three other operators alleging, among other things, that the supply of accessories that are intended for carrying cellular handsets on the body are sold in a manner that contradicts the instructions and warnings of the cellular handset manufacturers and the recommendations of the Ministry of Health, and without disclosing the risks entailed in the use of these accessories when they are sold or marketed. In these two class actions, Partner and the plaintiff filed a settlement agreement, which the court approved. The plaintiff filed an appeal with the Supreme Court regarding the court’s decision not to appoint an expert to examine the technical test which is part of the settlement.

In February 2009, a municipal court ruled against one of our competitors, stating that there is no need for the standard burden of proof to prove damages from a cellular network site, and that under certain circumstances it would be sufficient to prove the possibility of damage in order to transfer the burden of proof to the cellular companies. To the best of our knowledge, the defendant appealed the ruling and the ruling was dismissed as part of a settlement between the parties. Although we were not a party to this proceeding, such rulings could have an adverse effect on our ability to contend with claims of health damages as a result of the erection of network sites.

The perception of increased health risks related to network sites may cause us increased difficulty in obtaining leases for new network site locations or renewing leases for existing locations or otherwise in installing mobile

telecommunication devices. If it is ever determined that health risks existed or that there was a deviation from radiation standards which would result in a health risk from sites, other telecommunication devices or handsets, this would have a material adverse effect on our business, operations and financial condition, including through exposure to potential liability, a reduction in subscribers and reduced usage per subscriber. Furthermore, we do not expect to be able to obtain insurance with respect to such liability.

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3D.2n Equipment failures, system failures, natural disasters and hostile events such as acts of war, terror or cyber-attacks may materially adversely affect our results of operations.

Our ability to provide ongoing services to our subscribers, bill for services rendered and protect company and subscriber data are all vulnerable to various types of risks.

Such risks may include equipment failures, network failures, computer and IT system failures, transmission outages, spectral interferences, third-party systems and networks, natural disasters (such as fire, extreme weather and earthquakes), hostile events (such as acts of war, terror-attacks, see “Item 3D.2r The political and military conditions in Israel may adversely affect our financial condition and results of operations.”), cyber-attacks and data breaches whether by employees or other third parties. If any such events do occur, they could have a material adverse effect on our operations.

Like many other telecommunication companies, we have experienced an increase in cyber incidents over the past few years, some of which penetrated our cyber defenses, although no significant damage or loss of customer data resulted. We have integrated protective systems and prepared Disaster Recovery Plans (“DRP”) to mitigate such and other related risks, and we regularly consider our defensive systems and evaluate their effectiveness, including through simulated cyber penetrations; however it is not possible to determine in advance whether our defense systems and recovery plans will continue to be entirely effective, or how quickly we will be able to restore any affected service. We do not currently have insurance coverage for these types of risks.

As threats to our network, services and data continue to evolve, we may be required to expend significant efforts and resources to enhance our control environment, processes, practices and other protective measures.

If despite such efforts, we are unable to provide some or all of the telecommunications services to a substantial portion of our customers, whether temporarily or for an extended period of time, or if customer data is lost or accessed by third parties, we may be exposed to legal claims and liability, we may be found to be in breach of our legal obligations towards our customers, our brand and reputation may be damaged, we may suffer a loss of customers, our ability to attract new customers may be impaired, and we may be required to compensate our customers. Such eventualities may negatively affect our business, and our short- and long- term results of operations may be materially adversely affected.

3D.2o The telecommunications industry is subject to rapid and significant changes in technology and industry structure which could reduce demand for our services.

We face competition from existing or future technologies that have the technical capability to handle mobile, fixed-line and international long distance telephone calls, and to interconnect with local and international telephone networks and the Internet. Such new and evolving technologies include fixed-line and broadband wireless access services, Over the Top or Internet-based voice and multimedia services, Wi-Fi technologies and VoC. For example, internet-based services that provide user experience largely equivalent to our offerings, such as Voice over IP (“VoIP”), messaging services (WhatsApp, Skype, Viber), and video services (YouTube, video portals) are already available. In addition, the rapid development in recent years of technologies that allow international calls to be placed over the Internet without the need to use the services of an ILD has caused a decrease in the amount of international call minutes placed through the ILD services and also serve as an alternative for fixed-line communications. In particular, the risk posed by VoIP is that the purchase of a data package alone will be sufficient for the provision of most cellular voice, data and messaging services.

The effect of emerging and future technological changes, including the convergence of technologies, on the viability or competitiveness of our network cannot be accurately predicted. The technologies we employ or intend to employ may become obsolete or subject to competition from new disruptive technologies in the future. Competition from new technologies in the future may have a material adverse impact on our business and results of operations.

Moreover, global equipment vendors and Internet providers have expressed their interest in penetrating the cellular telephone industry and strengthening their position along the value chain. They have expressed their intention, and some have already begun, to provide direct access to the end-user to a wide variety of applications and services (e.g. Apple with iTunes and Google with the Android market). This has already changed our competitive position and may further increase the dominance of those new providers at the expense of cellular service providers. Changes in the industry value chain structure might result in an increase in our expenses as well as a decrease in our revenues.

3D.2p We are exposed to, and currently engaged in, a variety of legal proceedings, including requests to approve lawsuits as class actions related primarily to our network infrastructure and consumer claims.

In addition to a number of legal and administrative proceedings arising in the ordinary course of our business, we have been named as defendants in a number of civil and criminal proceedings related to our network infrastructure, which may result in civil liabilities or criminal penalties against us or our officers and directors, and consumer claims, including class action suits, regarding, for example, our tariff plans and billing methods or alleging, for example, unlawful charges, which are costly to defend and may result in significant monetary damages and civil penalties. The number of class actions that have been filed against us has increased over the past few years and this trend may continue in light of various amendments to the Consumer Protection Law and stricter regulatory policies that have been adopted. In class actions that require interpretation of our license provisions, the courts have in some instances requested the position of the Ministry of Communications or the Attorney General. In cases where the interpretation contradicts our interpretation and the court adopts such interpretation, it may enforce the implementation of such provisions retroactively which may adversely affect our financial results. The costs that may result from these lawsuits are only accrued when it is more likely than not that a liability, resulting from past events, will be incurred and the amount of that liability can be quantified or estimated within a reasonable range. The amount of the provisions recorded is based on a case-by-case assessment of the risk level, and events arising during the course of legal proceedings may require a reassessment of this risk. The Company's assessment of risk is based both on the advice of legal counsel and on the Company's estimate of the financial exposure if the verdict is in favor of the plaintiff. If the requests to certify lawsuits against us as class actions are approved and succeed or if we underestimate the potential exposure our financial results will be adversely affected. See "Item 8A.1 Legal and Administrative Proceedings".

We are also subject to the risk of intellectual property rights claims against us, including in relation to innovations we develop ourselves and the right to use content, including television, video and music content, which we have purchased or licensed from third parties who present themselves as the owners or official licensors (or as the representatives of owners or licensors) of the intellectual property rights included in the content, when in fact they may not be. These claims may require us to initiate or defend protracted and costly litigation, regardless of the merits of these claims. If any of these claims succeed, we may be forced to pay damages or may be required to obtain licenses for the infringing content, product or service, which may affect our financial results. If we cannot obtain all necessary licenses on commercially reasonable terms, we may be forced to cease using, distributing or selling the products and services.

3D.2q We are dependent upon our ability to interconnect with other telecommunications carriers. We also depend on Bezeq and other suppliers for transmission services and some of our Fixed-Line Services are dependent on our having access to Bezeq and the HOT Group's fixed-line network. The failure of these carriers to provide these services on a consistent basis could have a material adverse effect on us.

Our ability to provide commercially viable fixed-line and cellular telephone services depends upon our ability to interconnect with the telecommunications networks of existing and future fixed-line, cellular telephone and international operators in Israel in order to complete calls between our customers and parties on the fixed-line or other cellular telephone networks. All fixed-line, cellular telephone and international operators in Israel are legally required to provide interconnection to, and not to discriminate against, any other licensed telecommunications operator in Israel. We have interconnect relations with all the Israeli operators, including Bezeq and HOT Telecom, and we also depend on their internet broadband access infrastructure in order to provide TV, ISP services and VoB fixed telephony services. See "Item 3D.1a If the Ministry of Communications fails to enforce its fixed-line wholesale market reforms on Bezeq and HOT Telecom, or if it fails to prevent Bezeq or HOT Telecom from lowering their retail prices for fixed-line services and thereby narrowing our margin in these services, our business and results of operations" and "Item 3D.1c If the structural separation provisions (which apply to Bezeq and HOT) are not enforced or are removed before we have established ourselves in the fixed-line and TV markets, this would adversely affect our business and results of operations."

We are also dependent on the submarine infrastructure made available by TI Sparkle Israel (formerly Med Nautilus), which provides mutual international transmission based on fiber optics between Israel and other countries. See “10C Material Contracts”. We also depend on foreign operators that provide us with interconnection to the global internet network.

We also rely on agreements to provide ILD services to our subscribers. However, we cannot control the quality of the service that other foreign telecommunication companies provide or whether they will be able to provide the services at all, and it may be inferior to our quality of service.

We have no control over the quality and timing of the investment and maintenance activities that are necessary for these entities to provide us with interconnection to their respective telecommunications networks. Disruptions, stoppages, strikes and slowdowns experienced by them may significantly affect our ability to provide telecommunication services. The failure by our suppliers to provide reliable interconnections and transmission services to us on a consistent basis could have a material adverse effect on our business, financial condition or results of operations.

3D.2r The political and military conditions in Israel may adversely affect our financial condition and results of operations.

The political and military conditions in Israel directly influence us. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. Hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners and political instability within Israel or its neighboring countries are likely to cause our revenues to fall and harm our business. During the last decade, there has been a high level of violence between Israel and the Palestinians, including missile strikes by Hamas against Israel, which led to an armed conflict between Israel and the Hamas over the past few years and more recently in July 2014. In the last few years, Iran has threatened to attack Israel with nuclear weapons. There is evidence that Iran has a strong influence among extremist groups in areas that neighbor Israel, such as Hamas in Gaza and Hezbollah in Lebanon and Syria. This situation may potentially escalate in the future to violent events which may affect Israel and us. Ongoing violence between Israel and its Arab neighbors and Palestinians may have a material adverse effect on the Israeli economy, in general, and on our business, financial condition or results of operations. During such periods, incoming and outgoing tourism may be affected which consequently may have an adverse effect on our financial results. In particular, in recent conflicts, missile attacks have occurred on civilian areas, which could cause substantial damage to our infrastructure network, reducing our ability to continue serving our customers as well as our overall network capacity. In addition, in the event political unrest and instability in the Middle East, including changes in some of the governments in the region, causes investor concerns resulting in a reduction in the value of the shekel, our expenses in non-shekel currencies may increase, with a material adverse effect on our financial results.

Some of our directors, officers and employees are currently obligated to perform annual reserve duty. Additionally, all reservists are subject to being called to active duty at any time under emergency circumstances. In addition, some of our employees may be forced to stay at home during emergency circumstances in their area. We cannot assess the full impact of these requirements on our workforce and business if conditions should change.

During an emergency, including a major communications crisis in Israel’s national communications network, a natural disaster, or a special security situation in Israel, control of our network may be assumed by a lawfully authorized person in order to protect the security of the State of Israel or to ensure the provision of necessary services to the public. During such circumstances, the government also has the right to withdraw temporarily some of the spectrum granted to us. Under the Equipment Registration and Mobilization to the Israel Defense Forces Law, 1987, the Israel Defense Force may mobilize our engineering equipment for their use, compensating us for the use and damage. This may materially harm our ability to provide services to our subscribers in such emergency circumstances, and would thus have a negative impact on our revenues and results of operations.

Moreover, the Prime Minister of Israel may, under powers which the Telecommunications Law grants him for reasons of state security or public welfare, order us to provide services to the security forces, to perform telecommunications activities and to set up telecommunications facilities required by the security forces to carry out their duties. While the Telecommunications Law provides that we will be compensated for rendering such services to security forces, the government is seeking a change in the Telecommunications Law which would require us to bear some of the cost involved with complying with the instructions of security forces. Such costs may be significant and have a negative impact on our revenues and results of operations.

3D.2s Operating a telecommunications network involves the inherent risk of fraudulent activities and potential abuse of our services, which may cause loss of revenues and non-recoverable expenses.

There is an inherent risk of potential abuse by individuals, groups, businesses or other organizations that use our telecommunications services and avoid paying for them entirely or at all. The effects of such fraudulent activities may be, among others, a loss of revenue and out-of-pocket expenses which we will have to pay to third parties in connection with those services, such as interconnect fees, payments to international operators or to operators overseas and payments to content providers. Such payments may be non-recoverable. Although we are taking measures in order to prevent fraudulent activities, we have suffered from these activities in the past, and we may suffer from them in the future. The financial impact of fraudulent activities that have occurred in the past has not been material. However, fraudulent activities may in the future materially affect our financial condition and results of operations.

3D.2t Our business may be impacted by shekel exchange rate fluctuations and inflation.

Nearly all of our revenues and a majority of our operating expenses are denominated in shekels. However, in recent years, approximately one fifth of our operating expenses (excluding depreciation and amortization), including a substantial majority of our equipment purchases, were linked to or denominated in non-shekel currencies, mainly the US dollar. These expenses, where the price paid by us is based mainly in US dollars, included the acquisition of equipment and devices sold, payments for roaming services and payments to content suppliers. In addition, our capital expenditures include payments that are incurred in, or linked to, non-shekel currencies, mainly US dollars. A decline in the value of the shekel against the dollar (or other foreign currencies) could have an adverse impact on our results, which may be material if we are unable to pass on higher costs to our customers in the Israeli market. Material changes in exchange rates may cause the amounts that we must invest to increase materially in shekel terms.

Since May 2013, we have not entered into any derivative transactions to hedge underlying exposure to foreign currencies. As a matter of policy, we do not enter into transactions of a speculative or trading nature.

The repayments of principal and interest on our Series C Notes, due 2018, at a total principal of NIS 213 million as of December 31, 2017 (including current maturities, less offering expenses) are linked to the Israeli CPI. We also have entered into a number of operating leases whose rental payments are linked to the Israeli CPI. We may not be able to raise our tariffs in a manner that would fully compensate for significant increase in the CPI. Therefore, a significant increase in the rate of inflation may also have a material adverse impact upon us by increasing our financial expenses without an offsetting increase in revenue. See "ITEM 11 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK" for more information regarding the Company's exposure to exchange rate fluctuations and inflation.

3D.2u We may fail to maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, which may have a material adverse effect on our operating results and our share price.

Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 relating to the evaluation of our internal control over financial reporting require substantial resources, management time and attention. We expect these efforts to require a continued commitment of resources. If we fail to maintain the adequacy of our internal controls, we may not be able to conclude on an ongoing basis that we have effective internal control

over financial reporting. Although our management has concluded that our internal control over financial reporting was effective as of December 31, 2017, we may identify material weaknesses or other disclosable conditions relating to internal control over financial reporting in the future. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and significant effort and expense, and could have a material adverse effect on our operating results and on the market price of our ordinary shares.

3D.2v Based on a decision of the Board of Directors in 2012, dividend distributions are assessed from time to time on the basis of various factors. There can be no assurance that dividends will be declared or, if they are, at what level. No dividends have been distributed since 2013.

In September 2012, the Board of Directors resolved to cancel the then existing dividend policy, which targeted a minimum payout ratio of 80% of annual net income, and to assess dividend distributions (and their scope) from time to time, by reference to, among other things, the Company's cash flow, profitability, debt level, debt coverage ratios and the business environment in general. The level of any distribution of dividends may also be affected by the Company's stated intention to use its cash flow and take other measures to reduce its financial debt, as well as by the need to comply with existing financial covenants and to fund any necessary capital expenditures.

Under Israeli law, the payment of dividends is generally made from accumulated retained earnings or retained earnings accrued over a period of the last two years (after deducting prior dividends to the extent not already deducted from retained earnings), and in either case, provided there is no reasonable concern that the dividend will prevent the company from satisfying current or foreseeable obligations as they come due. A dividend distribution that does not meet the above mentioned conditions would be allowed only after receiving court approval and after providing debtors with the opportunity to present to the court any opposition to the dividend distribution.

There is no assurance that we will declare dividend distributions in the future or regarding the level of any dividend distribution which may be declared. No dividends have been distributed since 2013. A distribution of dividends that may result in a significant reduction of our future reserves could prevent us from complying with existing or future financial covenants, or limit our ability to fund capital expenditures. We may also be required to increase our financial indebtedness to obtain needed liquidity, which may not be possible on commercially reasonable terms or at all.

If we are unable to pay dividends at levels anticipated by our shareholders, the market price of our shares may be negatively affected and the value of our investors' investment may be reduced.

3D.2w Our tax liability may be greater than expected.

We are subject to taxation in Israel, and significant judgment is required in determining our provisions for taxes on income. We are also subject to audits by the Israeli tax authorities, including in relation to VAT payments. In such audits, it is possible to present our case according to our interpretation of tax legislation, and the relevant tax authorities may disagree, and then also challenge the amount of our profits subject to tax in Israel.

While we believe that our estimates are reasonable, the final outcome of these audits and related legal litigations, in so much as they may occur, may differ from the amount of our provisions for taxes and therefore may affect our operating results. See also note 25 to our consolidated financial statements and "Item 5A.1c Settlement Agreement with Orange Brand Services Ltd."

3D.3 RISKS RELATED TO OUR PRINCIPAL SHAREHOLDER

3D.3a 29.37% of our issued and outstanding shares and voting rights were held by S.B. Israel Telecom Ltd., our largest shareholder, as of March 1, 2018.

As of March 1, 2018, our largest shareholder, S.B. Israel Telecom Ltd. ("S.B. Israel Telecom"), held approximately 29.37% of our issued and outstanding shares.

As our largest shareholder, S.B. Israel Telecom has the ability to significantly influence our business through its ability to appoint directors serving on our Board of Directors and thereby substantially control all actions that require approval of our Board of Directors. S.B. Israel Telecom is not obligated to provide us with financial support or to exercise its rights as a shareholder in our best interests or in the best interests of our other shareholders and noteholders, and it may engage in activities that conflict with such interests. If the interests of S.B. Israel Telecom conflict with the interests of our other shareholders and noteholders, those shareholders and noteholders could be disadvantaged by the actions that it may pursue. However, S.B. Israel Telecom is subject to the fairness duty of a controlling shareholder under the Israeli Companies Law, and, in the context of related party transactions, to vote for the approval of transactions which are in favor of the Company. See “Item 6C.10 Duties of a Shareholder”.

ITEM 4. INFORMATION ON THE COMPANY

4A. History and Development of the Company

We were incorporated in Israel under the laws of the State of Israel on September 29, 1997, as Partner Communications Company Ltd. Our products and services were marketed under the “Orange” brand until February 16, 2016, when it was replaced with the “Partner” brand. In addition, since 2011, we have used the “012 Smile” brand for certain products and services. Our principal executive offices are located at 8 Amal Street, Afeq Industrial Park, Rosh Ha’ayin 48103, Israel (telephone: +972-54-7814-888). Our website addresses are www.partner.co.il and www.012mobile.co.il. Information contained on our websites does not constitute a part of this annual report. Our authorized U.S. representative is Puglisi and Associates, 850 Library Avenue, Suite 204, Newark, Delaware, 19711 and our agent for service in the United States is CT Corporation, 111 Eighth Avenue, New York, New York 10011.

Since our incorporation, we have achieved a number of important milestones:

- In April 1998, we received our license to establish and operate a cellular telephone network in Israel.

- In January 1999, we launched full commercial operations with approximately 88% population coverage and established a nationwide distribution.

- In October 1999, we completed our initial public offering of ordinary shares in the form of American Depositary Shares, and received net proceeds of approximately NIS 2,092 million, with the listing of our American Depositary Shares on NASDAQ and the London Stock Exchange. We used part of these net proceeds to repay approximately NIS 1,494 million in indebtedness to our principal shareholders, and the remainder to finance the continued development of our business. (In March 2008, we voluntarily delisted our ADSs from the London Stock Exchange.)

- In August 2000, we completed an offering, registered under the US Securities Act of 1933, as amended, of \$175 million (approximately \$170.5 million after deducting commissions and offering expenses) in 13% unsecured senior subordinated notes due 2010. These notes were redeemed in August 2005.

- In July 2001, we registered our ordinary shares for trading on the Tel Aviv Stock Exchange.

- In December 2001, the Ministry of Communications awarded us two bands of spectrum: one band of GSM 1800 spectrum and one band of 2100 UMTS third generation spectrum.

- In June 2002, our license was extended until February 2022.

- In December 2004, we commercially launched our 3G network.

- In March 2005, we completed a debt offering, raising NIS 2.0 billion in a public offering in Israel of notes due 2012.

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In April 2005, we repurchased approximately 33.3 million shares from our Israeli founding shareholders, representing approximately 18.1% of our outstanding shares immediately before the repurchase.

In the third quarter of 2005, our Board of Directors and shareholders approved the distribution of our first cash dividend, in the amount of NIS 0.57 per share, totaling approximately NIS 86.4 million.

In March 2006, we launched services based on the High Speed Downlink Packet Access (“HSDPA”) technology.

In July 2006, we purchased Med-1 I.C.-1 (1999) Ltd.’s fiber-optic transmission business for approximately NIS 71 million, in order to enable us to reduce our transmission costs as well as to provide our business customers with bundled services of transmission of data and voice and fixed-line services.

In January 2007, we were granted a domestic fixed license by the Ministry of Communications, and in February 2007 we were granted a network termination point license.

In December 2008 and January 2009, we launched three additional non-cellular business lines: VoB telephony services, ISP services and Web VOD (video on demand).

In October 2009, Scailex became our principal shareholder through acquiring the entire interest in the Company of our previous controlling shareholder.

In February 2010, following the District Court’s approval, a total amount of NIS 1.4 billion or approximately NIS 9.04 per share was paid on March 18, 2010, to shareholders and ADS holders of record on March 7, 2010, as a special dividend distribution.

In March 2011, we acquired all of the outstanding shares of 012 Smile Telecom Ltd., a leading provider of broadband and traditional telecommunications services in Israel. The acquisition of 012 Smile supported our strategy of becoming a leading comprehensive communications group, expanding our range of services and products.

In January 2013, S.B. Israel Telecom, an affiliate of Saban Capital Group, a private investment firm, based in Los Angeles, California, specializing in the media, entertainment and communications industries, became our principal shareholder through acquiring 30.87% of our issued and outstanding shares, principally from our previous controlling shareholder, Scailex Corporation Ltd.

In November 2013, we entered into a 15-year Network Sharing Agreement with HOT Mobile pursuant to which the parties agreed to create a 50-50 limited partnership to operate and develop a cellular network to be shared by both parties (among others, as a result of pooling both parties’ radio access network infrastructures to create a single radio access network). The Network Sharing Agreement was approved by the Israeli anti-trust authorities, subject to conditions in May 2014, and by the Ministry of Communications in April 2015. Following approval by the Minister of Communications, the Network Sharing Agreement with HOT Mobile entered into effect. See “Item 4B.8 Our Network”.

In July 2014, we commercially launched limited 4G services in Israel over a frequency band of only 5 MHz in the 1800 spectrum.

In March 2015, the acting Minister of Communications approved the results of the tender bid process in which we won an additional 5 MHz in the 1800 spectrum (in addition to our 10 MHz frequency bands in the 1800 spectrum).

In February 2016, we rebranded our products and services that were previously under the “Orange” brand to be under the new “Partner” brand. See "Item 5A.1c Settlement Agreement with Orange Brand Services Ltd."

In June 2017, we launched Partner TV service based on Over the Internet (OTT) platform which completed our offering as a comprehensive communications company.

In August 2017, we launched the commercial phase and accelerated deployment of our fiber optic network in residential areas throughout the country.

For information on our capital expenditures for the last three financial years, and for the principal capital expenditures currently in progress, see “Item 4B.8 Our Network” and “Item 5B.4 Total Net Financial Debt- Capital Expenditures”.

4B. Business Overview

Partner Communications Company Ltd. is a leading Israeli telecommunications company, providing a wide integrated and customized range of cellular and fixed-line telecommunication services, including infrastructure, international long distance (ILD), internet services provider (ISP), television and other services. We offer our subscribers a full range of products and services to address a broad range of communications needs based on advanced technologies and competitive tariff plans.

As a comprehensive communications group, we supply our services through two business segments:

- the cellular segment, our main business, which represents the largest portion of our total revenues. The cellular business segment includes cellular communications services such as airtime calls, international roaming services, text messaging, internet browsing, value-added and content services, and services provided to other operators that use the Company's cellular network. The Company also sells and leases a range of equipment related to cellular services. See "Item 4B.5a Cellular Services and Products".

At December 31, 2017, we had approximately 2,674 thousand cellular subscribers, representing an estimated 25% of total Israeli cellular telephone subscribers at that date. As of that date, approximately 87% of our subscriber base (approximately 2,320 thousand subscribers) was represented by subscribers who subscribe to post-paid tariff plans and 13% (approximately 354 thousand subscribers) by subscribers who subscribe to pre-paid tariff plans. (For a definition of “subscriber”, see “Item 3A Selected Financial Data”).

Our GSM/UMTS network covered 99% of the Israeli population at year-end 2017. Our LTE network currently covers 99% of the Israeli population, in line with the deployment milestones in our license. We currently operate our GSM network in the 900 MHz and 1800 MHz bands, the UMTS network in the 900 MHz and 2100 MHz band and the LTE network in the 1800 MHz band. Our services provided on our network include standard and enhanced services, as well as value-added services and products. See “Item 4B.5 SERVICES AND PRODUCTS”.

In 2017, we marketed our cellular services and products mainly under the Partner brand as well as under the 012 Mobile brand;

and

- the fixed-line segment, which includes a number of services provided over fixed-line networks including (a) Internet services including access to the internet through both fiber optics and wholesale broadband access, ISP services, internet Value Added Services (“VAS”) such as cyber protection, anti-virus and anti-spam filtering, and fixed-line voice communication services provided through Voice Over Broadband (“VOB”); (b) Business solutions including SIP voice trunks, Network Termination Point Services (“NTP”) – under which the Group supplies, installs, operates and maintains endpoint network equipment and solutions, including providing and installing equipment and

cabling within a subscriber's place of business or premises, hosting services, transmission services, Primary Rate Interface ("PRI") and other fixed-line communications solution services; (c) International Long Distance services ("ILD"): outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services; and (d) Television services over the Internet ("TV"). In addition, this segment includes sales and leasing of related equipment. See "Item 4B.5b Fixed-line Services and Products".

In 2017, our fixed-line services were marketed under the Partner brand and our ILD services were marketed under the 012 brand.

In 2017, we were named by the Maala organization in their highest platinum plus category for corporate social responsibility for the tenth consecutive year.

4B.1 SPECIAL CHARACTERISTICS OF THE CELLULAR TELECOMMUNICATIONS INDUSTRY IN ISRAEL

We believe that the following special characteristics differentiate the Israeli market from other developed cellular telecommunications markets. In particular, as noted below, on-going, significant changes in regulations applicable to cellular operators have created a complex environment specifically intended to substantially increase competition:

High Rate of Unlimited Packages. Israeli cellular operators provide, among other price-competitive offers, a particularly high rate of unlimited voice and text packages, and various data packages consisting of relatively high volumes of data at competitive prices.

Lack of Migration Barriers, High Churn and Recruitment Rate of Subscribers. The Israeli cellular market to date has limited migration barriers. There is full number portability. Operators are prohibited from selling SIM locked handsets and are no longer able to link the sale of handsets to services. In addition, operators are no longer allowed to charge exit fees from residential or small business customers or offer better tariff plans to new customers. As a result of this, as well as the entrance of new competitors, there is a high rate of churn and recruitment rate of subscribers in the Israeli cellular market.

Cellular Telephone Market Saturation. Since 1994, the market has sustained a rapid annual rate of growth from a 2.6% penetration rate at year-end 1994 to an estimated penetration rate in Israel at December 31, 2017, of 120%, representing approximately 10.4 million subscribers out of an estimated population of approximately 8.8 million. The total number of estimated cellular telephone subscribers includes dormant subscribers and subscribers to multiple networks as well as other subscribers who are not included in the Israeli population figures, such as Palestinians, visitors, and foreign workers.

Multiple Operators in a Small Market. The regulatory changes in the telecommunications industry, particularly with respect to additional entrants that include cellular operators and MVNOs, have created multiple operators in a relatively small market, which has led to a high level of competition in the industry.

Favorable Geography. Israel covers an area of approximately 8,000 square miles (20,700 square kilometers) and its population tends to be centered in a small number of densely populated areas. In addition, the terrain of Israel is relatively flat. These factors facilitate the roll out, maintenance and subsequent upgrades of a cellular network in a cost effective manner.

High Penetration of Smartphones. Published market data shows that the relatively young Israeli population has a propensity to accept and use high technology products. The level of penetration of smartphones in the Israeli market is also estimated to be one of the highest in the world.

4B.2 SPECIAL CHARACTERISTICS OF THE FIXED-LINE TELECOMMUNICATIONS INDUSTRY IN ISRAEL

Bezeq and HOT Telecom are the only telecommunications services providers with their own nationwide fixed-line infrastructure. IBC, which has a license to provide fixed-line services nationwide, has started a limited deployment of its fiber-based fixed-line services. Partner and Cellcom have fiber optic lines in certain areas nationwide.

Fixed-line telephony Services

Bezeq is the incumbent provider of fixed-line telephony services in Israel and holds more than 69% of the market. The remaining portion of the market is divided between HOT Telecom the next largest provider, Cellcom and Partner.

Broadband and Internet services

The fixed internet access market used to be divided into two tiers of services: infrastructure services and ISP service. Since February 2015, with the launch of the wholesale market reform, ISPs have begun to market bundled packages which include both (Bezeq's) infrastructure and ISP components.

The Ministry of Communications declared its intention to provide an incentive for Bezeq to implement the wholesale market by reducing the regulations requiring Bezeq to maintain a "structural separation" between its fixed-line and its TV services and other telecommunications operations. The MoC has also declared its intention to promote the removal of corporate separation in the Bezeq group and to publish a hearing in 2017 suggesting removal of the structural separation in the Bezeq group. See "Item 3D.1c If the structural separation provisions (which apply to Bezeq and HOT) are not enforced or are removed before we have established ourselves in the fixed-line and TV markets, this would adversely affect our business and results of operations."

In August 2013, the Israel Broadband Company (IBC), was granted licenses after winning the tender published by the State of Israel for the election of a minority shareholder in the Israel Electric Corporation telecommunication project. IBC introduced a new business model which enables it to reach the retail market through the services of ISPs. IBC has launched a web portal in which it offers ISP services to end users. ISPs which reach agreements with IBC are listed on the web portal. Currently only niche ISPs have reached agreements with IBC.

Internet access is currently provided by three major Internet service providers, or ISPs: Netvision from the Cellcom Group, Bezeq International and Partner, as well as some other niche players. All three major providers are also suppliers of ILD services (see below).

Until 2011, the Israeli ISPs were connected to the World Wide Web through an underwater communications cable owned and operated by TI Sparkle Israel (formerly Med Nautilus), a subsidiary of Telecom Italia SpA. Since January 2012, Bezeq International has its own underwater communications cable, and in February 2012, the Tamares Group's underwater communications cable commenced operations. These additional underwater cables have increased the effective bandwidth of international data connectivity and reduce costs for ISPs.

International long distance services

ILD services in Israel have been open for competition since 1996. There are currently eight players in this market. The three major players are: Partner, through 012 Smile, Bezeq International and Cellcom through Netvision, who are estimated to hold together approximately 80% of the market. The other players are Xfone and Telzar 019 International Telecommunications Services Ltd., which commenced operations in 2011, and Hashikma Communications Marketing Ltd., Golan Telecom and HOT Mobile, that commenced operations in 2012. Beginning in 2012, as part of the unlimited packages that the cellular companies began offering their customers, most of them, including the Company, included ILD services to certain destinations in these packages. Proposed regulations intend, among others, to allow all general telecommunications licensees (including MVNOs) to provide international call services to international destinations included in their subscribers' tariff plans and only calls to destinations not included in the subscriber's plans would be routed through ILD providers. See "Item 4B.12e - iii Hearings and Examinations". Such regulations may alter the ILD market structure in Israel and decrease the volume of international calls routed through ILD providers.

4B.3 OUR STRATEGY

Partner's strategy is to further reinforce and develop its position as a comprehensive telecommunications company that offers an entire range of telecommunication solutions to a variety of customers, and we intend to lead the market in service as well as technology. The most recent elements in pursuit of this strategy were added during 2017 with the launch of our Partner TV Service and the entry into service of our fiber optic network. The principle elements of our business strategy are as follows:

Offer our customers a variety of cellular and fixed-line services. For our core businesses we intend to continue to offer our customers a variety of services that include a wide integrated and customized range of cellular and fixed-line services. In addition, during 2018, we intend to expand the variety of value-added services such as cyber solutions and IOT (Internet of Things).

Increase penetration of Partner TV Service. In June 2017, we launched Partner TV Service, an Over the Top service ("OTT") based on Android TV platform. This was the first service of its kind in the Israeli television market. Partner TV Service allows our customers to enjoy an advanced interface and enables us to connect our customers "Any place, Any time, Any device" (AAA). As part of our strategy to offer our customers unique television services we have partnered with world-leading internet television networks, including Netflix. The attractive prices that we offer for our Partner TV Service together with the innovative interface have created for the first time competition in the Israeli television market previously dominated by only two companies.

Further extend deployment of a fiber optic network over which the Company will offer high quality internet services. In August 2017, we commercially launched our fiber optic network. Our investment in the fiber optic network is part of our strategy to maintain our technological leadership in the market. The fiber optic network enables us as a comprehensive communications group to offer increased internet speeds compared to current market offerings, manage the quality of service and customer experience, and offer additional advanced services. The combination of the fiber optic network together with Partner TV Service, which can be offered over our fiber optic network, provides us with a unique advantage and reduces our dependency on the fixed-line infrastructure operators.

Preserve and enhance customer satisfaction to strengthen customer loyalty and decrease churn. In order to increase customer satisfaction, we constantly strive to provide advanced services at a high level of technology and simplify processes and information. Towards this goal, we strive to provide our customers with a high level of accessible customer service at our service centers, call centers, and digital channels, as well as through our in-house technicians for fixed-line services.

Increase our online services for our customers. To provide our customers with advanced digital services, we are constantly developing possibilities for our customers to purchase services and self services as well as equipment through digital means and cellular apps.

Continue to be a major player in the retail sale of handsets and accessories. We continuously adapt ourselves to the changing needs of our customers, while offering new and innovative equipment and accessory developments and changes in the telecommunications market.

Lead in technology and innovation in our cellular network in order to remain at the technological edge. We have the widest 4G coverage compared to other cellular operators as a result of having the largest deployment of 4G cell sites. See "Item 4B.8 OUR NETWORK". As part of our strategy to remain a leading telecommunications operator in the cellular market and offer more advanced services, we intend to continue investing in 2018 in both the shared network with HOT Mobile as well as in our core cellular network. We intend to continue to deploy advanced technologies, for instance LTE Advanced. During 2018, the Company plans to examine the architecture and the technological aspects related to the implementation of the 5G network in preparation for its anticipated implementation in 2020.

4B.4 MARKETING AND BRAND

We continuously utilize a variety of marketing tools and channels in order to strengthen our brand presence in the market and promote sales. The year 2017 was dedicated to the consolidation of our brand architecture to one distinct and leading brand, "Partner", representing us as a full range telecommunications company. We advertise our brand and services in a variety of media channels, including press, television, radio, digital and social networks. Our advertising emphasizes leading and innovative product services and technologies and is targeted to various market segments using several languages.

Our marketing strategy for the year 2018 will be to focus on presenting Partner as a one stop shop for all customer communication needs. Our objective is to differentiate ourselves from our competitors on the basis of our added value services and competitive pricing, as well as the introduction of our new innovative products. For example in 2017, we launched Partner TV and offered our Post-Paid cellular subscribers a free six month subscription to Apple Music streaming service as a result of an exclusive collaboration with Apple Music.

4B.5 SERVICES AND PRODUCTS

Our principal business, which provided approximately 80% of our revenues in 2017 (excluding inter-segment revenues) was derived from our cellular segment. Approximately 20% of our revenues (excluding inter-segment revenues) were generated from our fixed-line segment.

4B.5a Cellular Services and Products

Cellular Services

Our main business is cellular telephony - including basic cellular telephony services, text messaging, internet browsing and data transfer, content services, roaming services and services provided to other operators that are permitted to use the Company's cellular network. Cellular content and value-added services offered include multimedia messaging, cyber protection, cloud backup, ringtones, music streaming service and a range of business services.

International Roaming

We offer our customers roaming services abroad, which allow a mobile phone subscriber to place and to receive calls while in the coverage area of foreign networks owned by operators with whom we have commercial roaming agreement. Our roaming packages allow our customers to benefit from attractive rates in nearly 190 destinations. We offer data-only packages as well as packages that combine calls, data and SMS. The Ministry of Communications may introduce new regulations that would limit our revenues from roaming services. See "Item 4B.12e - iii Hearings and Examinations".

At December 31, 2017, we had commercial roaming relationships with 490 operators in 190 countries or jurisdictions, 340 3G roaming agreements in 160 countries and 86 4G roaming agreements in 87 countries. Creating roaming relationships with multiple operators in each country increases potential incoming roaming revenue for us and gives our subscribers more choice in coverage, services and prices in that country. The 3G and 4G roaming agreements enable our 3G roamers to initiate video calls, high speed data and video and audio content while abroad.

Although GSM (2G), UMTS (3G) and LTE (4G) are standardized, the frequency allocation per each technology varies from one country to another. Currently we operate our GSM services on the 900 MHz and 1800 MHz bands, UMTS on 900 MHz and 2100 MHz bands and LTE on 1800 MHz bands. All 4G handsets which we sell, support all the above listed technologies and bands while 3G handsets support the above listed bands for GSM and UMTS. While roaming, there is a possibility that a subscriber's handset will not support all the technologies due to lack of support of

a country's specific frequency bands; however this is rare in GSM and UMTS, due to technology maturity. Standardization bodies allow for more than 27 different LTE bands and since LTE in many countries utilizes reframed GSM and UMTS bands, there may be cases where handsets do not support the frequency allocated for LTE in specific countries.

Cellular Equipment and Devices

Equipment and device sales in the cellular segment include sales and leases of cellular handsets and related cellular devices and accessories. Until 2017, some sales of digital audio visual equipment and other related equipment were also recorded under the cellular segment. However, as from 2017, in view of updates to our sales strategy and the launch of television services, sales of Wi-Fi only devices and other devices not directly related to cellular services, including televisions, were recorded under the fixed-line segment instead of the cellular segment.

4B.5b Fixed-line Services and Products

Fixed-Line Services

We offer fixed-line services that include internet services, ILD services, transmission services, telephony services (including SIP services) and TV services.

ISP services. As an internet service provider providing access to the World Wide Web, we offer our customers, in addition to access, additional ISP services including email accounts, Wi-Fi networking as well as additional value added services such as anti-virus and anti-spam filtering. We also offer a bundled package that includes infrastructure and ISP access services following the wholesale market reform, and since 2017, we also offer access services over our own optic fiber fixed-line infrastructure in certain parts of the country, with speeds up to 1 GB. As of March 2018, tens of thousands of households are able to connect to Partner's fiber services. Furthermore, we offer our business customers additional tailored value services that combine an entire array of solutions including: network and data infrastructures, advanced information security solutions, integration solutions, designated services for customers with multiple branches and commercial networks, business information storage in a secured and advanced data center and cloud services. ISP services include the leasing of related equipment including modems and routers.

ILD services. As an international long distance provider, we offer our residential and business customers international telephony services including direct international dialing services, international and domestic pre-paid and post-paid calling cards, and call-back services. Most of the pre-paid calling cards are sold to foreign workers in Israel. In addition, we offer our business customers international toll-free numbers that offer fixed rates on calls from anywhere in the world. As an international long distance provider, we also provide hubbing traffic routing between network operators for termination of long distance calls outside of Israel.

Transmission. We provide fixed-line transmission and data capacity services. Our fixed-line capacity also includes capacity which we lease from other fixed-line telecommunications service providers as well as inland fiber optic infrastructure and complimentary micro wave radio links. The services we offer include primarily connectivity services, on an SDH (Synchronous Digital Hierarchy) transmission network, by which we provide high quality, dedicated, point-to-point connection for business customers and telecommunications providers, as well as fixed-line services to business customers. We also provide international transmission services to our business customers between Israel and other countries.

VoB and PRI. The VOB service allows business and residential customers to make and receive telephone calls over the Internet through an internet connection. The PRI is a landline network service connecting organizational switchboards to Partner's network and allows business customers to make multiple calls simultaneously. We offer traditional voice services to business customers throughout Israel.

Television services. In June 2017, we launched our OTT television services that provide our customers with an enhanced user interface experience of television services based on an open platform, the Android TV. Partner TV service offers our customers dozens of live linear channels, including "catch up" capability of up to 14 days, video on demand library, direct access to YouTube and Netflix content through a dedicated button on our remote control allowing our customers to access their favorite show with a simple click. We also enable customers to subscribe and pay for Netflix through the Partner TV bill. Partner TV service includes a fully supported 4K set-top box with an Android TV operating system which enables the viewer to add content, games and music applications directly from the Google Play store. Our full TV service can also be accessed by smartphones and tablets (TV everywhere). As of the date of this report, Partner TV service, which has the highest growth rate among all TV operators in Israel, reached over 64,000 subscribed households.

High speed broadband fiber optic based network. In August 2017, we launched the commercial phase and acceleration of our fiber optic network in residential areas throughout the country, which provides for the first time a more advanced and cost-effective alternative to the existing fixed infrastructure in Israel. See "Item 4B.8d Fiber optics network".

Value-Added Services

In addition to standard fixed-line value-added services, we offer a variety of value-added services such as defense and security services for the computer and e-mail that include, among others, parental monitoring control, firewall, web hosting, anti-virus and site filtering based on the customer's restriction definition, and other value added internet services including hosting, cloud-based hosted services and virtual switchboard. We also offer an upgraded data center that provides customers with business solutions on a secure site including hosting services (storage and maintenance of physical and virtual servers, website hosting, information storage and disaster recovery site), management communication services, and integrated services.

Fixed-Line Equipment and Devices

Equipment and devices sales in the fixed-line segment include sales and rental of modems, domestic routers, servers, smartboxes and related equipment, as well as sales of audio visual equipment and devices and other related equipment. In addition, we provide our business customers with office communication Private Branch Exchanges (PBX). This service, available on the premises or cloud-based, provides all telephony services including unified communication features as well as Direct Inward Dialing (DID), which provides a block of telephone numbers for calling into the customer's PBX system. DID allows us to offer our customers individual phone numbers for each person or workstation within the company without requiring a physical line into the PBX for each possible connection.

4B.5c Tariff Plans

As of December 31, 2017, approximately 87% of our cellular subscriber base (approximately 2,320 thousand subscribers) subscribed to post-paid tariff plans, and 13% (approximately 354 thousand subscribers) subscribed to pre-paid tariff plans.

Business cellular tariff plans. Our post-paid cellular business tariff plans offer features attractive to business users such as bundles including unlimited amounts of call minutes and SMS (subject to reasonable use) as well as browsing packages; bundles with fixed amounts of call minutes and SMS and browsing packages; tariff plans with fixed tariffs for airtime usage without adding the interconnect charges imposed by other cellular and fixed-line providers for calls made by our subscribers that terminate on third party networks; and providing discounts for calls to designated numbers within a subscriber's calling circle. Some of these bundles also include a limited amount of international call minutes and other value-added services. Furthermore, some of our contracts with large business customers with over

100 subscribers include commitment terms with exit fees for early termination.

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Private customer cellular tariff plans. Most of our post-paid cellular tariff plans for private customers are bundles including unlimited amounts of call minutes and SMS (subject to reasonable use) as well as browsing packages. Some of these bundles also include a limited amount of international call minutes and other value-added services. In addition, we offer a limited number of bundles with fixed amounts of call minutes and SMS and browsing packages. The elements of our cellular tariff plans for post-paid private customers are packaged and marketed in various ways to create tariff packages attractive to target markets, including families, military personnel, youth, students, family members of business customers and other sectors. Our private customer subscriber agreements do not have any commitment periods.

Since 2012, the Company has also marketed cellular tariff plans under an alternative brand, “012 Mobile”, based on the 012 Smile brand. Under this brand, the Company offers plans mainly under a digital self-service model through a dedicated website (including web-chat with customer representatives) at competitive prices. These tariff plans were launched in order to compete with offers of new operators launched in 2012. Under our pre-paid plans, upon purchase of a SIM card or phone card or prepayment by credit card or cash, customers can use our network, including some of our value-added services, without the need to register with us or enter into any contract. Our pre-paid plans enable us to compete in the pre-paid cellular services market.

Fixed-line tariff plans. For our Fixed-Line Services, we have a wide range of diverse plans to meet the needs of the various sub-markets-ISP, ILD, transmission, TV, VOB and PRI. We have also launched an unlimited plan for our VoB packages. In the ILD services market we have tariff plans based on call destinations and level of use. Our Internet Service prices and our wholesale infrastructure services prices are based on bandwidth speed. We offer a variety of internet solutions for home and business use according to each customer's needs. With our entrance into the TV services market, we now offer our customers bundled plans that include infrastructure, internet and TV services as well as triple offers that include infrastructure/ internet, TV and home telephony services.

4B.6 SALES AND DISTRIBUTION

4B.6a Customer Care

We apply a multi-channel approach to target various market segments and to coordinate our cellular and fixed-line sales strategy for both our business as well as private customers. Our customer support and service provides several channels for our customers: call centers, walk-in centers and self-service support, which include web-based services, mobile application, Interactive Voice Response (“IVR”), automated SMS, messaging and digital chat.

Call Centers. Guided by our aim to provide high quality service, our call-center services are divided into several sub-centers including business, private and pre-paid for cellular and fixed-line services, and specialized support and services (finance, network, international roaming and data transfer related issues). The call center services are provided in several languages and also provide chat, digital and SMS services through the Company’s websites.

Walk-in Centers. We currently operate 25 service and sales centers across Israel. These centers provide a face-to-face, uniformly designed, contact channel and offer all services that we provide to customers: sales, handset upgrade, handset maintenance, tablet sales, fixed-line services (such as VOB and ISP) and other services (such as finance, rate-plan changes and subscription to new services) as well as accessories sales. Lease agreements for our retail stores and service centers are for periods of two to ten years. We have the option to extend the lease agreements for different periods including the initial lease period. See also note 19 to the consolidated financial statements.

Self-Service. We provide our customers with various self-service channels, such as IVR, web-based services, and services via SMS, mobile and smartphone applications. The services provided through these channels include general and specific information, tariff plans, account balance, billing-related information and roaming tariffs. They also provide customers with information regarding trouble shooting and handset operation, and enable customers to activate services and to download content as well as to purchase various services and update tariff plans.

Technical support. The Company's in-house technicians provide our customers with support services and initial TV and fiber installation services.

All of our service channels are monitored and analyzed regularly in order to ensure the quality of our services and to detect areas that require improvement.

Management Systems. Our management systems are certificated and monitored by IQC (The Institute for Quality Control, an RVA accredited Certification Body authorized by Bureau Veritas Quality International) to the appropriate international standards:

ISO 9001:2015, which focuses on fulfillment of clients and legal requirements;

ISO 14001:2015, which coordinates our commitment to habitat and environment; and

OHSAS 18001:2007, which directs our efforts to provide a safe and healthy work environment at our premises.

4B.6b Sales and Distribution Channels

We distribute our services and products through direct sales channels and indirect sales channels.

4B.6b - i Direct Sales Channels

Sales and Service Centers: Our walk-in centers in stores and malls also serve as sales centers. The face-to-face contact enables customers to get the “touch and feel” of new handsets, tablets, accessories and services demonstrated by our representatives. We have stands in some of our centers in cooperation with Apple called "CEP" –channel excellence program, in which we demonstrate Apple products to customers. As of December 31, 2017, we are the only cellular operator in Israel that has this type of agreement with Apple.

Direct Sales Force: Our sales force is comprised of sales and service representatives.

A team of representatives and customer account managers that support small to medium-sized businesses;

A team of corporate representatives and customer account managers who support large corporate customers;

A Small Medium Enterprises (“SME”) sales-force team located in regional offices focuses on individual and small business customers;

A telemarketing department conducts direct sales by phone (to private and business customers), initiates contacts with prospective customers and coordinates appointments for the sales representatives.

Our sales force undergoes regular training to improve their skills in selling advanced solutions such as cellular data, intranet extension and connectivity, virtual private networks, location based services, m2m services, and other value-added services that appeal to corporate customers.

In addition, as of December 31, 2017, we have 17 Partner stands in shopping centers throughout the country.

4B.6b - ii Indirect Sales Channels

We have agreements with many traditional dealers that provide over 60 points of sale, selling a range of our products. The private dealer network is an important distribution channel because of its ability to attract existing cellular users to our network. Our dealer network focuses primarily on sales to individual customers and, to a lesser extent, small

business customers. These dealers specialize in sales for post-paid customers and handset sales.

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In addition we have agreements with prepaid distributors that specialize in sales for pre-paid customers and distribution of pre-paid plans to sub-dealers.

We also have specific dealers that target different segments of the Israeli population with the appropriate style, language and locations. We provide regular training to employees of our dealers to update them on our products and services. Our managers visit dealers on a regular basis to provide information and training, answer questions and solve any problems that may arise. We pay our dealers commissions; however, dealers are not entitled to commissions for any customers that terminate their service within 90 days of activation.

4B.6b - iii Online Sales Channels

Our cellular and fixed-line services are also available to be purchased online. We also manage an online service for the purchase of handsets and other equipment that we sell.

4B.7 POST-PAID CUSTOMER CONTRACTS AND CREDIT POLICY

Our standard customer agreements with most of our private customers do not include commitment periods, since they are not permitted under Israeli law. Some of our business customers that have more than 100 cellular subscribers enter into an agreement with a commitment period of up to 36 months, as do some of our fixed-line customers with monthly invoices of over NIS 5,000. Customers are billed monthly for charges per services. Roaming access for direct debit cellular customers is subject to credit scoring by our credit supervisors with the assistance of outside credit agencies and may require additional guarantees or deposits.

Our customers pay for their services by credit card or by direct bank debit. All credit card accounts are subject to an initial maximum credit limit each month, which varies depending upon the type of credit card and for which we obtain prior approval from the card issuer. When a customer account reaches this limit, we may seek approval from the card issuer. If the card issuer does not grant the approval, we may require the customer to provide other means of payment or arrange an increase in the approved limit from his credit card issuer. If this does not occur, the customer's usage may be limited or suspended, after receiving our prior notice of such limitation or suspension, until we receive a cash deposit or guarantee from the customer.

Most of our customers pay for equipment devices with long term financing plans whereby the customer pays for the equipment through monthly payments (generally between 12 and 36 months), which are charged directly to their credit card or to their monthly bill. Where the customer opts to pay the monthly payments via their monthly bill, the outstanding installment payments are not secured. Customers acquiring more than a certain number of device sales are subject to a credit scoring review performed by Partner's credit supervisors with the assistance of outside credit agencies. During 2016, changes were made to the credit scoring review process whereby stricter requirements were imposed for customers to be accepted for long term financing plans. These changes significantly adversely affect the level of sales of equipment with long term financing plans. See also "Item 5A.1b Business Developments in 2017".

4B.8 OUR NETWORK

We have built an extensive, resilient and advanced network system in Israel, allowing us to offer extensive coverage and consistent high quality. During the years ended December 31, 2016 and 2017, we made capital expenditures of NIS 73 million and NIS 152 million (\$44 million), respectively, in our network infrastructure, including in our new fiber optic network. See "Item 5B.4 Total net financial debt".

4B.8a Overview

Our network is a converged fixed and mobile telecommunications network. For mobile services we built a multi generation (2G, 3G & 4G) wireless network, which offers full interactive multimedia capabilities. This technology brings wire-free networks significantly closer to the capabilities of fixed-line networks. Improvements in coding and data compression technology provide better voice quality and more reliable data transmission. UMTS is the global standard adopted for the implementation of third generation wireless telecommunications capable of data rates of up to 42 Mbps in the down-link and is the 3G technology we use. HSPA is a technological enhancement to our 3G services that offers subscribers the ability to access our 3G services at higher speeds for downloading (HSDPA) and uploading (HSUPA) data. LTE is the most advanced mobile network technology which is currently available in more than half of the macro base stations. Our LTE network has nationwide coverage and based on the existing spectrum of 20 MHz in 1800 MHz band and 10MHz in 2100 band can support up to 225Mbps in the downlink using carrier-aggregation and up to 50Mbps in the uplink.

Cellular Network Sharing Agreement. In November 2013, we entered into a 15-year Network Sharing Agreement with HOT Mobile that was approved by the Antitrust Authority Commissioner in May 2014 and by the Ministry of Communications in April 2015. Pursuant to the agreement, the parties created a 50-50 limited partnership in the form of a limited partnership under the name P.H.I. Networks (2015) Limited Partnership ("PHI"), the purpose of which is to operate and develop a radio access network to be shared by both parties starting with a pooling of both parties' radio access network infrastructures to create a single shared pooled radio access network ("Shared Network"). The parties have also established a 50-50 company limited by shares under the name Net 4 P.H.I Ltd., to be the general partner of the limited partnership. In August 2015, we were allocated a frequency bandwidth of 5MHz in the 1800MHz spectrum as a result of the 4G frequencies tender conducted by the Ministry of Communications in January 2015. PHI started to operate in August 2015, at which time each of Partner and HOT Mobile transferred to PHI certain employees who were previously engaged in their respective radio operations.

Both companies continue to compete and differentiate their services and be responsible for providing cellular telecommunication services to its own customers, including the provision of customer service, value-added services, marketing and sales. Each company continues to retain and operate its own core network.

According to the Network Sharing Agreement, HOT Mobile paid Partner a onetime amount of NIS 250 million ("Lump Sum"), and since April 1, 2016, (i) each party bears half of the expenditures relating to the Shared Network, and (ii) responsibility for the operating costs of the Shared Network is apportioned according to a pre-determined mechanism, according to which one half of the operating costs are shared equally by the parties, and one half are divided according to the relative volume of traffic of each party in the Shared Network ("Capex-Opex Mechanism"). See "Item 5A.1d Network Sharing Agreement with HOT Mobile" and notes 9 and 26(d) to the consolidated financial statements with respect to balances and transaction with PHI.

In May 2014, the Antitrust Commissioner approved the Network Sharing Agreement, subject to conditions, the most important of which are set forth below:

• Prohibition on exchange of information that is not required for the activities of PHI under the Restrictive Trade Practices Law, 1988 ("Restrictive Trade Practices Law"). See 4B.12e - v Anti-Trust Regulation.";

• Limitations with respect to serving as an officer or employee in either Partner or HOT Mobile concurrent with serving as an officer or employee of PHI and certain cooling off periods were set in case of transition of officers and employees from PHI to the companies. However, this should not prevent PHI from employing employees or officers, who are currently serving as employees or officers in the companies and does not prevent an office holder in Partner or HOT Mobile from serving as a director in PHI's general partner's board of directors;

• Rules regarding the administration and documentation of the meetings of PHI organs were set;

Either of the companies shall be allowed, at any time and at its sole discretion, to engage in an agreement with a third party for the provision of cellular telecommunications services that involves use of the core network of that company. All of the rights and obligations deriving from such service agreement shall apply solely to that company and PHI shall not be a party to such service agreement and will not be entitled to payments payable pursuant to it;

After a period of seven years from the date of the Commissioner's approval or after a period of six years from the issue date of all the approvals of the Ministry of Communications, whichever is earlier, the Commissioner shall be allowed to notify the companies of the cancellation of his resolution, if he has concluded that the establishment of PHI, its existence or operations are liable to be substantively detrimental to the competition ("Cancellation Notice"). If a Cancellation Notice is issued, a graduated layout of dismantling PHI activity was set in the Commissioner resolution, as follows:

- a. at the end of two years after the issuance of the Cancellation Notice, PHI shall cease all activity apart from the management, maintenance and operation of the passive elements of the network.
- b. at the end of five years after the issuance of the Cancellation Notice, the companies shall dismantle PHI and shall separate their assets fully and entirely.

In April 2015, the Ministry of Communications also approved the Network Sharing Agreement.

4B.8b Infrastructure

As of December 31, 2017, our network consists of the following main elements:

Our radio access network domain consist of 2,005 macro GSM base transceiver stations, 19 micro GSM base transceiver stations and 207 indoor GSM transceiver stations, all linked to 7 base station controllers (HDBSC);

- 2,279 macro UMTS base transceiver base stations (eNodesBs), 16 micro UMTS base transceiver stations and 560 indoor UMTS transceiver stations, all linked to 21 radio network controllers;

2,584 macro LTE base transceiver base stations (eNodesBs), 10 micro LTE base transceiver stations and 200 indoor LTE transceiver stations.

Our core network domain consisted of 3 mobile switching centers, 3 media gateways, 2 service GPRS support node/mobility management entity and 2 gateway GPRS support node/evolved packet gateway.

The base transceiver stations, the mobile switching centers and the radio network controllers are interconnected by 5,250 transmission links for voice services, and a dedicated IP radio access network and a mobile packet backbone network (IP-RAN, MPBN) for voice and data traffic for the 3G and 4G network.

Ericsson is our sole radio and core network equipment supplier. See "Item 4B.8g Suppliers".

Our fixed-line network domain consists of circuit-switched and Voice over Internet Protocol (VoIP) platforms. Ericsson, Dialogic Networks, Sonus, Broadsoft and ACME Packet supplies our VoIP solution, whereas the circuits-switched services utilize the mobile switching center platforms alongside Sonus's switches. The International Long Distance network domain consists of Dialogic ILD Switch, together with NSN's Signaling Transit Point.

In addition, our network is interconnected with two public switched telephone companies, Bezeq and HOT Telecom, in several locations across Israel. Our network is also connected to all of the cellular networks, all the Israeli international operators, the fixed-line telephone network of the Palestine Telecommunication Co. Ltd. ("Paltel"), and the cellular network of Wataniya Palestine Mobile Telecommunication Company ("Wataniya"), and indirectly to the cellular network of Palestine Cellular Communications Ltd. ("Jawwal"). Our transmission network is made up mainly by our own microwave links and fiber optic infrastructure, while for sites that are unreachable with our own transmission, we lease lines from Bezeq and other operators. Currently approximately 10% of our transmission network consists of leased lines. Our fiber-optic and microwave transmission network enables us to reduce our transmission costs as well as to provide our customers with bundled services of data and voice transmission and fixed-line services. Currently, our transmission network has more than 19 hundred kilometers of fiber optics and more than 12 hundred microwave links. See "Item 4B.8d Fiber optics network".

Our radio networks covered 99% of the Israeli population at year-end 2017. We are continuing to expand and improve the coverage, capacity and quality of our LTE network.

4B.8c Network Design

Our primary cellular network design objective is to further expand and improve our network to provide high voice, video and packet quality, service reliability, high capacity and high coverage quality. In formulating our network design objectives, we have been guided by our business strategy to continue to broaden the highest quality network. The quality parameters that we seek to satisfy are those that we believe are important to cellular users: voice quality, high data rate packet sessions, low “blocked call” rate, low “dropped call” rate and deep indoor penetration, especially in densely populated areas or areas of special commercial interest. The two main examined parameters used to measure network performance are the setup call success rate and the dropped calls rate.

With these quality parameters in mind, we rolled out our UMTS/HSPA network starting in 2004, which shares locations with the GSM sites. In December 2007, we signed an agreement with LM Ericsson Israel Ltd. (Ericsson”) for the replacement of third party 3G radio equipment existing in our network, and in October 2010, we signed an agreement with Ericsson for the upgrade of our existing fixed-mobile network and the deployment of our fourth generation network.

We use monitoring probes and counters to ensure network quality.

Our transmission network design confers the following benefits: (i) necessary bandwidth for GSM and UMTS/HSPA and LTE services; (ii) resilience; (iii) use of high transmission rate back-bone routes based on Synchronous Digital Hierarchy; and (iv) the ability to utilize a new generation of sophisticated technology to optimize the system and increase capacity where necessary. Our switching architecture is based on two STP switches connected to all of our systems and platforms and three MSCBCs and MGWs.

In our Fixed-Line business we offer telephony lines using VoB technology, SIP voice trunks, PRI, Internet Services, data transmission and ILD services targeting households and business customers in the Israeli market. These services are provided over third parties’ existing network infrastructure as well as our own partially country covering infrastructure. In order to provide the Fixed-line Services in the residential market, we developed a home gateway box (smartbox/all in one router), that provides the customer with a setup of a home network Wi-Fi based on the protocol 802.11n & AC, Voice FXS and DECT supported phones, and built-in firewall. We also develop home gateway for our LTE, G.FAST/fiber infrastructure. This solution enables us to provide services to our customers such as call “hijack” which allows customers to retrieve incoming mobile line calls on their fixed-line and vice-versa, improved email accounts, anti-virus and site filtering based on the customer’s restriction definition.

4B.8d Fiber optics network

In July 2006, we purchased Med-1 I.C.–1 (1999) Ltd.'s fiber-optic transmission business. Since then we continued to expand our fiber optics network.

MoC Regulations and a recent amendment to the Telecommunications Law now allow us to make use of the ducts and manholes (and other passive network elements) deployed by landline domestic operators (including Bezeq and HOT) in order to deploy our own fiber optic cables.

Following these regulatory developments, in August 2017, we commercially launched the expansion of our fiber optic network. Our investment in the expansion of our fiber optic network is part of our strategy to maintain our technological leadership in the market, compared to current market offerings. As of March 2018, tens of thousands of households are able to connect to Partner's fiber services. The fiber optic network enables us as a comprehensive communications group to offer increased internet speeds compared to current market offerings, manage the quality of service and customer experience, and offer additional advanced services. The combination of the fiber optic network together with Partner TV Service, which can be offered over our fiber optic network, provides us with a unique advantage and reduces our dependency on the fixed-line infrastructure operators.

In November 2017, the Company announced that it is holding negotiations with Cellcom regarding a potential long term cooperation agreement, for the deployment of a fiber optic infrastructure by both companies whereby each company will be entitled to purchase from time to time, as per its needs and its sole discretion, fiber optic infrastructure services (including indefeasible right of use) from the other company's present and/or future fiber optic infrastructure in order to connect residential buildings throughout Israel. The finalization of the agreement is subject to further negotiations between the companies and if concluded the execution of the agreement will be subject to the required regulatory approvals.

4B.8e Spectrum Allocation and Capacity

Spectrum availability is limited and is allocated by the Ministry of Communications through a licensing process. Pursuant to the terms of our license and subsequent allocations, we were allocated 2x10.4 MHz in the 900 MHz frequency band, of which 2 x 2.4 MHz are shared with Jawwal which operates in the West Bank and the Gaza Strip and an additional 2 x 2.4 MHz of Jawwal's spectrum is partially available to us.

We were also allocated two additional bands of spectrum: 2 x 10 MHz of UMTS/HSDPA third generation in the 2100 MHz frequency band. We operate GSM 900 MHz band base transceiver stations that enhance the capacity of our network's quality. In May 2012, we shifted 5MHz of our 900MHz spectrum from the 2G GSM network to the 3G HSPA+ network. In July 2014, we shifted 10MHz of our 1800MHz spectrum from the 2G GSM network to the 4G LTE network. In March 2015, the Minister of Communications approved the results of the tender bid process in which we won an additional 5 MHz in the 1800 spectrum. HOT Mobile was also awarded two bandwidths of 5 MHz of frequencies in the 1800 band, both of which are expected to be used for the limited partnership created by the companies. Now that we have been allocated these frequencies, and have successfully reformed our existing frequency bands and successfully implemented the Network Sharing Agreement with HOT Mobile, our total spectrum available for 4G is 20 MHz, which allows us to offer full 4G services. See "Item 4B.8a Overview – Cellular Network Sharing Agreement". We have amended the technical annex to our license in order to allow us to refarm some of our existing spectrum (in the 2100 MHz band) for the implementation of LTE Advanced and carrier aggregation technologies. In February 2017, the MoC approved the refarming (the conversion of existing frequencies to a different technology) of these frequencies.

For a discussion of the risks associated with regulatory developments in spectrum allocation, see "Item 3D.1b The MoC might require us to terminate the use of certain spectrum ranges which have been allocated to us, limit our use of such spectrum or fail to respond to our demands for the allocation of additional spectrum. Such eventualities may adversely affect our business and results of operations."

4B.8f Site Procurement

Once a new coverage area has been identified, professional staff determines the optimal base station location and the required coverage characteristics. The area is then surveyed to identify network sites. In urban areas, typical sites are building rooftops. In rural areas, masts are usually constructed. Professional staffs also identify the best means of connecting the base station to the network, for example, via leased or owned and operated microwave or fiber links or wired links leased from Bezeq. Once a preferred site has been identified and the exact equipment configuration for that site decided, the process of obtaining necessary approvals begins.

The erection of most of these network sites requires building permits from local or regional authorities, as well as a number of additional permits from governmental and regulatory authorities, such as:

- erection and operating permits from the Ministry of Environmental Protection;
- permits from the Civil Aviation Authority, in certain cases; and
- permits from the Israeli Defense Forces.

See "Item 4B.12h Network Site Permits" for a description of the approvals that are required for the erection and operation of network sites and the requirement to provide indemnification undertakings to local committees.

4B.8g Suppliers

Suppliers for our cellular network. For a number of years, we purchased our network equipment, such as switching equipment, base station controllers and base transceiver stations and network software, from Ericsson and Nokia. Starting in January 2008, we purchase all our UMTS network equipment from Ericsson, and in 2010 we entered into an agreement with Ericsson, for the upgrade of our existing cellular networks and the deployment of our fourth generation network. The initial term of the inclusive agreement with Ericsson ended on December 31, 2014. We extended, with certain modifications, the maintenance period by additional periods until the end of 2018. Ericsson has gradually become our sole supplier of cellular core equipment and systems. See “Item 10C Material Contracts”. See also “Item 3D.2j We depend on a limited number of suppliers and vendors for key equipment and services. Our results of operations could be adversely affected if our suppliers and vendors fail to provide us with needed services and adequate supplies of network equipment, handsets and other devices or maintenance support on a timely basis.”

We continue to purchase certain network components, for our cellular, fixed and ISP services, from various other key suppliers. For example, Juniper Networks provides the Company with solutions for all network segments.

Handset and other equipment suppliers. Following the expiration of our previous agreement in 2016, in June 2016 we entered into a non-exclusive agreement with Apple for the purchase and resale of iPhone handsets in Israel for a three-year period. See “Item 10C Material Contracts”. During 2017, Apple was a major supplier of the Company’s iPhone handsets. We also purchase handsets and other equipment, including tablets and laptops, from Samsung and other vendors.

Suppliers for TV content and equipment. In May 2017, we partnered with Netflix, the world leading internet entertainment network, to make its services directly accessible through our TV service.

In addition, we have agreements with well known suppliers in the industry for the provision of the following:

- sports and kids content channels;
- set top boxes for our TV service;
- management system;
- encoding system;
- content distribution system (live channels and VOD) for end equipment (set top boxes and applications);
- application interface installed on set top boxes and cellular devices.

Suppliers for our fixed-line network. Bezeq and HOT Groups own the majority of the fixed-line telecommunications infrastructures in Israel. As a result, we rely on interconnection with the Bezeq and HOT Groups’ infrastructure. Bezeq supplies the Company with fixed-line transmission services for connecting traffic between approximately 10% of the Company’s sites. The HOT Group supplies the Company with interconnect lines between the broadband backbone and the ISP backbone. See “Item 3D.1c3D.1c If the structural separation provisions (which apply to Bezeq and HOT) are not enforced or are removed before we have established ourselves in the fixed-line and TV markets, this would adversely affect our business and results of operations.” In addition, for hard-line connection to all major Western European countries and the United States, TI Sparkle Israel (formerly Med Nautilus) supplies the Company with transmission services through its submarine infrastructure. See “Item 10C Material Contracts”.

Dialogic Inc. and Broadsoft Inc. supply us with switches for the fixed-line telephony services based on Internet Protocol (“VoIP”). As part of the mentioned above with Ericsson, these services will gradually shift to equipment

supplied by Ericsson.

4B.8h Interconnection

All telecommunications providers with general licenses in Israel have provisions in their licenses requiring them to connect their networks with all other telecommunications networks in Israel. Currently, our network is connected directly with all other telecommunications networks operating in Israel.

We are currently operating without any formal interconnect agreements with Bezeq. Day-to-day arrangements with Bezeq substantially conform to a draft interconnect agreement negotiated with Bezeq. Bezeq is required by law not to discriminate against any licensed telecommunications operator in Israel with respect to the provision of interconnect services. We currently pay Bezeq an interconnection fee based on a tariff structure set forth in the Interconnection Regulations (Telecommunications and Broadcasts) (Fees for Interconnection) (2000) (“Interconnection Regulations”).

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We have formal interconnect agreements with all Israeli cellular and with the other fixed-line and voice over cellular companies. The interconnect tariffs are set forth in the Interconnection Regulations that impose a uniform call interconnect tariff for all cellular operators.

Our network is connected directly to Paltel, the Palestinian fixed-line operator, Wataniya, a Palestinian cellular operator, and indirectly to Jawwal, the cellular operator of Paltel. The interconnect tariffs are set out in commercial agreements.

Two of our subsidiaries have a domestic fixed-line license. One of our subsidiaries- Partner Land-Line Communications Solutions LP is connected directly with other telecommunication networks operating in Israel and the other is indirectly connected to other telecommunication networks, through said entity. The interconnection fees are set by the Interconnection Regulations.

4B.9 COMPETITION

An overview of our principal competitors and of some aspects of the competitive environment for telecommunications services is set forth below. For further information regarding the impact of regulation and regulatory changes on competition, including measures to enable new service providers to enter the market, and the competitive pressures arising from the development of full-service telecommunications providers and new technologies, see "Item 3D.1 Risks Relating To The Regulation Of Our Industry." and "Item 3D.2a As a result of substantial and continuing changes in our regulatory and business environment, our operating results and profitability have decreased significantly in the past five years, with a loss for 2015. In 2017 we earned profits of NIS 114 million (US\$ 33 million). Profit without the impact of the early adoption of IFRS 15 in 2017 would have been NIS 61 million (US\$ 18 million), and profit in 2016 was NIS 52 million. Our operating results may again decline in 2018 and beyond, which may adversely affect our financial condition."

Within the Israeli telecommunications market there are 4 major communication groups: Bezeq, HOT, Cellcom and Partner, as well as a number of smaller operators. See Item "3D.2f Competition resulting from the full service offers by telecommunications groups and additional entrants into the mobile telecommunications market, as well as other actual and potential changes in the competitive environment and communications technologies, may continue to cause a further decrease in tariffs, an increase in subscriber acquisition and retention costs, and may continue to reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations."

4B.9a Competitors in the Cellular Services market

There are currently six cellular telephone network operators in Israel: Partner, Cellcom, Pelephone, HOT Mobile, Golan Telecom and Xfone. Except for Golan Telecom and Xfone, these cellular operators are part of the four main telecommunications groups. In addition, there are three active MVNO operators – Hashikma Communications Marketing Ltd., ("Rami Levy"), Telzar 019 International Telecommunications Services Ltd. ("Telzar") and Cellact Communications Ltd. ("Cellact").

We compete principally on the basis of telecommunications service quality, brand identity, variety of handsets and other equipment, tariffs, value-added services and the quality of customer services.

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The table below sets forth an estimate of each operator's share of total subscribers in the Israeli cellular market at year-end for the years 2013 to 2017.

Estimated Market Shares*	2013	2014	2015	2016	2017
Partner	29 %	28 %	27 %	26 %	25 %
Cellcom	31 %	29 %	28 %	28 %	27 %
Pelephone	26 %	25 %	26 %	23 %	23 %
HOT Mobile	8 %	10 %	11 %	14 %	15 %
Golan Telecom and others	6 %	8 %	8 %	9 %	10 %

* Based on Partner subscriber data, as well as information contained in published reports, and public statements issued by other operators.

Cellcom. Cellcom is an Israeli corporation founded in 1994 that is traded both on the Tel Aviv stock exchange as well as NYSE. Cellcom's major beneficial shareholder is Discount Investment Corporation Ltd., which is controlled by Mr. Eduardo Elzstain. In August 2011, Cellcom acquired Netvision, an Israeli fixed-line operator. Cellcom operates nationwide cellular telephone networks as well as fixed-line telephony, transmission and data services and has partially deployed LTE. In 2014, Cellcom launched OTT television services. In April 2017, Cellcom announced that following receipt of regulatory approvals, its 3G and 4G networking sharing and 2G hosting services agreement with Golan Telecom, came into effect. In addition, in March 2017, Cellcom announced that it received regulatory approval for a networking sharing and hosting services agreement with Xfone. See "Item 3D.1d The Network Sharing Agreement we entered into with HOT Mobile may be terminated earlier than we expected due to regulatory intervention. In such case we will be required to split the shared network with HOT Mobile, and the resources, time and expense it may take us to have our own network on a nation-wide coverage may be substantial and could also materially harm our business and the results of operations at such time. Network sharing and similar agreements entered into by our competitors may place us at a competitive disadvantage."

Pelephone. Pelephone is an Israeli corporation that is a wholly-owned subsidiary of Bezeq, Israel's largest telecommunications provider and the primary fixed-line operator that is controlled by B Communications Ltd. B Communications Ltd. is indirectly controlled by Shaul Elovitz, the controlling shareholder of Eurocom Communications Ltd. Bezeq and its subsidiaries offer fixed-line telephony services, cellular telephony services, PRI, internet broadband access, ISP services, transmission and data communications services, ILD services and multi-channel television services.

HOT Mobile. HOT mobile is held indirectly by the Altice Group, a French media group, controlled by Mr. Patrick Drahi, who also holds control of HOT Telecommunications Systems Ltd. ("HOT Telecommunications"). The HOT Group's main areas of activity are multi-channel television services, fixed-line telephony services, PRI, internet broadband access, transmission and data communications services as well as ISP services through its subsidiary HOT-NET.

In April 2015, the MoC approved a 15-year network sharing agreement between Partner and HOT Mobile pursuant to which the parties created a limited partnership, to operate and develop a radio access network to be shared by both parties. See "Item 4B.8 Our Network- Cellular Network Sharing Agreement".

Other Operators

Golan Telecom. Since April 2017, Golan Telecom, is held by Electra Consumer Products Ltd., ("Electra") following the acquisition from Michael Golan, Xavier Niel and the Parienti family. In April 2017, Electra announced that following receipt of regulatory approvals, it finalized the acquisition of Golan Telecom and the 3G and 4G networking sharing and 2G hosting services agreement with Cellcom which came into effect. Golan Telecom began operations in early 2012 after winning a Ministry of Communications' tender offer for frequencies in the 2100 MHz spectrum.

Xfone. Xfone is a privately owned telecommunications company that provides telecommunications services, was awarded a 5MHz frequency band in the 1800 spectrum and recently entered the market as the sixth facility-based cellular operator. Xfone offers cellular services as well as ISP and ILD services.

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MVNOs. The Ministry of Communications has granted MVNO licenses to various companies, some of which have entered into hosting agreements with cellular operators. The major MVNOs are Rami Levy, which is a subsidiary of a major Israeli discount supermarket chain; Telzar, an ILD operator and Cellact which is owned by Cellact Ltd., a communications group active also in the content field.

In May 2013, we signed an MVNO agreement with Telzar with respect to their use of Partner's network as an MVNO.

Following a hearing published by the Ministry of Communications, in November 2014, the Ministry published an administrative decision, regarding the pricing of MVNO hosting by cellular operators. The MoC has decided that the reference point for whether a hosting price is considered reasonable will be the most favorable business proposals each cellular operator has offered to its commercial subscribers. An MVNO that claims that the hosting conditions prevent it from competing and does not reach an agreement with a cellular operator to change them, particularly as regards the price, may request the Minister of Communications to evaluate whether they are reasonable. As a result, the pricing we charge to host MVNOs on our network may be affected causing an adverse impact on our revenues.

In addition, Paltel operates a GSM mobile telephone network under the name "Jawwal" in the Palestinian Administered Areas. Paltel also operates a fixed-line network. Paltel's GSM network competes with our network in some border coverage overlap areas. A second Palestinian operator, Wataniya launched its GSM network during 2009.

Several service providers offer competitive roaming solutions. The service is offered, among others, by the International Long Distance vendors as well as by specialized enterprises. See also "Item 3D.1i Potential future regulation of roaming services may decrease our roaming revenues and negatively affect our income."

Market Saturation. Because the Israeli cellular market has reached a level of full saturation, except for natural market growth through the growth of population, any acquisition of new subscribers by any service provider typically results in a loss of market share for its competitors.

4B.9b Competitors in Fixed-line Services

In the fixed-line market, our main competitors are Bezeq, Israel's largest telecommunications provider and the primary fixed-line operator, HOT Telecom, and other telecommunication services providers, including Cellcom who operate in the fixed-line market. The Bezeq Group, the HOT Group and Cellcom provide cellular telephony services, ILD services, PRI, internet broadband access, ISP services, transmission and data communications services and multi-channel television services.

We compete principally on the basis of the variety of telecommunications services and offers which include bundled and triple service packages, service quality, brand identity, the variety of handsets and other equipment, tariffs and value-added services.

The Bezeq Group. The Bezeq Group is under structural separation rules which apply to management, employees, assets, marketing and finance and data systems. Starting in 2010, the Ministry of Communications has allowed the Bezeq Group to market bundled telecommunications services to the private sector, subject to certain conditions and limitations, including provisions which prevent Bezeq from discounting the price of bundled services from their unbundled prices and from including its fixed-line telephony service within bundles. See "Item 4B.2 Broadband and Internet services." Following implementation of the broadband wholesale market, the requirement for structural separation may be removed, which would allow Bezeq to take advantage of its nationwide presence and cross-subsidization to market and sell more competitive and attractive offers than we will be able to offer. Bundled offerings have become more frequent in Israel and have caused price erosion in the services included. See "Item 3D.1c3D.1c If the structural separation provisions (which apply to Bezeq and HOT) are not enforced or are removed before we have established ourselves in the fixed-line and TV markets, this would adversely affect our business and results of operations."

The HOT Group. The HOT Group may offer a bundle of services only including fixed-line telephony, broadband infrastructure and multi-channel television (“Triple”). The bundle of services currently offered by the HOT Group does not include cellular services (other than a bundle of cellular services with ISP services offered by its subsidiaries HOT Mobile and HOT-Net Internet Services Ltd. (“HOT-NET”).

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The Ministry of Communications allowed HOT Telecom LLP, HOT Telecommunication and HOT Mobile to sell and market each other's services and exchange information regarding such marketing activities.

Once an effective wholesale fixed-line market is operating, the Ministry of Communications may cancel the structural separation imposed on the Bezeq and HOT Groups. This will allow the groups to offer attractive bundles that include all of the above services that may result in a loss of market share by Partner in all relevant telecom markets. See "Item 3D.1c3D.1c If the structural separation provisions (which apply to Bezeq and HOT) are not enforced or are removed before we have established ourselves in the fixed-line and TV markets, this would adversely affect our business and results of operations."

The Cellcom Group. Cellcom provides landline telephony, transmission, PRI, ISP and data services through inland fiber optic transmission and complementary microwave links to business customers and private sectors. Since February 2015, Cellcom began marketing an ADSL infrastructure product (wholesale Bit Stream Access service provided over Bezeq's network). During 2015, Cellcom entered the television market using hybrid OTT-DTT television services which may be bundled with additional IP TV or over the top (OTT) offerings.

In the ILD services market, we compete with Netvision from the Cellcom Group, Bezeq International, Xfone, Hashikma Communications Marketing Ltd., Telzar 019 International Telecommunication Service Ltd, Golan Telecom International Ltd. and HOT Mobile International Telecommunications Ltd.

In the ISP services market, we compete with Netvision, Bezeq International, HOT Net from the HOT Group, Xfone, Triple C Cloud Computing Company Ltd., Telzar 019 International Telecommunication Service Ltd, Qwick linq 011 International Ltd., and 099 Primo Communications Ltd.

In the TV services market, we compete with Yes, a subsidiary of Bezeq, which offers TV services provided via satellite and via OTT, HOT that offers TV services provided via cable and via OTT, Cellcom that offers hybrid OTT-DTT TV services and Triple C Cloud Computing Company Ltd. that offers TV services via OTT. In addition, there are international VOD content providers that offer complementary TV content. See also "Item 4B.2 Special characteristics of the Fixed-Line Telecommunications Industry in Israel".

Israel Broadband Company (IBC). IBC received a general license for the provision of fixed-line telecom services (infrastructure) and for the establishment of a nationwide optic fiber network using the Israeli Electric Company's infrastructure in August 2013. IBC is owned by Israel Electric Corporation (40%) and a consortium of companies elected as the winning bidder in the election process, which is comprised of the following companies: ViaEuropa Israel Ltd., RAPAC Communication & Infrastructure Ltd., BATM advanced Communication Ltd., Tamares Holdings Sweden AB and Zisapel Properties (1992) Ltd. and Cisco Systems Finance International (60%). Although IBC is in principle permitted to provide its services only to other telecommunications licensees on a wholesale basis, IBC has introduced a new business model which enables it to reach the retail market through the services of ISPs who sign agreements with them. Currently, IBC has agreements with the relatively small ISPs while the three major ISPs in Israel (Bezeq International, Netvision and Partner) have no distribution agreements with IBC. IBC has retained Rothschild Bank in its attempt to find a strategic investor. Partner is examining the feasibility of such investment, as are other entities.

4B.10 INFORMATION TECHNOLOGY

We depend upon a wide range of information technology systems to support network management, subscriber registration and billing, customer service, marketing and management functions. These systems execute critical tasks for our business, from rating and billing of calls, to monitoring our points of sale and network sites, to managing highly segmented marketing campaigns. We have devoted resources to expanding and enhancing our information technology systems, including Customer Relations Management ("CRM") systems, which have contributed to our customers' satisfaction with our service, as well as updating our financial management and accounting system. We

believe these systems are an important factor in our business success.

While many of our systems have been developed by third-party vendors, all of them have been modified and refined to suit our particular needs. In certain instances, we have developed critical information technology capabilities internally to meet our specific requirements. In connection with our transformation into a diversified multi-service communications provider, we have completed significant milestones in our CRM upgrade project. In addition, the Company invested resources to improve the quality of the IT processes and billing accuracy.

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4B.11 INTELLECTUAL PROPERTY

We are the registered owners of the trademark “Partner” in Israel with respect to telecommunications-related devices and services, as well as additional trademarks. We have also registered several internet Web domain names, including, among others: www.partner.co.il. 012 Smile is the registered owner of several trademarks in Israel with respect to telecommunications-related services that include the numbers “012”. In addition, 012 Smile has registered several internet Web domain names, including, among others, www.012.net and www.012.net.il. Partner is the assignee in a patent application filed in March 2012 that claims a method for delivering short messages originated by roaming prepaid subscribers. A Notice of Allowance was issued for the application in September 2013 and a patent was issued on January 14, 2014.

In addition, we are a full member of the GSMA Association. In conjunction with the promotion and operation of our GSM network, we have the right to use their relevant intellectual property, such as the GSM trademark and logo, security algorithms, roaming agreement templates, and billing transfer information file formats. We are eligible to remain a member of the GSMA Association for as long as we are licensed to provide GSM service.

4B.12 REGULATION

4B.12a Overview

We operate within Israel primarily under the Telecommunications Law, the Wireless Telegraphy Ordinance (New Version), 1972 (the “Wireless Telegraphy Ordinance”), the regulations promulgated by the Ministry of Communications and our license. The Ministry of Communications issues the licenses which grant the right to establish and operate mobile telephone and other telecommunication services in Israel, and sets the terms by which such services are provided. The regulatory framework under which we operate consists also of the Companies Law, the Securities Law, the Planning and Building Law, the Consumer Protection Law, 1981, and the Non-Ionizing Radiation Law. Additional areas of Israeli law may be relevant to our operations, including antitrust law, specifically the Restrictive Trade Practices Law, the Class Actions Law, 2006, the Centralization Law, 2013 and administrative law.

4B.12b Telecommunications Law

The principal law governing telecommunications in Israel is the Telecommunications Law and related regulations. The Telecommunications Law prohibits any entity, other than the State of Israel, from providing public telecommunications services without a license issued by the Ministry of Communications.

General licenses, which relate to telecommunications activities over a public network or for the granting of nationwide services or international telecommunications services, have been awarded to the Bezeq Group, to the HOT Group, to four other cellular operators besides Partner and to the international operators. In addition, the Ministry of Communications has granted MVNO licenses to a number of companies. During 2015 and 2016, the Ministry of Communications substituted almost all of the MVNO licenses and all general licenses for ILD services and unique-general licenses for fixed line services, with a single type of general unified license which governs all the services regulated under all of such licenses.

The Ministry of Communications has the authority to amend the terms of any license. The grounds to be considered in connection with such an amendment are government telecommunications policy, public interest, the suitability of the licensee to perform the relevant services, the promotion of competition in the telecommunications market, the level of service and changes in technology. The Ministry of Communications may also make the award of certain benefits, such as new spectrum, conditional upon the licensee’s consent to a license amendment. The Ministry of Communications also has the authority to revoke, limit or suspend a license at the request of the licensee or when the licensee is in breach of a fundamental condition of the license, when the licensee is not granting services under the license or is not granting services at the appropriate grade of service or when the licensee has been declared bankrupt

or an order of liquidation has been issued with respect to the licensee. Public interest may also be grounds for the rescission or suspension of a license.

The Ministry of Communications, with the consent of the Ministry of Finance, may also promulgate regulations to determine interconnect tariffs, or formulae for calculating such tariffs. Moreover, the Ministry of Communications may, if interconnecting parties fail to agree on tariffs, or if regulations have not been promulgated, set the interconnect tariff based on cost plus a reasonable profit, a benchmark (derived from relevant retail prices in Israel or abroad), or based on each of the interconnecting networks bearing its own costs.

The Telecommunications Law also includes certain provisions which may be applied by the Ministry of Communications to general licensees, including rights of way which may be accorded to general licensees to facilitate the building of telecommunications networks or systems and a partial immunity against civil liability which may be granted to a general licensee, exempting the licensee, among others, from tort liability with the exception of direct damage caused by the suspension of a telecommunications service and damage stemming from intentional or grossly negligent acts or omissions of the licensee. The Ministry of Communications has applied the partial immunity provisions to us, including immunity in the event that we cause a mistake or change in a telecommunication message, unless resulting from our intentional act or gross negligence. The Ministry of Communications initiated a review to re-evaluate the scope of the immunity provisions.

The Ministry of Communications is authorized to impose significant monetary sanctions on a license holder that breaches a provision of the Telecommunications Law or of its license.

Frequency Fees. Under the Telegraph Regulations, the Company is committed to pay an annual fixed fee for each frequency used. For the years 2015, 2016 and 2017, the Company paid a total amount of approximately NIS 65 million, NIS 64 million and NIS 63 respectively. See also note 17(1) to the consolidated financial statements. Under the above Regulations, should the Company choose to return a frequency band, such payment is no longer due. Commencing August 2016, the total amount of frequency fees of both the Company and HOT Mobile under the regulations is split between the Company and HOT Mobile, through PHI, according to the OPEX-CAPEX mechanism (see also note 9 to the consolidated financial statements).

Royalties. Pursuant to the Communications Regulations (Telecommunications and Broadcasting) (Royalties), 2001, royalties may be payable to the State of Israel calculated as a percentage of relevant revenues. However since 2013 the royalty rate has been set at 0%.

4B.12c Fair Competition and Antitrust Law

Provisions prohibiting Partner from engaging in anti-competitive practices can be found in our license and in the licenses of the other telecommunications operators, in the various telecommunications regulations and in the Restrictive Trade Practices Law. Our license emphasizes the principle of granting users equal access to the systems of each of the operators upon equitable terms. The Telecommunications Law also provides certain protection against disruption of telecommunications services.

The Restrictive Trade Practices Law is the principal statute concerning restrictive practices, mergers and monopolies. This law prohibits a monopoly from abusing its market position in a manner that might reduce competition in the market or negatively affect the public. The law empowers the Commissioner of Restrictive Trade Practices to instruct a monopoly abusing its market power to perform certain acts or to refrain from certain acts in order to prevent the abuse. Bezeq has been declared a monopoly in certain markets. HOT has been declared a monopoly in the multi-channel television market.

4B.12d Securities Administrative Enforcement and Antitrust Enforcement

The Israeli Securities Authority, or ISA may impose various civil enforcement measures, including financial sanctions, payment to the harmed party, prohibition of the violator from serving as an executive officer for a certain period of time, annulment or suspension of licenses, approvals and permits granted under securities and

securities-related laws and adopt an agreed settlement mechanism as an alternative for a criminal or administrative proceeding. In case of a violation by a corporation, the Israeli Securities laws provide for additional responsibility of the Chief Executive Officer in some cases, unless certain conditions have been met, including the existence of procedures for the prevention of the violation, as part of an internal enforcement plan. The Company is prohibited from insuring, paying or indemnifying directors or senior officers for financial sanctions imposed on them subject to certain exemptions set forth in the law.

The Company has implemented an internal enforcement plan and has implemented an internal antitrust enforcement plan intended to ensure that all relevant parties in the Company comply with antitrust laws and regulations. The Company provides ongoing guidance and training to the Company's directors, office holders and relevant employees.

4B.12e Regulatory Developments

See also “Item 3D.1RISKS RELATING TO THE REGULATION OF OUR INDUSTRY” for a discussion of how recent regulatory developments create risks for our financial condition, business and results of operations.

4B.12e - i Privacy Protection Regulations

In May 2018, the Privacy Regulations (Data Security), 2017 will enter into force , extensively overhauling the current data security regulations dating back to 1986, and introducing modern privacy and data security requirements to Israeli law. Among other requirements, the new regulations introduce data breach notification for significant breaches, which, in some cases, may also need to be notified to data subjects and to the Privacy Protection Authority. In its 2016 Annual Report, published in November 2017, the Privacy Protection Authority pledged to review gaps between Israeli law and the EU’s General Data Protection Regulation (Regulation (EU) 2016/679, “GDPR”), also due to enter into force in May 2018, and to recommend the required adaptations. These developments would impose a heavier regulatory burden on the company requiring it to change its data processing practices in a manner which could limit some of its activities, including in the area of big data. The heavier regulatory load, and its enhanced transparency requirement, could also result in more enforcement and litigation.

4B.12e - ii Wholesale Bit Stream internet access service on HOT's infrastructure

In June 2017, the Ministry of Communications published the maximum tariffs for HOT's wholesale bit-stream internet access service. The Ministry has yet to publish its decisions regarding several critical issues which have so far delayed the actual implementation of this wholesale market. In addition, HOT has failed to implement some aspects of the service and these await enforcement by the Ministry. Therefore, there is still no clear deadline for the implementation of the service.

4B.12e - iii Hearings and Examinations

The Ministry of Communications and other regulators have also conducted hearings and examinations on various matters related to our business, such as:

Roaming fees. The Ministry of Communications is evaluating the cost of roaming and may introduce new regulations that would limit fees charged by Israeli cellular companies for calls made by the customers of foreign network operators while they are in Israel and using our network, as well as for calls made by our own customers using their handsets abroad. The Ministry of Communications has requested additional and more specific international roaming data from the cellular companies. Because we consider roaming charges to be a significant source of revenue, such regulatory limits could adversely affect our revenues.

Roaming services. In August 2014, the Ministry of Communications published a hearing aimed at increasing competition in roaming services abroad currently provided by cellular licensees. As part of the hearing, the Ministry proposed to enable every cellular subscriber to receive roaming services abroad from operators which are not his cellular provider (on top of his cellular operator) while keeping his cellular number. These alternative roaming providers include other cellular licensees, MVNOs, ISPs, ILD licensees and fixed telephony licensees. The Ministry of Communications also suggested determining various measures intended to improve transparency and to limit subscriber payments only to the exact volume of services consumed. Such measures include: all roaming calls abroad (incoming and outgoing) would be billed using time units of 1 second; all roaming data sessions would be billed using volume units of 1KB; the billable duration of all voice calls would be from the second in which the call was connected and until it ended (explicitly excluding any wait period from pushing the “call” button until the call is connected). Because we consider roaming charges to be a significant source of revenue, such regulatory limits could adversely affect our revenues.

Frequency fees. The Ministry of Communications is conducting a re-assessment of the frequency fees set forth in the law, which includes the assessment as to its economic value, in order to support effective allocation and the utmost utilization of the frequencies.

Roaming services during emergencies. In September 2012, the Ministry of Communications published a hearing with respect to roaming during a state of emergency or during a significant continuous malfunction in which the Ministry of Communications considers determining that under certain conditions, upon the Minister of Communications’ instruction, cellular operators that have their own network infrastructure, will be required to provide roaming services to the subscribers of other cellular operators that have network infrastructure, whose network has been rendered non-functioning for a significant amount of time following an event resulting from a state of emergency, a telecommunications crisis or during a significant continuous malfunction. The Company submitted its response to the hearing in October 2012. The revenues of the Company would be adversely affected if these proposed new regulations are adopted.

Intervention in international call market. In October 2013, the Ministry of Communications published a hearing regarding new regulation of the international call market. In the hearing, it was proposed by the Ministry to allow all general licensees (including MVNOs) to provide international call services to their subscribers, with respect to the international destinations which are included in their subscribers’ tariff plans and to international destinations for which the tariff is lower or equal to the tariff of a call on the licensee’s network (“Included Destinations”). The Ministry of Communications also proposed in the hearing that the general licensees (such as cellular operators) would not be allowed to collect an interconnect fee for outgoing international calls. The Company submitted its response to the hearing in January 2014. In October 2014, the Ministry published a secondary hearing on this matter, in which it proposed that all outgoing international calls which are not to Included Destinations, shall be preceded with a voice message stating the tariff of such call and allowing the subscriber to disconnect without being charged. The Company submitted its response to this secondary hearing in October 2014. The revenues of the Company may be adversely affected if the changes proposed in these hearings are adopted.

Filtering of offensive websites and content. In August 2014, the Ministry of Communications published a hearing regarding proposed amendments to telecommunications licenses granted to various operators, including the Company and its subsidiaries. According to the Telecommunications Law, ISP and cellular licensees, are required to provide a service for filtering of offensive websites and content at no additional cost to the subscriber. The Law also includes provisions which oblige said licensees to inform their subscribers of the dangers of internet use (including offensive websites and content). As part of the hearing, it is proposed to amend the ISP and cellular licenses to include additional requirements to the existing requirements described above. The proposed amendments include, among others, the following matters: (1) detailed specifications of the filtering service; (2) requirements regarding the informational leaflet to be provided to the subscriber; and (3) an obligation to offer filtering software to be installed on any type of terminal equipment. In October 2014, the Company filed its written position seeking to limit the impact of the proposed amendments. In November 2016, the Ministry of Communications sent the operators a

request for information regarding the execution of the filtering obligation of offensive websites and content, in light of the complaints received with respect to the implementation of the existing provisions regarding this matter. In this context, the Ministry sought to receive information with respect to, among others, the tools used by the Company to implement the license provisions and the rules and laws by which the filtering is executed. In addition, a number of draft bills have been submitted to the Knesset suggesting broadening the existing requirements regarding content and site filtering.

Consumer protection-call centers. In August 2014, the Ministry of Communications published a hearing regarding proposed amendments to telecommunications licenses granted to various operators, including the Company and its subsidiaries. As part of the hearing, it is proposed to amend the licenses with respect to the quality of service of the licensees' call centers. The amendments include, among others, the following matters: the maximum response times for each call and the average daily response times; recording requirement regarding a billing inquiry, termination of all services or termination of a single service calls; and requirement to issue and to publish on the licensees' websites detailed weekly reports that will include complete data in relation to their conduct regarding response times. The Company submitted its response to the hearing in October 2014. If the final decision in this hearing process will be similar to that suggested in the hearing, the Company may be negatively affected by the results of the hearing.

Transmission line connections between ISP providers' facilities and fixed-line infrastructure. In April 2015, the Ministry of Communications published a hearing, stating that Bezeq and HOT Telecom (the "infrastructure owners") would not be allowed to oblige ISP providers to purchase "Gigabit Ethernet" services (transmission services which connect ISP's facilities to Bezeq and HOT Telecom's infrastructures) from the infrastructure owners and the ISP providers would be allowed to purchase "Gigabit Ethernet" services from other licensees or perform such connections themselves. As part of the hearing, the Ministry stated that such a practice of the infrastructure owners does not presumably comply with the Telecommunications Law, which states that a licensee will be forbidden to condition the supply of a certain telecommunications service upon the supply of another telecommunications service. The Company submitted its response to this hearing. If the final decision in this hearing process will be as suggested in the hearing, the Company may be positively affected by the results of the hearing.

4B.12e - iv The Ministry of Communications policy regarding the fixed-line telecommunications sector

In May 2012, the Ministry of Communications published the final policy document with respect to increasing competition in the fixed-line telecommunications market. The document adopted the main recommendations of the Hayek Committee, a committee formed by the MoC to study and make recommendations regarding the Israeli telecommunications market. The main points were as follows:

A. Sale of wholesale services:

The two wireline infrastructure operators that provide retail telecommunication services will be required to offer i. wholesale services to the other telecommunication providers, that will offer services on the owners' infrastructure (the wholesale market), based on non-discriminatory conditions.

The wholesale services tariffs and the terms of agreement shall be determined through negotiations between the two wireline infrastructure operators and the service providers. An infrastructure owner that reaches an agreement with ii. such other provider shall be required to offer the same terms, without discrimination, to all other providers.

Affiliates of the infrastructure owner shall also be allowed to purchase wholesale services as long as these will be provided without discrimination to all other providers.

The Ministry of Communications shall intervene and set the wholesale tariffs and said terms of agreement, in case iii. an agreement has not been reached between the parties within 6 months from the date of the publication of the policy document or if the agreement between the parties includes tariffs or terms that are unreasonable, may harm the competition, may harm the public welfare or may harm the interest of the service provider.

B. Structural Separation

Within 9 months of a signed agreement between said parties, the structural separation between the fixed-line infrastructure owner and its international call provider and internet service provider (ISP) affiliates shall be abolished and replaced by an accounting separation.

The Minister of Communications shall consider providing leniencies or abolishing the structural separation (and replacing it with an accounting separation) between the fixed-line infrastructure owner and its affiliated cellular operator, in accordance with the development of the wholesale market and the pace of development of competition based on packaged services that combine fixed-line services and cellular services in the private sector.

In case a proper and appropriate wholesale market does not develop within 24 months from the date of the publication of the policy document, the Minister of Communications shall act to impose a structural separation in the fixed-line infrastructure owners, between the infrastructure and the services provided through this infrastructure to the end-customers.

C. Supervision over Bezeq Tariffs

Within 6 months from the date such an agreement is signed between the said parties, the Ministry of Communications shall act to change the manner of supervision over Bezeq tariffs so that the supervision shall be done by setting a maximum tariff.

D. Television Broadcasts

The Ministry of Communications shall examine imposing a requirement to offer unbundled television services that are included in services packages that include telecommunication services (fixed-line and mobile) or broadband access services, which means a requirement to provide them at the same tariff as part of a service package or separately.

The abolishing of the structural separation with respect to multi-channel television shall be done if there is a reasonable possibility to provide a basic package of television services through the internet by service providers that do not own fixed-line infrastructure.

In June 2013, since no agreement had been achieved according to clause a(iii) above, the Ministry of Communications published a hearing regarding a basic offering of wholesale services and their prices, that an infrastructure owner shall be required to offer on the same terms, without discrimination, to all providers. After a long process involving several hearings (regarding the texts of the relevant service portfolios and the prices of said wholesale services), in November 2014, the Ministry of Communications published the decision of the Minister of Communications regarding regulation of the wholesale market for broadband fixed-line telecommunications services - defining a format for the supply of wholesale services and setting a tariff for the supply of these services.

Within this framework, the Minister of Communications decided to amend the licenses of the infrastructure owners - Bezeq and HOT - and to prescribe the service portfolio - managed broadband access and wholesale telephony service. The regulations attached to the Minister of Communications' decision prescribe the obligation to supply the wholesale services, including ancillary services, as well as maximum tariffs (requiring the approval of the Minister of Finance) for the said wholesale services. The tariffs set at this stage, relate solely to services to be provided by Bezeq. The Ministry of Communications initiated a separate regulation process addressing the tariffs for the wholesale services to be provided by HOT, a cable infrastructure owner, as described hereinafter.

In December 2014, Bezeq submitted a petition to the High Court of Justice against the MoC and the Minister regarding said decision. In the petition Bezeq claims, among others, that the hearing procedure conducted by the MoC

did not comply with the administrative law requirements and that both the wholesale telephony service and the tariffs that were set for the wholesale market services deviate from the Minister's authority under the Law. The Company was nominated as a respondent to the petition. If changes are made to the Minister's decision that cause an increase in the wholesale tariffs or a worsening of the technical and operational standards set by the MoC, this could negatively affect our results of operations. In October 2015, the Court published a decision, in which the Court rejected Bezeq claims with respect to the feasibility of implementation of a telephony wholesale market. The MoC has since published a consultation with respect to the resale of Bezeq's telephony services during an interim period of approximately one year.

Margin Squeeze - In November 17, 2014, the Ministry of Communications published a hearing to examine the format for preventing a “margin squeeze” by the fixed-line infrastructure owners - Bezeq and HOT - which occurs when an infrastructure owner lowers its retail prices and narrows the margin between its retail prices and the wholesale price of those infrastructure inputs being purchased by service-providers to a level that erodes the service-providers’ margin to the point of eradicating the economic feasibility of continuing their operations, the objective being to push service-providers out of the market. The Company submitted its response to the hearing in December 2014. In August 29, 2017, the Ministry of Communications published a secondary hearing on this subject in which it suggested several changes to the format suggested in the first hearing on this issue. The Company submitted its response to the secondary hearing in November 2017. Should the Ministry of Communications’ decision with regard to the margin squeeze mechanism not prove effective in ensuring the effectiveness of the wholesale market, our profitability and results of operations could be materially adversely affected.

In December 2015, the MoC issued an administrative instruction regarding the use of terminal equipment, as part of the wholesale market services, in order to ensure continuity of the service for the end users. As part of its decision, the MoC established the following arrangements:

A service provider which loaned or rented terminal equipment to its subscriber, that later becomes a subscriber of another service provider in the wholesale market, will not be able to prevent or limit the continuity of the subscriber's ordinary use of the terminal equipment, for a period of 21 days;

The payment to the service provider for the terminal equipment during such interim period will be performed by the subscriber, in a similar manner to its arrangement with its previous service provider (and the subscriber would not pay any payment for such equipment to the new service provider).

In July 2015, one day before the date of entry into force of the wholesale service of access to passive infrastructure of infrastructure owners, the Ministry of Communications published new instructions regarding the compliance with security requirements in relation to the use of HOT and Bezeq's passive infrastructure, valid until November 1, 2015. According to the instructions, during such period, the performance of the work required for the grant of access to HOT and Bezeq's infrastructure will be made only by the infrastructures owners (Bezeq or HOT) and not by the service providers. In addition, the instructions set restrictions regarding the access to the infrastructure owner's information, concerning the deployment of infrastructure. As part of the Economic Program Law for the years 2017-2018, that was published at the end of December 2016 it was determined, among others, that Bezeq and HOT Telecom will be required to allow other domestic operators including Partner, access to passive infrastructures. Following the enactment of this legislation, Bezeq has begun to partially observe its duty to provide access to its passive infrastructures and deployed several fiber optic cables for licensees using its own personnel.

On October 19, 2017, the Ministry of Communications instructed Bezeq to comply with its existing policy and clarified that it must allow other domestic operators (including Partner) to deploy fiber optic cables with their own contractors (without the need for the use of Bezeq personnel). This change has the potential to substantially increase the speed of deployment of Partner's fiber infrastructure. Bezeq has filed an administrative appeal to the Supreme Court against the MoC's demand for compliance, but its appeal has been rejected on January 29, 2018.

In December 2015, the Ministry of Communications published a hearing with respect to the resale of Bezeq's telephony services in the wholesale market. In the hearing, the Ministry proposed to allow Bezeq to offer telephony services in a resale format, instead of the wholesale telephony service, for a period of 12 months; this, by amendment of Bezeq's general license and adding the said services to the list of services that Bezeq may provide. Respectively, the Ministry is considering amending Bezeq's license so that during this interim period, Bezeq will not be obliged to offer wholesale telephony services. According to the hearing, the payment offered by Bezeq for the resale of services will be derived from the retail prices of Bezeq's attractive minute bundles which are reduced at a rate of 40%, and said reduction should be derived from the average rates for the first and second year tariffs of these bundles. The Company submitted its response to this hearing in the beginning of 2016 in which it argued against the interim arrangement and

the MoC authority to set wholesale prices in a license (such regulation requires the setting of regulations to be co-signed by the Minister of Finance). Alternatively, the Company argued that the suggested price for the resale telephony service is too high and does not leave any margin for competition and market entry.

In May 2017, the Ministry of Communications published its decision on this issue and obliged Bezeq to offer its telephony services to other operators in a resale format as of July 2017. The price paid to Bezeq by the operators for the resale telephony was suggested by the Ministry to be set substantially higher than the prices set for the planned full wholesale telephony product.

According to the decision, the date of implementation of the full wholesale telephony service has been postponed at the latest by July 18, 2018. However, the Ministry will consider whether to extend the temporary resale arrangement or to make it permanent in light of the competitive situation over the coming year.

The Ministry allowed interested parties to present their positions regarding the prices set for the resale format and the Company filed its response with the Ministry. The Company argued for lower tariffs for the resale telephony product and insisted that this arrangement can only be a temporary arrangement. The Minister committed that any possible change to the price (that may result from the hearing) would be applied retroactively.

The Ministry has not yet decided on any change to the price of the resale service. At the current price level, such service remains unprofitable and has not been taken up by any service provider.

In order to provide an incentive for Bezeq to implement the wholesale market, the MoC has announced that it intends to cancel the regulations requiring Bezeq to maintain a "structural separation" between its fixed-line and mobile telecommunications operations, and to change the current retail fixed-price tariff control mechanism to a "maximum tariff" one. In 2016, the MoC has published official announcements which indicate its satisfaction with the implementation of the wholesale market reform. We have strongly opposed the factual descriptions and the conclusions in the announcement. Furthermore, in December 2016, the MoC also declared its intention to promote the cancelation of "corporate separation" in the Bezeq Group, subject to a hearing, and to publish a hearing in 2017 suggesting canceling the "structural separation" in the Bezeq Group. The Ministry of Finance, the Anti-Trust Commissioner and the State Comptroller have stated their objection to the implementation of the MoC's intent at this stage. If the MoC removes the structural separation provisions based on its above-mentioned announcements before we have firmly established ourselves in the fixed-line telecommunications services market (in both fixed-line telephony and broadband), Bezeq may be able to propose bundled services more effectively than us, and thereby gain a competitive advantage which would negatively affect our results of operations. Also see "Item 3D.1c3D.1c If the structural separation provisions (which apply to Bezeq and HOT) are not enforced or are removed before we have established ourselves in the fixed-line and TV markets, this would adversely affect our business and results of operations."

4B.12e - v Anti-Trust Regulation.

Pursuant to the Israeli Restrictive Trade Practices Law, if the Anti-Trust Commissioner decides that the Israeli cellular market is oligopolistic, the Director General will have the authority to give instructions to all or some of the participants in our market, in order to, among other objectives, maintain or increase the competition level among the participants, the Director General's authority would include the ability to issue orders to remove or to ease entry or transfer barriers, to terminate a participant's activity, or otherwise to regulate the activities of the market.

4B.12f Our Mobile Telephone License

On April 7, 1998, the Ministry of Communications granted to us a general license to establish and operate a mobile telephone network in Israel as well as offer roaming services outside the State of Israel.

Under the terms of the license, we have provided an \$80 million guarantee to the State of Israel to secure the Company's adherence to the terms of the license.

Our license allocates to us specified frequencies and telephone numbers.

Term. Our license was originally valid for a period of ten years (until April 2008), but has been extended until 2022. At the end of this period, the license may be extended for additional six-year periods upon our request to the Ministry of Communications, and a confirmation from the Ministry of Communications that we have met the following performance requirements:

- observing the provisions of the Telecommunications Law, the Wireless Telegraphy Ordinance, the regulations and the provisions of our license;

- acting to continuously improve our mobile telephone services, their scope, availability, quality and technology, and that there has been no act or omission by us harming or limiting competition in the mobile telephone sector;

- having the ability to continue to provide mobile telephone services of a high standard and to implement the required investments in the technological updating of our system in order to improve the scope of such services, as well as their availability and quality; and

- using the spectrum allocated to us efficiently, compared to alternative applications.

We believe that we will be able to receive an extension to the license upon request.

Our license may also be revoked, limited or altered by the Ministry of Communications if we have failed to uphold our obligations under the Telecommunications Law, the Wireless Telegraphy Ordinance or the regulations, or have committed a substantial breach of the license conditions. Examples of the principal undertakings identified in our license in this connection are:

- We have illegally ceased, limited or delayed any one of our services;

 - Any means of control in Partner or control of Partner has been transferred in contravention of our license;

- We fail to invest the required amounts in the establishment and operation of the mobile radio telephone system in accordance with our undertakings to the Ministry of Communications;

- We have harmed or limited competition in the area of mobile radio telephone services;

- A receiver or temporary liquidator is appointed for us, an order is issued for our winding up or we have decided to voluntarily wind up; or

Partner, an Office Holder in Partner or an Interested Party in Partner or an Office Holder in an Interested Party of Partner is an Interested Party in a competing mobile radio telephone operator or is an Office Holder in a competing mobile radio telephone operator or in an interested party in a competing mobile radio telephone operator without first obtaining a permit from the Ministry of Communications to do so or has not fulfilled one of the conditions included in such permit. See “Item 4B.12f Our Mobile Telephone License-Our Permit Regarding Cross Ownership.”

Our license authorizes us on a non-exclusive basis to establish and operate a mobile telephone network in Israel. The Ministry of Communications amended our license in August 2015 to include the provision of 4G services in the 1800 MHZ spectrum and to allow us access network sharing with HOT Mobile, another cellular operator at a bandwidth of up to 25 MHZ in the 1880 MHZ spectrum.

License Conditions. Our license imposes many conditions on our conduct.

- We must at all times be a company registered in Israel.

Our founding shareholders and their approved substitutes must hold, in the aggregate, at least 26% of each of our means of control. Furthermore, the maintenance of at least 26% of our means of control by our founding shareholders and their approved substitutes allows Partner to be protected from a license breach that would result from a transfer of shares for which the authorization of the Ministry of Communications was required, but not obtained.

Israeli entities from among our founding shareholders and their approved substitutes must hold at least 5% of our issued and outstanding share capital and of each of our means of control. "Israeli entities" are defined as individuals who are citizens and residents of Israel and entities formed in Israel and controlled, directly or indirectly, by individuals who are citizens and residents of Israel, provided that indirect control is only through entities formed in Israel, unless otherwise approved by the Israeli Prime Minister or Minister of Communications.

At least 10% of our Board of Directors must be appointed by Israeli entities, as defined above, provided that if the Board of Directors is comprised of up to 14 members, only one such director must be so appointed, and if the Board of Directors is comprised of between 15 and 24 members, only two such directors must be so appointed.

Matters relating to national security shall be dealt with only by a Board of Directors' committee that has been formed for that purpose. The committee includes at least 4 members, of which at least one is an external director. Only directors with the required clearance and those deemed appropriate by Israel's General Security Service may be members of this committee. Resolutions approved by this committee shall be deemed adopted by the Board of Directors.

The Ministry of Communications shall be entitled to appoint an observer to the Board of Directors and its committees, subject to certain qualifications and confidentiality undertakings.

Contracting with Customers. Pursuant to our license, we have submitted our standard agreement with customers to the Ministry of Communications for their examination. To date, we have not received any comments from the Ministry of Communications regarding this agreement.

Tariffs. Our license requires us to submit to the Ministry of Communications our tariffs (and any changes in our tariffs) before they enter into effect. Our license allows us to set and change our tariffs for outgoing calls and any other service without approval of the Ministry of Communications. However, the Ministry of Communications may intervene in our tariffs if it finds that our tariffs unreasonably harm consumers or competition.

Payments. Our license specifies the payments we may charge our subscribers. These include one-time installation fees, one-time SIM card payments, fixed monthly payments, airtime fees, payments for the use of other telecommunication systems, payments for handset maintenance and payments for additional services. In some of our tariff plans we have chosen to charge only for airtime and use of services. See "Item 4B.5c Tariff Plans."

Interconnection. Like the licenses of Pelephone, Cellcom and HOT Mobile, our license requires that we interconnect our mobile telephone network to other telecommunications networks operating in Israel, including that of Bezeq and other domestic fixed-line operators, the other mobile telephone operators and the international operators.

Conversely, we must allow other network operators to interconnect to our network. See "Item 4B.8h Interconnection".

Service Approval. The Ministry of Communications has the authority to require us to submit for approval details of any of our services (including details concerning tariffs). In addition, we are required to inform the Ministry of Communications prior to the activation of any service on a specified list of services.

Access to Infrastructure. The Ministry of Communications has the power to require us, like the other telephone operators in Israel, to offer access to our network infrastructure to other operators. We may also be required to permit other operators to provide value-added services using our network.

Universal Service. We are required to provide any service with the same coverage as our existing network. According to our license, we are required to meet certain coverage requirements for our 3G and 4G services.

Territory of License. In May 2000, we were also granted a license from the Israeli Civil Administration, to provide mobile services to the Israeli populated areas in the West Bank. The license is effective until February 1, 2022. The provisions of the general license described above, including as to its extension, generally apply to this license, subject to certain modifications. We believe that that we will be able to receive an extension to this license upon request.

Transfer of license, assets and means of control. Our license may not be transferred, mortgaged or attached without the prior approval of the Ministry of Communications.

We may not sell, lease or mortgage any of the assets which serve for the implementation of our license without the prior approval of the Ministry of Communications, other than in favor of a banking corporation which is legally active in Israel, and in accordance with the conditions of our license.

Our license provides that no direct or indirect control of Partner may be acquired, at one time or through a series of transactions, and no means of control may be transferred in a manner which results in a transfer of control, without the consent of the Ministry of Communications. Furthermore, no direct or indirect holding of 10% or more of any means of control may be transferred or acquired at one time or through a series of transactions, without the consent of the Ministry of Communications. In addition, no shareholder of Partner may permit a lien to be placed on shares of Partner if the foreclosure on such lien would cause a change in the ownership of 10% or more of any of Partner's means of control unless such foreclosure is made subject to the consent of the Ministry of Communications. For purposes of our license, "means of control" means any of:

- voting rights in Partner;
- the right to appoint a director or managing director of Partner;
- the right to participate in Partner's profits; or
- the right to share in Partner's remaining assets after payment of debts when Partner is wound up.

Each of our ordinary shares and ADSs is considered a means of control in Partner.

In addition, Partner, any entity in which Partner is an Interested Party, as defined below, an Office Holder, as defined below, in Partner or an Interested Party in Partner or an Office Holder in an Interested Party in Partner may not be a party to any agreement, arrangement or understanding which may reduce or harm competition in the area of mobile telephone services or any other telecommunications services.

In connection with our initial public offering, our license was amended to provide that our entering into an underwriting agreement for the offering and sale of shares to the public, listing the shares for trading, and depositing shares with the depositary or custodian will not be considered a transfer of any means of control, as defined below. Pursuant to the amendment, if the ADSs (or other "traded means of control," that is, means of control which have been listed for trade or offered through a prospectus and are held by the public) are transferred or acquired in breach of the restrictions imposed by the license with respect to transfer or acquisition of 10% or more of any means of control, we must notify the Ministry of Communications and request the Ministry's consent within 21 days of learning of the breach. In addition, should a shareholder, other than a founding shareholder, breach these ownership restrictions, or provisions regarding acquisition of control or cross-ownership or cross-control with other mobile telephone operators or shareholdings or agreements which may reduce or harm competition, its shareholdings will be marked as exceptional shares and will be converted into dormant shares, as long as the Ministry's consent is required but not obtained, with no rights other than the right to receive dividends and other distributions to shareholders, and to participate in rights offerings.

The dormant shares must be registered as dormant shares in our share registry. Any shareholder seeking to vote at a general meeting of our shareholders must notify us prior to the vote, or, if the vote is by deed of vote, must so indicate on the deed of vote, whether or not the shareholder's holdings in Partner or the shareholder's vote requires the consent of the Ministry of Communications due to the restrictions on transfer or acquisition of means of control, or provisions regarding cross-ownership or cross-control with other mobile telephone operators or shareholders. If the shareholder does not provide such certification, his instructions shall be invalid and his vote not counted.

The existence of shareholdings which breach the restrictions of our license in a manner which could cause them to be converted into dormant shares and may otherwise provide grounds for the revocation of our license will not serve in and of themselves as the basis for the revocation of our license so long as:

the founding shareholders or their approved substitutes of Partner continue to hold in the aggregate at least 26% of the means of control of Partner;

our Articles of Association include the provisions described in this paragraph;

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- we act in accordance with such provisions;

Our Articles of Association provide that an ordinary majority of the voting power at the general meeting of Partner is entitled to appoint all the directors of Partner other than external directors.

The dormant share mechanism does not apply to our founding shareholders.

The provisions contained in our license are also contained in our Articles of Association. In addition, our Articles of Association contain similar provisions in the event the holdings of shares by a shareholder breaches ownership limits contained in our license.

Revoking, limiting or altering our license. Our license contains several qualifications that we are required to meet. These conditions are designed primarily to ensure that we maintain at least a specified minimum connection to Israel. Other eligibility requirements address potential conflicts of interest and cross-ownership with other Israeli telecommunications operators. The major eligibility requirements are set forth below. A failure to meet these eligibility requirements may lead the Ministry of Communications to revoke, limit or alter our license, after we have been given an opportunity and have failed to remedy it.

Founding shareholders or their approved substitutes must hold at least 26% of the means of control of Partner.

Israeli entities from among our founding shareholders and their approved substitutes must hold at least 5% of our issued share capital and of each of our means of control.

The majority of our directors, and our general manager, must be citizens and residents of Israel.

Neither the general manager of Partner nor a director of Partner may continue to serve in office if he has been convicted of certain legal offenses.

No trust fund, insurance company, investment company or pension fund that is an Interested Party in Partner may: (a) hold, either directly or indirectly, more than 5% of any means of control in a competing mobile radio telephone operator without having obtained a permit to do so from the Ministry of Communications, or (b) hold, either directly or indirectly, more than 5% of any means of control in a competing mobile radio telephone operator in accordance with a permit from the MoC, and in addition have a representative or appointee who is an Office Holder in a competing mobile radio telephone operator, unless it has been legally required to do so, or (c) hold, either directly or indirectly, more than 10% of any means of control in a competing mobile radio telephone operator, even if it received a permit to hold up to 10% of such means of control.

No trust fund, insurance company, investment company or a pension fund that is an Interested Party in a competing mobile radio telephone operator may: (a) hold, either directly or indirectly, more than 5% of any means of control in Partner, without having obtained a permit to do so from the Ministry of Communications; or (b) hold, directly or indirectly, more than 5% of any means of control in Partner in accordance with a permit from the Ministry of Communications, and in addition have a representative or appointee who is an Office Holder in Partner, unless it has been legally required to do so; or (c) hold, either directly or indirectly, more than 10% of any means of control in Partner, even if it received a permit to hold up to 10% of such means of control.

Partner, an Office Holder or Interested Party in Partner, or an Office Holder in an Interested Party in Partner does not control a competing mobile radio telephone operator, is not controlled by a competing mobile radio telephone operator, by an Office Holder or an Interested Party in a competing mobile radio telephone operator, by an Office Holder in an Interested Party in a competing mobile radio telephone operator, or by a person or corporation that controls a competing mobile radio telephone operator.

Change in license conditions. Under our license, the Ministry of Communications may change, add to, or remove conditions of our license if certain conditions exist, including:

• A change has occurred in the suitability of Partner to implement the actions and services that are the subject of our license.

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▲ A change in our license is required in order to ensure effective and fair competition in the telecommunications sector.

● A change in our license is required in order to ensure the standards of availability and grade of service required of Partner.

▲ A change in telecommunications technology justifies a modification of our license.

● A change in the electromagnetic spectrum needs justifies, in the opinion of the Ministry of Communications, changes in our license.

○ Considerations of public interest justify modifying our license.

▲ A change in government policy in the telecommunications sector justifies a modification of our license.

▲ A change in our license is required due to its breach by Partner.

During an emergency period, control of Partner's mobile radio telephone system may be assumed by any lawfully authorized person for the security of the State of Israel to ensure the provisions of necessary service to the public, and some of the spectrum granted to us may be withdrawn. In addition, our license requires us to supply certain services to the Israeli defense and security forces. Furthermore, certain of our senior officers are required to obtain security clearance from Israeli authorities.

For the purposes of this discussion, the following definitions apply:

● "Office Holder" means a director, manager, company secretary or any other senior officer that is directly subordinate to the general manager.

"Control" means the ability to, directly or indirectly, direct the activity of a corporation, either alone or jointly with others, whether derived from the governing documents of the corporation, from an agreement, oral or written, from holding any of the means of control in the corporation or in another corporation, or which derives from any other source, and excluding the ability derived solely from holding the office of director or any other office in the corporation. Any person controlling a subsidiary or a corporation held directly by him will be deemed to control any corporation controlled by such subsidiary or by such controlled corporation. It is presumed that a person or corporation controls a corporation if one of the following conditions exist: (1) such person holds, either directly or indirectly, fifty percent (50%) or more of any means of control in the corporation; (2) such person holds, either directly or indirectly, a percentage of any means of control in the corporation which is the largest part in relation to the holdings of the other Interested Parties in the corporation; or (3) such person has the ability to prevent the taking of business decisions in the corporation, with the exception of decisions in the matter of issuance of means of control in a corporation or decisions in the matters of sale or liquidation of most businesses of the corporation, or fundamental changes of these businesses.

● "Controlling Corporation" means a company that has control, as defined above, of a foreign mobile radio telephone operator.

● "Interested Party" means a person who either directly or indirectly holds 5% or more of any type of means of control, including holding as an agent.

Our Permit Regarding Cross Ownership

Our license generally prohibits cross-control or cross-ownership among competing mobile telephone operators without a permit from the Ministry of Communications. In particular, Partner, an Office Holder or an Interested Party

in Partner, as well as an Office Holder in an Interested Party in Partner may not control or hold, directly or indirectly, 5% or more of any means of control of a competing mobile radio telephone operator. Our license also prohibits any competing mobile radio telephone operator or an Office Holder or an Interested Party in a competing mobile radio telephone operator, or an Office Holder in an Interested Party in a competing mobile radio telephone operator or a person or corporation that controls a competing mobile radio telephone operator from either controlling, or being an Interested Party in us.

However, our license, also provides that the Ministry of Communications may permit an Interested Party in Partner to hold, either directly or indirectly, 5% or more in any of the means of control of a competing mobile radio telephone operator if the Ministry of Communications is satisfied that competition will not be harmed, and on the condition that the Interested Party is an Interested Party in Partner only by virtue of a special calculation described in the license and relating to attributed holdings of shareholders deemed to be in control of a corporation.

4B.12g Other Licenses

Domestic Fixed-line License. In January, 2007, the Ministry of Communications granted Partner Land-Line Communication Solutions Limited Partnership, which is fully owned by the Company, a license for the provision of domestic fixed-line telecommunications services, including VoB services using the infrastructure of Bezeq and HOT Telecom to access customers. In February 2016, this license was replaced by the MoC with a general-unified license. In June and December 2016, this license was amended by the MoC to allow, in addition to domestic fixed-line telecommunications services, the provision of ILD services, ISP services and end-point services. See Exhibit 4.(a).2.1, which is incorporated herein by reference. The term of the new license is similar to the term of the previous fixed-line license which expires in twenty years from the original grant date in January 2007 but may be extended by the Ministry of Communications for successive periods of ten years provided that the licensee has complied with the terms of the license and has acted consistently for the enhancement of telecom services and their enhancement. The general conditions of the mobile telephone license described above, generally apply to this license, subject to certain modifications.

In March 2009, we were also granted a domestic fixed-line license to provide fixed-line services to the Israeli populated areas in the West Bank. In July 2016, this license was replaced by a general-unified license. The general conditions of the general-unified license granted to Partner Land-Line Communication Solutions Limited Partnership by the MoC, generally apply to this license, subject to certain modifications.

012 Telecom was also granted a similar domestic fixed-line license by the Ministry of Communications in December 2005 for 20 years. In February 2016, this license was replaced by the MoC with a general-unified license. The term of the new license is similar to the term of the previous fixed-line license. As part of the unification of the Company's licenses, in January 2018, the Company filed a request with the Ministry of Communications to terminate this license.

012 Telecom was also granted a license to provide domestic fixed-line services to the Israeli populated areas in the West Bank which was valid until February 2018. This license was replaced in July 2016 with a general-unified license. The general conditions of the general-unified license granted to 012 Telecom by the MoC, generally apply to this license, subject to certain modifications. In January 2018, the Company filed a request with the Ministry of Communications to terminate this license.

ISP License. In March 2001, we received a special license granted by the Ministry of Communications, allowing us through our own facilities to provide internet access to fixed-line network customers. The license is valid until March 31, 2023. We began supplying commercial ISP services beginning in January 2009. We were also granted a special license to provide ISP services to the Israeli populated areas in the West Bank which is valid until March 30, 2023.

012 Smile was also granted a similar ISP license by the Ministry of Communications in December 2009 that is valid until June 2020 and a special license to provide ISP services to the Israeli populated areas in the West Bank which is valid until June 2020. In January 2018, the Company filed a request with the Ministry of Communications to terminate this license.

ILD License. In December 2009, the Ministry of Communications granted 012 Smile, a license for the provision of ILD services. The license expires in twenty years but may be extended by the Ministry of Communications for successive periods of ten years provided that the licensee has complied with the terms of the license and has acted consistently for the enhancement of telecom services and their enhancement. In February 2016, this license was replaced by the MoC with a general-unified license. The term of the new license is similar to the term of the previous ILD License. In January 2018, the Company filed a request with the Ministry of Communications to terminate this license.

012 Smile was also granted a license for the provision of International Long Distance services to the Israeli populated areas in the West Bank which is valid until February 2018. This license was replaced in July 2016 with a general-unified license. The general conditions of the general-unified license granted to 012 Smile by the MoC, generally apply to this license, subject to certain modifications. In January 2018, the Company filed a request with the Ministry of Communications to terminate this license.

012 Smile was also granted a similar NTP license by the Ministry of Communications in December 2009 that is valid until December 2020. In January 2018, the Company filed a request with the Ministry of Communications to terminate this license.

Other Licenses. The Ministry of Communications has granted us a trade license pursuant to the Wireless Telegraphy Ordinance. This license regulates issues of servicing and trading in equipment, infrastructure and auxiliary equipment for our network. We have also been granted a number of encryption licenses that permit us to deal with means of encryption, as provided in the aforementioned licenses, within the framework of providing mobile radio telephone services to the public.

4B.12h Network Site Permits

Permits of the Ministry of Environmental Protection

On January 1, 2006, the Non-Ionizing Radiation Law (5766-2006), which replaced the Pharmacists (Radioactive Elements and Products) Regulations, 1980 regarding matters that pertain to radiation from cellular sites, was enacted. This law defines the various powers of the Ministry of Environmental Protection as they relate, among others, to the grant of permits for network sites and sets standards for permitted levels of non-ionizing radiation emissions and reporting procedures. Pursuant to this law, most of which entered into effect on January 1, 2007, a request for an operating permit from the Ministry of Environmental Protection with respect to either new sites or existing sites would require a building permit for such site(s). The Ministry of Environmental Protection has adopted the International Radiation Protection Agency's standard as a basis for the consents it gives for the erection and operation of our antennas. This standard is an international standard based upon a number of years of scientific study.

If we continue to face difficulties in obtaining building permits from the local planning and building committee, we may fail to obtain also operation permits from the Ministry of Environmental Protection. Operation of a network site without a permit from the Ministry of Environmental Protection may result in criminal and civil liability to us or to our officers and directors.

Local Building Permits

The Planning and Building Law requires that we receive a building permit for the construction of most of our antennas. The local committee or local licensing authority in each local authority is authorized to grant building permits, provided such permits are in accordance with National Building Plan No. 36 which came into effect on June 15, 2002. The local committee is made up of members of the local municipal council. The local committee is authorized to delegate certain of its powers to subcommittees on which senior members of the local authority may sit.

The local committee examines the manner in which an application for a building permit conforms to the plans applying to the parcel of land that is the subject of the application, and the extent to which the applicant meets the requirements set forth in the Planning and Building Law. The local committee is authorized to employ technical, vista, and aesthetic considerations in its decision-making process. The local committee may grant building permits that are conditioned upon the quality of the construction of the structure, the safety of flight over the structure, and the external appearance of the structure. Every structure located on a certain parcel of land must satisfy the requirements and definitions set forth in the building plan applicable to such parcel.

On January 3, 2006, the National Council for Planning and Building added a new requirement for obtaining a building permit for network sites: the submission of an undertaking to indemnify the local committee for claims relating to the depreciation of the surrounding property value as a result of the construction or existence of the antenna.

A decision by a local committee not to grant a building permit may be appealed to the District Appeals Committee. A person harmed by the ruling of the District Appeals Committee may have such ruling examined judicially by means of an administrative petition to the District Court sitting as an Administrative Affairs Tribunal.

National Building Plan No. 36

National Building Plan No. 36 which came into effect on June 15, 2002 regulates the growth of telecommunications infrastructure in Israel. Chapter A of National Building Plan No. 36 sets forth the licensing requirements for the construction of mobile radio telephone infrastructure. National Building Plan No. 36 also adopts the radiation emission standards set by the International Radiation Protection Agency which were also previously adopted by the Ministry of Environmental Protection. We believe that we currently comply with these standards regarding our sites. National Building Plan No. 36 is in the process of being changed. On June 1, 2010, the National Council for Planning and Building approved the National Building Plan No. 36/A/1 version that incorporates all of the amendments to National Building Plan No. 36 (“the Amended Plan”).

Current proposed changes impose additional restrictions and/or requirements on the construction and operation of network sites and could, if adopted, harm our ability to construct new network sites, make the process of obtaining building permits for the construction and operation of network sites more cumbersome and costly, and may delay the future deployment of our network.

Under the Non-Ionizing Radiation Law, the National Council for Planning and Building was granted the power to determine the level of indemnification for reduction of property value to be undertaken as a precondition for a cellular company to obtain a building permit for a new or existing network site. As a result, the National Council for Planning and Building has decided that until National Building Plan 36 is amended to reflect a different indemnification amount, cellular companies will be required to undertake to indemnify the building and planning committee for 100% of all losses resulting from claims against the committee. Thus, at present, in order to obtain a building permit for a new or existing network site, we must provide full indemnification for the reduction of property value.

The Amended Plan sets forth the indemnification amounts as a percentage of the value of the depreciated property claims in accordance with the manner in which the licenses were granted as follows: If the license was granted in an expedited licensing route, which is intended for installations that are relatively small in accordance with the Amended Plan criteria, then the cellular companies will be required to compensate the local planning committees in an amount of 100% of the value of the depreciated property claim. If the license was granted in a regular licensing route, which is intended for larger installations in accordance with the Amended Plan criteria, then the cellular companies will be required to compensate the local planning committees in an amount of 80% of the value of the depreciated property claim. The Amended Plan is subject to governmental approval, in accordance with the Planning and Building Law. It is unknown when the government intends to approve the Amended Plan.

These recent developments may have a material adverse effect on our financial condition and results of operations, as well as plans to expand and enhance network coverage. For more information, see “Item 3D.1k In connection with some building permits, we may also be required to indemnify planning committees in respect of claims against them relating to the depreciation of property values that result from the granting of permits for network sites.”

Wireless access devices

We have set up several hundred small communications devices, called wireless access devices, pursuant to a provision in the Telecommunications Law which we and other participants in cellular telecommunications, believe exempts such devices from the need to obtain a building permit. Beginning in 2008, following the filing of a claim that the exemption does not apply to cellular communications devices, the Attorney General filed an opinion regarding this matter stating that the exemption does apply to wireless radio access devices under certain conditions and instructed the Ministry of Interior to prepare regulations setting conditions that would limit the exemption to extraordinary

circumstances. Recently, the relevant government ministries have agreed upon the wording of the regulations. The proposed text was submitted for approval to the Economics Committee of the Knesset and during December 2017 a discussion was held before the Committee. The Committee did not have time to review all the provisions of the regulations, and therefore clarified that it would hold another hearing to approve the text, which was also recommended for approval by the National Planning and Building Council. Insofar as the wording is approved in the format submitted to the Economics Committee, it will be very difficult to transfer existing wireless access devices from place to place and also to make changes to existing access devices. Following two petitions that were filed with the High Court of Justice opposing the Attorney General's recommendation that the exemption apply under certain conditions, in September 2010, the Supreme Court issued an interim order prohibiting further construction of wireless access devices in cellular networks in reliance on the exemption from the requirement to obtain a building permit. In February 2011, and in July 2012, the Supreme Court narrowed the scope of the interim injunction so that repair or replacement of existing wireless access devices is permitted under certain conditions that will be determined in a judgment. In March 2016, the Supreme Court further narrowed the scope of the interim injunction that allowed us to make modifications to the existing wireless access devices, including a change to their transmission power and allowed us to change the location of 10% of PHI's wireless access devices to alternative locations without the need for a building permit. If a definitive court judgment holds that the exemption does not apply to cellular devices at all or if the regulations finally approved do not apply the exemption to wireless access devices, this could adversely affect the Company's existing network. As a result, we may be required to remove existing devices and would not be able to install new devices on the basis of the exemption. Our network capacity and coverage would then be negatively impacted, which could have an adverse effect on our revenue and results of operations.

Other Approvals

The construction of our antennas may be subject to the approval of the Civil Aviation Administration which is authorized to ensure that the construction of our antennas does not interfere with air traffic, depending on the height and location of such antennas. The approval of the Israeli Defense Forces is required in order to coordinate site frequencies so that our transmissions do not interfere with the communications of the Israel Defense Forces.

We, like other cellular operators in Israel, provide repeaters, also known as bi-directional amplifiers, to subscribers seeking an interim solution to weak signal reception within specific indoor locations. In light of the lack of a clear policy of the local planning and building authorities, and in light of the practice of the other cellular operators, we have not requested permits under the Planning and Building Law for the repeaters. However, we have received from the Ministry of Communications an approval to connect the repeaters to our communications network. We have also received from the Ministry of Environmental Protection, the permits that are necessary for the repeaters.

In addition, we construct and operate microwave links as part of our transmission network. The various types of microwave links receive permits from the Ministry of Environmental Protection in respect of their radiation level. Based on an exemption in the Telecommunications Law, we believe that building permits are not required for the installation of most of these microwave links on rooftops, but if in the future the courts or the relevant regulator determine that building permits are necessary for the installation of these sites, it could have a negative impact on our ability to deploy additional microwave links, and could hinder the coverage, quality and capacity of our transmission network and our ability to continue to market our Fixed-Line Services effectively.

We have received approval from the Ministry of Communications for selling and distributing all of the handsets and other terminal equipment we sell. The Ministry of Environmental Protection also has authority to regulate the sale of handsets in Israel, and under the Non-Ionizing Radiation Law, certain types of devices, which are radiation sources, including cellular handsets, have been exempted from requiring an approval from the Ministry of Environmental Protection so long as the radiation level emitted during the use of such handsets does not exceed the radiation level permitted under the Non-Ionizing Radiation Law. Since June 2002, we have been required to provide information to purchasers of handsets on the Specific Absorption Rate (“SAR”) levels of the handsets as well as its compliance with certain standards pursuant to a regulation under the Consumer Protection Law. We attach a brochure to each handset that is sold that includes the SAR level of the specific handset. Such brochures are also available at our service centers and the information is also available on the Company’s website. SAR levels are a measurement of non-ionizing radiation that is emitted by a hand-held cellular telephone at its specific rate of absorption by living tissue. While, to the best of our knowledge, the handsets that we market comply with the applicable laws that relate to acceptable SAR levels, we rely on the SAR published by the manufacturer of these handsets and do not perform independent inspections of the SAR levels of these handsets. As the manufacturers’ approvals refer to a prototype handset and not for each and every handset, we have no information as to the actual SAR level of each specific handset and throughout its lifecycle, including in the case of equipment repair.

Under a December 2005 amendment to this procedure, in the event that the SAR level is not measured after the repair of a handset, the repairing entity is required to notify the customer by means of a label affixed to the handset that the SAR may have been altered following the repair, in accordance with the provisions relating to the form of such label set forth in the procedure. A consultant had been retained by the Ministry of Communications to formulate a recommendation regarding the appropriate manner to implement the procedure for repairing handsets but to date the Ministry of Communications has not yet issued any guidelines and given the continued delay we are informing our customers that there may be changes in the SAR levels.

In November 2005, a new procedure was adopted by the Ministry of Communications with regard to the importation, marketing, and approval for 2G and 2.5G handsets. Prior to the implementation of the new procedure, suppliers of 2G and 2.5G handsets in Israel were required to obtain an interim, non-binding approval of the handset type from the relevant cellular operators before receiving final approval from the Ministry of Communications to supply such handsets in Israel to such operators. Under the new procedure, handsets that have already received the internationally recognized Global Certification Forum approval prior to their importation into Israel are now exempt from the requirement of receiving an interim, non-binding approval from the relevant cellular operators in Israel. This could expose us to the risk that handsets not reviewed and approved by us may interfere with the operation of our network. The new procedures described above do not apply to 3G handsets, which still require cellular operators to grant an interim, non-binding approval to the Ministry of Communications before the MoC grants its final approval in all circumstances.

In addition, this procedure also called for repaired handsets to comply with all applicable standards required for obtaining handset type approval, including standards relating to the safety, electromagnetic levels, and SAR levels.

4C. Organizational Structure

We currently have five wholly-owned subsidiaries, Partner Future Communications 2000 Ltd., an Israeli corporation; Partner Land-Line Communications Solutions LP, an Israeli limited partnership; Partner Business Communications Solutions, LP, an Israeli limited partnership; Partner Communication Products 2016 LP and 012 Smile. 012 Smile has a wholly-owned subsidiary, 012 Telecom Ltd., an Israeli corporation. Partner Future Communications 2000 Ltd. serves as the general partner and the Company serves as the limited partner of each of the limited partnerships.

In November 2013, the Company entered into a 15-year Network Sharing Agreement with HOT Mobile. Pursuant to the Network Sharing Agreement, the parties created a 50-50 limited partnership - P.H.I. Networks (2015) Limited Partnership, which will operate and develop a cellular network to be shared by both parties, starting with a pooling of both parties' radio access network infrastructures to create a single shared radio access network. The parties have also established a 50-50 company under the name Net 4 P.H.I Ltd. to be the general partner of the limited partnership. See "Item 4B.8 Our Network".

4D. Property, Plant and Equipment

Headquarters

We lease our headquarter facilities in Rosh Ha-ayin, Israel, with a total of approximately 51,177 gross square meters (including parking lots). In the beginning of 2014, an amendment to the lease agreements for its headquarters facility in Rosh Ha'ayin was signed, according to which the lease term is extended until the end of 2024. The rental payments are linked to the Israeli CPI. We also lease call centers in several cities. The leases for each site have different lengths and specific terms. We believe that our current call center facilities are adequate for the foreseeable future, and that we will be able to extend the leases or obtain alternate or additional facilities, if needed, on acceptable commercial terms.

Network

For a description of our telecommunications network, see “Item 4B.8 Our Network” above.

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We lease most of the sites where our mobile telecommunications network equipment is installed throughout Israel. At December 31, 2017, we had 3,109 network sites (including micro-sites). The lease agreements relating to our network sites are generally for periods of two to ten years. We have the option to extend the lease periods up to ten years (including the original lease period).

The erection and operation of most of these network sites requires building permits from local or regional zoning authorities, as well as a number of additional permits from governmental and regulatory authorities, and we have had difficulties in obtaining some of these permits.

Difficulties obtaining required permits could continue and therefore affect our ability to maintain cell network sites. In addition, as we grow our subscriber base and seek to improve the range and quality of our services, we need to further expand our network, and difficulties in obtaining required permits may delay, increase the costs or prevent us from achieving these goals in full. See “Item 3D.1j We have had difficulties obtaining some of the building and environmental permits required for the erection and operation of our network sites, and some building permits have not been applied for or may not be fully complied with. These difficulties could have an adverse effect on the coverage, quality and capacity of our network. Operating network sites without building or other required permits, or in a manner that deviates from the applicable permit, may result in criminal or civil liability to us or to our officers and directors.” and “Item 4B.12 Regulation”.

In November 2013, the Company entered into a 15-year Network Sharing Agreement with HOT Mobile. Pursuant to the Network Sharing Agreement, the parties created a 50-50 limited partnership, which is intended to operate and develop a cellular network to be shared by both companies, starting with a pooling of both companies’ radio access network infrastructures to create a single shared pooled radio access network. See “Item 4B.8 Our Network”.

Service Centers and Points of Sale

Lease agreements for our retail stores and service centers are for periods of two to ten years. We have the option to extend the lease agreements for different periods of up to ten additional years (including the original lease period). The average size of our retail stores and service center is approximately 250 square meters. See also note 19 to the consolidated financial statements.

4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following operating and financial review and prospects are based upon and should be read in conjunction with our financial statements and selected financial data, which appear elsewhere in this report. You should also read the risk factors appearing in Item 3D of this annual report for a discussion of a number of factors that affect and could affect our financial condition and results of operations.

5A. Operating Results

5A.1 OVERVIEW

5A.1a Key Financial and Operating Data

The table below sets forth a summary of selected financial and operating data for the years ended December 31, 2015, 2016 and 2017.

	Year ended December 31,			
	2015	2016	2017*	2017**
Revenues (NIS million)	4,111	3,544	3,270	3,268
Operating profit (NIS million)	107	193	246	315
Income (loss) before taxes (NIS million)	(36)	88	66	135
Profit (loss) for the Year (NIS million)	(40)	52	61	114
Capital expenditures (additions) (NIS million)	271	202	333	417
Cash flows from operating activities (NIS million)	922	945	897	973
Cash flows from investing activities (NIS million)	(356)	(639)	4	(72)
Cellular Subscribers (end of period, thousands)	2,718	2,686	2,674	2,674
Annual cellular churn rate (%)	46 %	40 %	38 %	38 %
Average monthly revenue per cellular subscriber (ARPU) (NIS)	69	65	62	62
TV service households (end of period, thousands)	-	-	43	43

Without the impact of the early adoption of IFRS 15, Revenue from Contracts with Customers in 2017. See “Item 5A.1j Early adoption of IFRS 15 Revenue from Contracts with Customers – change in accounting policy” and also note 2(n) to the consolidated financial statements regarding the early adoption of IFRS 15, Revenue from Contracts with Customers.

**Includes the impact of the early adoption of IFRS 15, Revenue from Contracts with Customers.

NON-GAAP MEASURES

The following non-GAAP measures are used in this report. These measures are not financial measures under IFRS and may not be comparable to other similarly titled measures for other companies. Further, the measures may not be indicative of the Company's historic operating results nor are they meant to be predictive of potential future results.

Non-GAAP Measure	Calculation	Most Comparable IFRS Financial Measure
Adjusted EBITDA	Adjusted EBITDA: Profit (Loss) add Income tax expenses, Finance costs, net, Depreciation and amortization expenses (including amortization of intangible assets, deferred expenses-right of use and impairment charges), Other expenses (mainly amortization of share based compensation).	Profit (Loss)
Adjusted EBITDA margin (%)	Adjusted EBITDA margin (%): Adjusted EBITDA divided by Total revenues	
Adjusted Free Cash Flow*	Adjusted Free Cash Flow: Cash flows from operating activities deduct Cash flows from investing activities add Short-term investment in deposits	Cash flows from operating activities less Cash flows from investing activities
Total Operating Expenses (OPEX)	Total Operating Expenses: Cost of service revenues add Selling and marketing expenses add General and administrative expenses deduct Depreciation and amortization expenses, Other expenses (mainly amortization of employee share based compensation)	Sum of: Cost of service revenues, Selling and marketing expenses, General and administrative expenses
Net Debt	Net Debt: Current maturities of notes payable and borrowings add Notes payable add Borrowings from banks and others deduct Cash and cash equivalents deduct Short-term deposits	Sum of: Current maturities of notes payable and borrowings, Notes payable, Borrowings from banks and others
Various line items "without the impact of the early adoption of IFRS"	Line item less the amount of the impact of IFRS 15	The corresponding line item as reported in the Company's financial statements

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* Adjusted Free Cash Flow measure is fully equivalent to Free Cash Flow measure which was provided in reports for prior periods.

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5A.1b Business Developments in 2017

In 2017, competition in the Israeli telecommunications market remained intense, across both cellular segment services and fixed-line segment services, as well as in the market for equipment and device sales. As a result, the continued substantial price erosion in our principal markets has had a further significant negative impact on the Company's business results, with total revenues for 2017 decreasing by 8% compared with 2016 and by 21% compared with 2015.

Cellular market. As an illustration of the level of competition in the cellular market, approximately 2.5 million cellular subscribers are estimated to have switched operators within the Israeli market (with number porting) during 2017, compared with approximately 2.3 million in 2016 and 2.5 million in 2015. The annual churn rate for cellular subscribers in 2017 was 38%, compared with 40% in 2016 and 46% in 2015, mainly reflecting the continued intense competition in the cellular subscriber market. Significant price erosion continued to be caused by the amount of cellular subscribers who moved between different rateplans or airtime packages (generally with a lower monthly fee) within the Company.

Over 2017, the Company's cellular subscriber base declined net by approximately 12,000. The pre-paid subscriber base decreased by approximately 91,000, while the post-paid subscriber base increased by approximately 79,000. The decrease in the pre-paid subscriber base was largely attributed to the pre-paid subscribers moving to post-paid subscriber packages as a result of the significant price erosion (and hence increasing attractiveness) in these products, as well to increased competition for pre-paid subscribers. At the end of December 2017, the Company's active cellular subscriber base (including cellular data and 012 Mobile subscribers) was approximately 2.68 million, including approximately 2.3 million post-paid subscribers or 87% of the base, and approximately 354,000 pre-paid subscribers, or 13% of the subscriber base. Total cellular market share in Israel (based on the number of subscribers) at the end of 2017 was estimated to be approximately 25%, compared with 26% in 2016 and 27% in 2015.

The monthly Average Revenue Per User (ARPU) for cellular subscribers for the year 2017 was NIS 62 (US\$ 18), a decrease of approximately 5% from NIS 65 in 2016. The decrease mainly reflected the continued price erosion in the key cellular services including airtime, content, data and browsing, due to the persistent fierce competition in the cellular market, as well as a decrease in wholesale service revenues as a result of termination of the Right of Use Agreement with HOT Mobile from the second quarter of 2016. See "Item 5A.1e Right of Use Agreement with HOT Mobile". Overall, cellular service revenues decreased by 6% in 2017 compared with 2016.

Fixed line market. Total fixed line segment service revenues decreased by 10% in 2017, as a result of a decrease in revenues from international calling services (including the market for wholesale international traffic) which were adversely affected both by the increased penetration of internet-based solutions and increased competition from other service providers, and a decrease in inter-segment revenues. In 2017, the Company launched two services under the fixed line segment – Partner TV service (in June 2017) and the commercial phase and accelerated deployment of our fiber optic network in residential areas throughout the country (in August 2017). The launches of Partner TV service and the commercial phase and accelerated deployment of our fiber optic network did not have a significant impact on fixed-line segment revenues in 2017.

Equipment sales. In addition to a decrease in service revenues, revenues from equipment sales decreased in 2017 by 13%, reflecting principally a decline in sales volumes of both cellular devices and other non-core equipment including tablets, televisions and other audio visual devices.

See also “Item 5D.2 Outlook” and “Item 3D.2b Our level of indebtedness could adversely affect our business, profits and liquidity. Furthermore, difficulties in generating sustainable cash flow may impair our ability to repay our debt and reduce the level of indebtedness.”

Cost reductions and efficiency measures. In order to mitigate the impact of competition on price erosion and decreases in revenues and in profits from services and equipment sales, the Company continued to adjust its cost structure and to implement operational efficiency measures through 2017. This was reflected in a decrease in total operating expenses in 2017 of NIS 377 million (including cost of service revenues (NIS 2,083 million in 2017) and selling, marketing and administrative expenses (NIS 466 million in 2017), and excluding depreciation, amortization and impairment expenses and other expenses (mainly amortization of employee share based compensation) (NIS 602 million in 2017); this measure is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies). This decrease followed a decrease in total operating expenses in 2016 of NIS 139 million compared with 2015. The decrease in total operating expenses in 2017 mainly reflected decreases (i) in cellular network and cable maintenance and operating lease expenses, (in cost of service revenues) principally as a result of the network sharing agreement with HOT Mobile, (ii) in selling commissions, net (in selling, marketing, general and administrative expenses), principally as a result of the early adoption of IFRS 15 from the beginning of 2017, (iii) in international call expenses (in cost of service revenues), (iv) in bad debts and allowance for doubtful accounts expenses (in selling, marketing, general and administrative expenses), (v) in advertising and marketing expenses (in selling, marketing, general and administrative expenses) and (vi) in other expense items as a result of various efficiency measures. These decreases were partially offset by increases in expenses related to Partner TV service (in cost of service revenues) that was launched during 2017, and in expenses related to internet services (in cost of service revenues).

Profitability. Reported profit in 2017 was NIS 114 million (US\$ 33 million). Without the impact of the early adoption of IFRS 15 in 2017, profit would have been NIS 61 million, an increase of 17% compared with NIS 52 million in 2016. Adjusted EBITDA in 2017 totaled NIS 917 million (US\$ 264 million). Without the impact of the early adoption of IFRS 15 in 2017, Adjusted EBITDA would have been NIS 835 million, an increase of 0.1% from NIS 834 million in 2016.

5A.1c Settlement Agreement with Orange Brand Services Ltd.

In June 2015, the Company announced that it had entered into a settlement agreement with Orange Brand Services Ltd ("Orange") which created a new framework for their relationship and provided both Partner and Orange the right to terminate the brand license agreement which had been in force since 1998. In accordance with the terms of the settlement agreement, the Company received advance payments in a total of €90 million during 2015: €40 million of which was received between the signing of the agreement and the completion of a market study to assess the Company's position within the dynamics of the Israeli telecommunications services market; and €50 million of which was received in the fourth quarter of 2015, following the Company's notice to Orange of its decision to terminate the brand license agreement.

As set forth in the settlement agreement, the advance payments were recognized and reconciled evenly on a quarterly basis over a period until the second quarter of 2017, against contingent marketing, sales, customer services and other expenses to be incurred over this period. The income was recorded in the Company's income statement under "Income with respect to settlement agreement with Orange". For the years ended December 31, 2015, 2016 and 2017, the Company recognized income with respect to the settlement agreement in an amount, respectively, of NIS 61 million, NIS 217 million and NIS 108 million (US\$ 31 million). Based on a legal opinion provided to the Company, the advance payments are considered compensation payments and are therefore not subject to VAT charges.

5A.1d Network Sharing Agreement with HOT Mobile

In November 2013, the Company entered into a 15-year Network Sharing Agreement with HOT Mobile. Pursuant to the Network Sharing Agreement, the parties created a 50-50 limited partnership - P.H.I. Networks (2015) Limited Partnership, which operates and develops a radio access network shared by both parties, starting with a pooling of both parties' radio access network infrastructures creating a single shared pooled radio access network. See "Item 4B.9 Our Network."

In February 2016, HOT Mobile exercised its option under the Network Sharing Agreement ("NSA") to advance the payment date of a onetime amount of NIS 250 million ("Lump Sum"), which was received in 2016. Therefore according to the NSA from April 2016 onward (i) each party bears half of the expenditures relating to the Shared Network, and (ii) the operating costs of the Shared Network are borne according to a pre-determined apportionment mechanism, according to which one half of the operating costs is shared equally by the parties, and one half is divided between the parties according to the relative volume of their respective traffic consumption in the Shared Network ("Capex-Opex Mechanism").

The Lump Sum is recognized as deferred revenue for the cellular segment amortized quarterly in the income statement over a period of eight years, starting with the second quarter of 2016. Eight years has been determined to be the shorter of the expected period of the arrangement or the expected life of the related assets. Accordingly, approximately NIS 23 million and NIS 31 million (US\$ 9 million) was amortized to revenues in the income statement during 2016 and 2017, respectively. Until the termination of the eight-year amortization period, approximately NIS 31 million of the Lump Sum will be amortized to our revenues each year.

The Network Sharing Agreement provides material financial benefits to Partner in terms of both recognition of the amortized Lump Sum payments and savings in operational expenses and capital investments; however, such financial benefits are dependent on factors set forth in the related risk factor. See "Item 3D.2e If the network sharing agreement entered into with HOT Mobile is unilaterally terminated by HOT Mobile earlier than we expect, we will be required to split the shared network with HOT Mobile and the resources, time and expense it may take us to have our own network in a nationwide coverage, would be substantial and could also materially harm our business and the results of operations at such time."

5A.1e Right of Use Agreement with HOT Mobile

Partner and HOT Mobile entered into a separate Right of Use agreement which took effect in November 2013 and remained operational until March 2016. Under the Right of Use agreement, Partner provided services to HOT Mobile in the form of a right of use of Partner's cellular network. According to the Right of Use agreement, HOT Mobile paid Partner fixed base payments with additional variable payments, based, among other things, on traffic volume exceeding a defined threshold. HOT Mobile ceased making payments under the ROU from April 2016 when the Capex-Opex Mechanism became effective under the Network Sharing Agreement.

Cellular segment revenues recorded relating to the Right of Use agreement totaled approximately NIS 120 million and NIS 51 million for the years 2015 and 2016 respectively.

5A.1f Impairment of Fixed-Line Assets and Goodwill

Impairment of Fixed-Line Assets as of December 31, 2015.

In 2015, the Group decided to cease using the "012 Smile" trade name in 2017. This change in business induced the Group to determine that an indicator of impairment exists for the fixed-line segment. See also information with respect to change in estimate of useful life of the intangible asset trade name in note 4(a)(2) and 4(a)(1) to our consolidated financial statements.

For the purpose of the impairment test, the assets were grouped to the lowest level for which there are separately identifiable cash flows (CGU).

(i) The Group reviewed the recoverability of the VOB/ISP assets. As a result, an impairment charge in a total amount of NIS 98 million was recognized. The impairment charge was allocated to the assets of the CGU pro rata, on the basis of the carrying amount of each asset, provided that the impairment did not reduce the carrying amount of an asset below the highest of its fair value less costs to sell and its value-in-use, and zero. Accordingly, the following impairment charges were recorded in the assets of the above CGU (see note 13 to our consolidated financial statements):

- (a) Right of use of international fiber optic cables by NIS 76 million, recorded in cost of revenues;
- (b) Customer relationships by NIS 8 million, recorded in selling and marketing expenses;
- (c) Computers and information systems by NIS 7 million, recorded in cost of revenues;
- (d) Communication network by NIS 5 million, recorded in cost of revenues; and
- (e) Trade name by NIS 2 million, recorded in selling and marketing expenses.

The recoverable amount of the VOB/ISP CGU as of December 31, 2015 was assessed by management with the assistance of an external independent expert ("Giza Singer Even. Ltd") based on value-in-use calculations, which was NIS 250 million. The value in use calculations use pre-tax cash flow projections covering a five-year period and using extrapolation with specific adjustments expected until 2027, which is the economic life of the main asset of the CGU: the deferred expenses – Right of Use, and a pre-tax discount rate of 12.9%. The value-in-use calculations included all factors in real terms.

The impairment test was based on assessments of financial performance and future strategies in light of current and expected market and economic conditions. Trends in the economic and financial environment, competition and regulatory authorities' decisions, or changes in competitors' behavior in response to the economic environment may affect the estimate of recoverable amounts in future periods. See also note 2(i) and note 4(a)(2).

(ii) The Group reviewed the recoverability of the ILD CGU in the fixed line segment and determined that no impairment exists as of December 31, 2015.

Impairment test of Fixed-Line Goodwill as of December 31, 2015, 2016 and 2017.

Goodwill is allocated to a single group of CGUs which constitute all the operations of the fixed-line segment, in an amount of NIS 407 million.

For the purpose of the goodwill impairment tests as of December 31, 2015, 2016 and 2017 the recoverable amount was assessed by management with the assistance of an external independent experts (2015: "Giza Singer Even. Ltd", 2016, 2017: "BDO Ziv Haft Consulting & Management Ltd.") based on value-in-use calculations. The value-in-use calculations use pre-tax cash flow projections covering a five-year period. Cash flows beyond the five-year period to be generated from continuing use are extrapolated using estimated growth rates. The growth rate represents the long-term average growth rate of the fixed-line communications services business. The key assumptions used are as follows:

	As of December 31,		
	2015	2016	2017
	(negative		
Terminal growth rate	0.09%)	0.5 %	0.9 %
After-tax discount rate	10.3 %	9.8 %	9.3 %
Pre-tax discount rate	13.4 %	11.9 %	11.2 %

The impairment tests as of December 31, 2015, 2016 and 2017 were based on assessments of financial performance and future strategies in light of current and expected market and economic conditions. Trends in the economic and financial environment, competition and regulatory authorities' decisions, or changes in competitors' behavior in response to the economic environment may affect the estimate of recoverable amounts.

As a result of the impairment tests, the Group determined that no goodwill impairment existed as of December 31, 2015, 2016 and 2017. See also note 4(a)(3) and note 2(h) to our consolidated financial statements.

Sensitivity Analysis:

The headroom of the fixed line segment recoverable amount over the carrying amount as of December 31, 2015, 2016 and 2017 was approximately 9%, 23% and 23% respectively. Sensitivity analysis was performed for the recoverable amount as of December 31, 2017 for a change of the after-tax discount rate within the range of $\pm 10\%$ multiplied by the variable 9.3% (8.4% to 10.2%), assuming all other variables constant. Sensitivity analysis was also performed for a change of the terminal permanent growth rate within the range of $\pm 1\%$ of the variable 0.9% (minus 0.9% to 1.9%), assuming all other variables constant. Results showed that no impairment charge is required for both analyses.

5A.1g Agreement for the Upgrade of Our Existing Networks and the Deployment of Fourth Generation Network in Israel

On October 25, 2010, the Company signed an agreement with LM Ericsson Israel Ltd. ("Ericsson") for the upgrade of its then existing networks and the deployment of a fourth generation network in Israel (the "Agreement") for approximately US \$100 million. The Agreement includes the upgrade, replacement and the expansion of certain parts of the Company's existing cellular and fixed-line networks and the maintenance of its networks, including enhancement of the Company's abilities with respect to the cellular and fixed-line ISP services it provides. The initial term of the all-inclusive agreement with Ericsson ended on December 31, 2014. We extended, with certain modifications, the maintenance period by additional periods until the end of 2018.

5A.1h Significant regulatory developments

For information regarding developments which have had and may have a significant impact on our operating results, see "Item 3D.1 RISKS RELATING TO THE REGULATION OF OUR INDUSTRY" and "Item 4B.13 Regulation".

5A.1i Revenues

We derive revenues from both providing services and selling equipment.

Our principal source of revenues is the cellular segment, deriving from the sale of cellular network services to subscribers, including basic cellular telephony services, text messaging, internet browsing and data transfer, content services, roaming services and services provided to other operators that use the Company's cellular network.

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The fixed-line business segment derives revenues from a variety of fixed-line services that include internet services, ILD services, transmission services, telephony services (including SIP services) and, starting in 2017, TV services.

Equipment revenues are derived from the sale and leasing of a variety of communications, digital audio visual equipment and other related equipment, including cellular handsets and related cellular devices and accessories, landline phones, business communications equipment, modems, domestic routers, servers, smartboxes and related equipment. See also "Item 4B.5 SERVICES AND PRODUCTS".

5A.1j Early adoption of IFRS 15 Revenue from Contracts with Customers – change in accounting policy

In the third quarter of 2017 the Group early adopted IFRS 15, Revenue from Contracts with Customers and its clarifications ("IFRS 15", "The Standard") (the standard is effective from January 1, 2018, earlier application is permitted) with a retrospective date of application to January 1, 2017 (the "transition date") using the cumulative effect approach, which effect was immaterial as of the transition date. IFRS 15 outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes IAS 18, Revenue, and IAS 11, Construction contracts (the "previous standards"). The model includes five steps for analyzing transactions so as to determine when to recognize revenue and at what amount:

1. Identifying the contract with the customer.
2. Identifying separate performance obligations in the contract.
3. Determining the transaction price.
4. Allocating the transaction price to separate performance obligations.
5. Recognizing revenue when the performance obligations are satisfied.

In accordance with the model, the Group recognizes revenue when it satisfies performance obligations by transferring control over the goods or services to the customers. Revenue is measured based on the consideration that the Group expects to receive for the transfer of the goods or services specified in a contract with the customer, taking into account rebates and discounts, excluding amounts collected on behalf of third parties, such as value added taxes. The transaction price is also adjusted for the effects of the time value of money if the contract includes a significant financing component (such as sales of equipment with non-current credit arrangements, mainly in 36 monthly installments) and for any consideration payable to the customer. See also note 2(n) to our consolidated statements. With respect to sales that constitute a revenue arrangement with multiple performance obligations, the transaction price is allocated to separate performance obligations based on their relative stand-alone selling prices, see also note 4(b)(2) to our consolidated statements.

The performance obligations are separately identifiable where the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the Group's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract. The performance obligations are mainly services, equipment, and options to purchase additional goods or services that provide a material right to the customer. Revenues from services and from providing rights to use the Group's assets (see note 1(b) in our consolidated financial statements) (either month-by-month or long term arrangements) are recognized over time, as the services are rendered to the customers, and all other revenue recognition criteria are met. Revenue from sale of equipment (see note 1(b) in our consolidated financial statements) is recognized at a point of time when the control over the equipment is transferred to the customer (mainly upon delivery) and all other revenue recognition criteria are met.

The Group determines whether it is acting as a principal or as an agent. The Group is acting as a principal if it controls a promised good or service before they are transferred to a customer. Indicators for acting as a principal include: (1) the Group is primarily responsible for fulfilling the promise to provide the specified good or service, (2) the Group has inventory risk in the specified good or service and (3) the Group has discretion in establishing the price for the specified good or service. On the other hand, the Group is acting as an agent or an intermediary, if these criteria are not met. When the Group is acting as an agent, revenue is recognized in the amount of any fee or commission to which the Group expects to be entitled in exchange for arranging for the other party to provide its goods or services. A Group's fee or commission might be the net amount of consideration that the Group retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party. The Group determined that it is acting as an agent in respect of certain content services provided by third parties to customers; therefore the revenues recognized from these services are presented on a net basis in the statement of income.

The application of IFRS 15 did not have a material effect on the measurement and timing of the Group's revenue in the reporting period, compared to the provisions of the previous standards. Capitalization of contract costs resulted in a significant impact from the adoption, see below.

Transition to the new revenue recognition model:

The Group applied IFRS 15 using the cumulative effect approach as from the transition date, without a restatement of comparative figures. As part of the initial implementation of IFRS 15, the Group has chosen to apply the expedients in the transitional provisions, according to which the cumulative effect approach is applied only for contracts not yet complete at the transition date, and therefore there is no change in the accounting treatment for contracts completed at the transition date. The Group also applied the practical expedient of examining the aggregate effect of contracts changes that occurred before the transition date, instead of examining each change separately. Contracts that are renewed on a monthly basis and may be cancelled by the customer at any time, without penalty, were considered completed contracts at the transition date. The transition resulted in an immaterial amount on the statement of financial position as of the transition date, as the cumulative effect as of the transition date was immaterial.

Other practical expedients implemented:

The Group applies IFRS 15 practical expedient to the revenue model to a portfolio of contracts with similar characteristics if the Group reasonably expects that the financial statement effects of applying the model to the individual contracts within the portfolio would not differ materially.

The Group applies a practical expedient in the standard and measures progress toward completing satisfaction of a performance obligation and recognizes revenue based on billed amounts if the Group has a right to invoice a customer at an amount that corresponds directly with its performance to date; for which, or where the original expected duration of the contract is one year or less, the group also applies the practical expedient in the standard and does not disclose the transaction price allocated to unsatisfied, or partially unsatisfied, performance obligations, such as constrained variable consideration.

The Group applies a practical expedient in the standard and does not adjust the transaction price for the effects of a significant financing component if, at contract inception, the Group expects the period between customer payment and the transfer of goods or services to be one year or less (see note 23 to our consolidated statements - unwinding of trade receivables and note 7(a) to our consolidated statements). See also disaggregation of revenues in note 22 to our consolidated statements.

The Group applies in certain circumstances where the customer has a material right to acquire future goods or services and those goods or services are similar to the original goods or services in the contract and are provided in accordance with the same terms of the original contract, a practical alternative to estimating the stand-alone selling price of the customer option, and instead allocates the transaction price to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration.

Recognition of receivables:

A receivable is recognized when the control over the goods or services is transferred to the customer, and the consideration is unconditional because only the passage of time is required before the payment is due. See note 7 to our consolidated statements and also note 6(a)(3) to our consolidated statements regarding trade receivables credit risk.

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Recognition of contract assets and contract liabilities:

A contract asset is a Group's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the Group's future performance).

A contract liability is a Group's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer; therefore the Group records contract liabilities for payments received in advance for services, such as transmission services and pre-paid calling cards, as deferred revenues until such related services are provided.

Capitalization of contract costs:

The main effect of the Group's application of IFRS 15 is the accounting treatment for the incremental costs of obtaining contracts with customers, which in accordance with IFRS 15, are recognized as assets when the costs are incremental to obtaining the contracts, and it is probable that the Group will recover these costs, instead of recognizing these costs in the statement of income as incurred (mainly direct commissions paid to resellers and sales employees for sales and upgrades). The assets are amortized in accordance with the expected service period (mainly over 2-3 years), using the portfolio approach, see note 4(a)(2) to our consolidated statements. IFRS 15 also determines that direct costs of fulfilling a contract which the Group can specifically identify and which produce or improve the Group's resources that are used for its future performance obligation (and it is probable that the Group will recover these costs) are recognized as assets (together: "contract costs"), see note 11 to our consolidated statements. Contract costs that were recognized as assets are presented in the statements of cash flows as part of cash flows used in investing activities. Other costs incurred that would arise regardless of whether a contract with a customer was obtained are recognized as an expense when incurred. Under the previous accounting policy, contract costs were not capitalized, and instead, subsidies, in some cases, of sales of handsets to end subscribers at a price below its cost, securing a fixed-term service contract, were capitalized as subscriber acquisition and retention costs (SARC costs). SARC costs were eliminated upon the transition to IFRS 15, see notes 2(f)(5) and 11 to our consolidated financial statements.

Use of judgments and estimates:

Implementation of the accounting policy described above requires management to exercise discretion to estimate the expected service period and the anticipated subscriber churn rate. Changes in such estimates may result in a change in depreciation and amortization expenses and changes in the contract costs asset, see note 4(a)(1) to our consolidated statements.

Management estimates the stand-alone selling prices of performance obligations, see note 4(b)(2) to our consolidated statements.

The tables below summarize the effects of IFRS 15 on the consolidated statement of financial position as at December 31, 2017 and on the consolidated statements of income and cash flows for the year then ended. See also disaggregation of revenues and additional information in note 22 to our consolidated financial statements.

Effect of change on consolidated statement of financial position:

		New Israeli Shekels in millions	
		As of December 31, 2017	
	note	Previous accounting policy	Effect to IFRS 15 as reported
Current assets - other receivables and prepaid expenses - Contract assets		-	2

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Non current assets - costs to obtain contracts recognized in intangible assets, net – non-current assets	11,2(f)(5)	-	71	71
Deferred income tax asset	25	71	(16)	55
Current liabilities - other deferred revenues – Contract liabilities	22	36	4	40
Non-current liabilities – other non-current liabilities – Contract liabilities	22	6	-	6
Deferred revenues from HOT Mobile – Contract liabilities (current and non-current)	22	195	-	195
Equity		1,381	53	1,434

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Effect of change on consolidated statement of income:

	New Israeli Shekels In millions (except per share data) Year ended December 31, 2017		
	Previous accounting policy	Effect change	According to IFRS 15 as reported
Revenues	3,270	(2)	3,268
Selling and marketing expenses	340	(71)	269
Operating profit	246	69	315
Profit before income tax	66	69	135
Income tax expenses	5	16	21
Profit for the year	61	53	114
Depreciation and amortization expense	567	13	580
Basic earnings per share	0.38	0.32	0.70
Diluted earnings per share	0.37	0.32	0.69

Effect of change on consolidated statement cash flows:

	New Israeli Shekels in millions Year ended December 31, 2017		
	Previous accounting policy	Effect change	According to IFRS 15 as reported
Net cash provided by operating activities	897	76	973
Net cash provided by (used in) investing activities	4	(76)	(72)

5A.1k Cost of Revenues

The principal components of our cost of revenues are:

- Transmission, communication and content providers
- Cost of equipment and accessories
- Depreciation and amortization (including impairment)
- Wages, employee benefits expenses and car maintenance

- Operating lease, rent and overhead expenses
- Network and cable maintenance
- Internet infrastructure and service providers (“ISPs”)
- Costs of handling, replacing or repairing equipment
- Car kit installation, IT support, and general operating expenses
- Amortization of rights of use (including impairment)

5A.1l Selling and Marketing Expenses

The principal components of our selling and marketing expenses are:

- Wages, employee benefits expenses and car maintenance
- Depreciation and amortization (including impairment)
- Advertising and marketing
- Selling commissions, net
- Operating lease, rent and overhead expenses

5A.1m General and Administrative Expenses

The principal components of our general and administrative expenses are:

- Wages, employee benefits expenses and car maintenance
- Bad debts and allowance for doubtful accounts
- Professional fees
- Credit card and other commissions
- Depreciation

5A.1n Income with Respect to the Settlement Agreement with Orange

Income with respect to the Settlement Agreement with Orange consists of recognized payments received by Partner thereunder (see Item "5A.1c Settlement Agreement with Orange Brand Services Ltd."). The recognition of such payments terminated after the second quarter of 2017.

5A.1o Other Income, Net

The principal components of our other income, net, are:

- Unwinding of trade receivables

Capital gain from sale of property and equipment

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5A.1p Finance Costs, Net

The principal component of our finance expenses is:

Interest expenses

CPI linkage expenses

The principal components of our finance income are:

Net foreign exchange rate gains

Interest income from cash equivalents

Fair value gain from derivative financials instruments, net

5A.1q Key Cellular Business Indicators (Operating Data)

Our primary key cellular business indicators are described below. These indicators are widely used in the cellular telephone service industry to evaluate performance.

Number of subscribers

Average monthly revenue per subscriber (ARPU)

Churn rate

5A.1r Critical Accounting Estimates and Judgments

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below. See also note 4 to the consolidated financial statements.

5A.1r - i Critical accounting estimates and assumptions

(1) Assessing the useful lives of assets

The useful economic lives of the Company's assets are an estimate determined by management. The Group defines useful economic life of its assets in terms of the assets' expected utility to the Group. This estimation is based on assumptions of future changes in technology or changes in the Group's intended use of these assets, and experience of the Group with similar assets, and legal or contract periods where relevant. The assets estimated economic useful lives are reviewed, and adjusted if appropriate, at least annually. See also note 2(e) and note 2(f) to the consolidated financial statements. See also information with respect to the change in estimate of the useful life of the "012 Smile" trade name in (2) below.

The useful economic lives of contract costs (see notes 2(n) and 2(f)(5) to our consolidated financial statements) are an estimate determined by management. Contract costs are amortized in accordance with the expected service period (mainly over 2-3 years), using the portfolio approach. The assets estimated economic useful lives are reviewed, and

adjusted if appropriate, at least annually. See also note 11 to our consolidated financial statements.

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(2) Assessing the recoverable amount for impairment tests of assets with finite useful lives

The Group is required to determine at the end of each reporting period whether there is any indication that an asset may be impaired. If indicators for impairment are identified the Group estimates the assets' recoverable amount, which is the higher of an asset's fair value less costs to sell and value in use. The value-in-use calculations require management to make estimates of the projected future cash flows. Determining the estimates of the future cash flows is based on management past experience and best estimate for the economic conditions that will exist over the remaining useful economic life of the Cash Generating Unit ("CGU"). See also note 2(i) to our consolidated financial statements.

No indicators for an impairment or reversal of impairment of assets with finite useful lives were identified in 2017.

In the fourth quarter of 2015, the Group decided to cease using the "012 Smile" trade name in 2017. This change in business induced the Group to determine that an indicator of impairment exists for the fixed-line segment. See note 13(2) to the consolidated financial statements.

An Impairment test in the fourth quarter of 2015 for the VOB/ISP CGU of the fixed line segment resulted in an impairment charge to certain assets in a total amount of NIS 98 million, based on the key assumptions described in note 13(2) to the consolidated financial statements. The recoverable amount of the VOB/ISP CGU assets as of December 31, 2015 was assessed by management with the assistance of an external independent expert ("Giza Singer Even. Ltd") based on value-in-use calculations, which was NIS 250 million. The value in use calculations use pre-tax cash flow projections covering a five-year period and using extrapolation with specific adjustments expected until 2027, which is the economic life of the main asset of the CGU: the deferred expenses – Right of Use, and a pre-tax discount rate of 12.9%. The value-in-use calculations included all factors in real terms. The value-in-use of the assets of the CGU was estimated to exceed the fair value less costs to sale.

The impairment test in the fourth quarter of 2015 was based on assessments of financial performance and future strategies in light of current and expected market and economic conditions. Trends in the economic and financial environment, competition and regulatory authorities' decisions, or changes in competitors' behavior in response to the economic environment may affect the estimate of recoverable amounts in future periods. See also note 2(i) to our consolidated financial statements.

As a result of the decision in 2015 to cease the usage of the "012 Smile" trade name the Group revised its expected useful life to end in 2017 as a change in accounting estimate. As a result the amortization expenses of the trade name increased in 2015, 2016 and 2017 by NIS 1 million, NIS 16 million and NIS 6 million, respectively. See note 11 to our consolidated financial statements.

Further increase in the level of competition that will continue to push downward prices may require the Group to perform further impairment tests of assets. Such impairment tests may lead to recording significant impairment charges, which could have a material negative impact on the Group's operating and net profit.

(3) Assessing the recoverable amount of goodwill for impairment tests

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. The recoverable amount of the fixed line segment to which goodwill has been allocated to have been determined based on value-in-use calculations. For the purpose of the goodwill impairment tests as of December 31, 2015, 2016 and 2017 the recoverable amount was assessed by management with the assistance of an external independent experts (2015: "Giza Singer Even. Ltd", 2016, 2017: "BDO Ziv Haft Consulting & Management Ltd.") based on value-in-use calculations. The value-in-use calculations use pre-tax cash flow projections covering a five-year period. Cash flows beyond the five-year period to be generated from continuing use

are extrapolated using estimated growth rates. The growth rate represents the long-term average growth rate of the fixed-line communications services business.

The key assumptions used in the December, 31, 2017 test were as follows:

Terminal growth rate	0.9%
After-tax discount rate	9.3%
Pre-tax discount rate	11.2%

The impairment test as of December 31, 2017 was based on assessments of financial performance and future strategies in light of current and expected market and economic conditions. Trends in the economic and financial environment, competition and regulatory authorities' decisions, or changes in competitors' behavior in response to the economic environment may affect the estimate of recoverable amounts. See also note 13(1) and note 2(h) to the consolidated financial statements. No impairment charges were recognized in with respect to goodwill in 2015, 2016 and 2017.

Sensitivity Analysis:

The headroom of the fixed line segment recoverable amount over the carrying amount as of December 31, 2015, 2016 and 2017 was approximately 9%, 23% and 23% respectively. Sensitivity analysis was performed for the recoverable amount as of December 31, 2017 for a change of the after-tax discount rate within the range of $\pm 10\%$ multiplied by the variable 9.3% (8.4% to 10.2%), assuming all other variables constant. Sensitivity analysis was also performed for a change of the terminal permanent growth rate within the range of $\pm 1\%$ of the variable 0.9% (minus 0.9% to 1.9%), assuming all other variables constant. Results showed that no impairment charge is required for both analyses.

(4) Assessing allowance for doubtful accounts

The allowance is established when there is objective evidence that the Group will not be able to collect amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, or delinquency or default in debtor payments are considered indicators that a trade receivable is impaired. Individual receivables which are known to be uncollectable are written off by reducing the carrying amount directly. The other receivables are assessed collectively. For these receivables the allowance is determined based on percentage of doubtful debts in collection, considering the likelihood of recoverability based on the age of the balances, the historical write-off experience net of recoveries, changes in the credit worthiness, and collection trends. The trade receivables are periodically reviewed for impairment. See note 7 to the consolidated financial statements.

(5) Considering uncertain tax positions

The assessment of amounts of current and deferred taxes requires the Group's management to take into consideration uncertainties that its tax position will be accepted and of incurring any additional tax expenses. This assessment is based on estimates and assumptions based on interpretation of tax laws and regulations, and the Group's past experience. It is possible that new information will become known in future periods that will cause the final tax outcome to be different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made. See also notes 2(p) and note 25 to the consolidated financial statements.

5A.1r - ii Critical judgments in applying the Company's accounting policies

(1) Considering the likelihood of contingent losses and quantifying possible settlements:

Provisions are recorded when a loss is considered probable and can be reasonably estimated. Judgment is necessary in assessing the likelihood that a pending claim or litigation against the Group will succeed, or a liability will arise,

quantifying the possible range of final settlement. These judgments are made by management with the support of internal specialists, or with the support of outside consultants such as legal counsel. Because of the inherent uncertainties in this evaluation process, actual results may be different from these estimates. See notes 2(m), 14, and 20 to our consolidated financial statements.

(2) Considering contracts with customers with multiple performance obligations

Some contracts with customers include several performance obligations, and consideration (including any discounts) is allocated to them based on their relative stand-alone selling prices. Management estimates the stand-alone selling price at contract inception based on observable prices of the type of goods and services in similar circumstances to similar customers. Where these are not directly observable, they are estimated based on cost-plus expected margin or adjusted market approach. See also note 2(n) to the consolidated financial statements.

(3) Accounting treatment for the investment in PHI

The Board of Directors of Net 4 P.H.I Ltd., consists of three directors nominated by the Company, three directors nominated by HOT Mobile and one independent director who acts as a chairman. Net 4 P.H.I Ltd. controls PHI. This governance provides that the Company does not control PHI nor does it have joint control over it, and the Company accounts for its investment in PHI according to the equity method, see also note 2(c)(2) and note 9 to the consolidated financial statements.

5A.2 RESULTS OF CONSOLIDATED OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2017 COMPARED TO THE YEAR ENDED DECEMBER 31, 2016

REPORTED RESULTS OF CONSOLIDATED OPERATIONS*

	New Israeli Shekels		Year ended December 31, 2017*	
	In millions			
	Cellular segment	Fixed-line segment	Elimination	Consolidated
Segment revenue – Services	1,960	622		2,582
Inter-segment revenue – Services	18	155	(173)	
Segment revenue – Equipment	610	76		686
Total revenues	2,588	853	(173)	3,268
Segment cost of revenues – Services	1,470	613		2,083
Inter-segment cost of revenues - Services	154	19	(173)	
Segment cost of revenues – Equipment	490	54		544
Cost of revenues	2,114	686	(173)	2,627
Gross profit	474	167		641
Operating expenses (1)	367	98		465
Income with respect to settlement agreement with Orange	108			108
Other income, net	29	2		31
Operating profit	244	71		315
Adjustments to presentation of Segment Adjusted EBITDA				
– Depreciation and amortization	445	135		580
– Other (2)	21	1		22
Segment Adjusted EBITDA (3)	710	207		917
Reconciliation of profit for the year to Adjusted EBITDA				
Profit for the year				114
Depreciation and amortization				580
Finance costs, net				180
Income tax expenses				21

Other (2)	22
Adjusted EBITDA (3)	917

* See “Item 5A.1j Early adoption of IFRS 15 Revenue from Contracts with Customers – change in accounting policy ” and also note 2(n) and 2(f)(5) to the consolidated financial statements regarding the early adoption of IFRS 15, Revenue from Contracts with Customers. In 2017 costs of obtaining contracts with customers were capitalized in amounts of NIS 64 million and NIS 20 million for the cellular segment and the fixed-line segment, respectively. The adoption of IFRS 15 resulted in an increase in amortization expenses in 2017 for the cellular segment and the fixed-line segment in amounts of NIS 11 million and NIS 2 million, respectively.

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New Israeli Shekels
Year ended December 31, 2016

In millions

Cellular Fixed-line
segmentsegment Elimination Consolidated

Segment revenue – Services	2,080	672		2,752
Inter-segment revenue – Services	19	194	(213)	
Segment revenue – Equipment	729	63		792
Total revenues	2,828	929	(213)	3,544
Segment cost of revenues – Services	1,659	617		2,276
Inter-segment cost of revenues – Services	192	21	(213)	
Segment cost of revenues – Equipment	596	52		648
Cost of revenues	2,447	690	(213)	2,924
Gross profit	381	239		620
Operating expenses (1)	571	118		689
Income with respect to settlement agreement with Orange	217			217
Other income, net	41	4		45
Operating profit	68	125		193
Adjustments to presentation of Segment Adjusted EBITDA				
–Depreciation and amortization	447	148		595
–Other (2)	47	(1)		46
Segment Adjusted EBITDA (3)	562	272		834
Reconciliation of profit for the year to Adjusted EBITDA				
Profit for the year				52
Depreciation and amortization				595
Finance costs, net				105
Income tax expenses				36
Other (2)				46
Adjusted EBITDA (3)				834

(1) Operating expenses include selling and marketing expenses and general and administrative expenses.

(2) Mainly amortization of employee share based compensation.

(3) Adjusted EBITDA as reviewed by the CODM represents Earnings Before Interest (finance costs, net), Taxes, Depreciation and Amortization (including amortization of intangible assets, deferred expenses-right of use and impairment charges) and Other expenses (mainly amortization of share based compensation). Adjusted EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. Adjusted EBITDA may not be indicative of the Group's historic operating results nor is it meant to be predictive of potential future results. See "Item 5A.1a - NON-GAAP MEASURES" above. The usage of the term "Adjusted EBITDA" is to highlight the fact that the Amortization includes amortization of deferred expenses – right of use and amortization of employee share based compensation and impairment charges; it is fully comparable to EBITDA information which has been previously provided for prior periods.

Impact of early adoption of IFRS 15 on statement of income, and reconciliation between Non GAAP measures without impact of early adoption of IFRS 15 and most comparable IFRS financial measures:

	New Israeli Shekels in millions					
	Year ended December 31, 2017					
	Effect of Previous accounting policy	Effect of change – cellular segment	Effect of change – Fixed-line segment	Effect of change – Consolidated		According to IFRS 15 as reported
Revenues	3,270	(1)	(1)	(2)		3,268
Selling and marketing expenses	340	(53)	(18)	(71)		269
Operating profit	246	52	17	69		315
Profit before income tax	66			69		135
Income tax expenses	5			16		21
Profit for the year	61			53		114
Depreciation and amortization expenses	567	11	2	13		580

Total revenues. In 2017, total revenues were NIS 3,268 million (US\$ 943 million), a decrease of 8% from NIS 3,544 million in 2016.

Revenues from services. Service revenues in 2017 totaled NIS 2,582 million (US\$ 745 million), a decrease of 6% from NIS 2,752 million in 2016.

Revenues from equipment. Equipment revenues in 2017 totaled NIS 686 million (US\$ 198 million), a decrease of 13% from NIS 792 million in 2016, largely reflecting a significant decrease in sales volumes of both cellular devices and other non-core equipment such as tablets, televisions and other audio visual devices. The decrease mainly reflected the impact of the tightening of the Company's customer credit policy, whereby the Company imposed stricter requirements for customers to be accepted for long term financing plans under which the customer pays for the equipment through monthly payments (generally between 12 and 36 months).

Gross profit from service revenues. The gross profit from service revenues in 2017 was NIS 499 million (US\$ 144 million), compared with NIS 476 million in 2016, an increase of 5%. This increase reflected the decrease in the cost of service revenues, which was partially offset by the smaller decrease in service revenues. See also note 22 to our consolidated financial statements.

Gross profit from equipment sales. Gross profit from equipment sales in 2017 was NIS 142 million (US\$ 41 million), compared with NIS 144 million in 2016, a decrease of 1%. This decrease reflected the decrease in gross profit from equipment sales for the cellular segment which was partially offset by the increase in gross profit from equipment sales for the fixed-line segment. See also "Item 5D.2 Outlook".

Selling, marketing, general and administrative expenses. Reported selling, marketing, general and administrative expenses totaled NIS 465 million (US\$ 134 million) in 2017 following the adoption of IFRS 15, compared with NIS 689 million in 2016 (before the adoption of IFRS 15), a decrease of 33%. This decrease mainly reflected decreases in sales commissions as a result of the adoption of IFRS 15, as well as in payroll and related expenses, in bad debts and allowance for doubtful accounts expenses and in advertising and marketing expenses related, in part, to the marketing activities for the rebranding of the Company in 2016. Without the impact of the early adoption of IFRS 15 in 2017, selling, marketing, general and administrative expenses would have been NIS 536 million, a decrease of 22% from NIS 689 million in 2016.

Total operating expenses ("OPEX"). Total operating expenses amounted to NIS 1,946 million (US\$ 561 million) in 2017. Without the impact of the early adoption of IFRS 15 in 2017, total operating expenses would have been NIS 2,030 million, a decrease of 13% or NIS 294 million from 2016. Total operating expenses ("Opex") (not a financial measure under IFRS and not necessarily comparable to similarly titled measures for other companies) includes cost of service revenues (NIS 2,083 million in 2017) and selling, marketing, general and administrative expenses (NIS 465 million in 2017), and excludes depreciation, amortization and impairment expenses and other expenses (mainly amortization of employee share based compensation) (NIS 602 million in 2017). The decrease in total operating expenses in 2017 without the impact of the early adoption of IFRS 15 mainly reflected decreases (i) in cellular network and cable maintenance and operating lease expenses (in cost of service revenues) principally as a result of the network sharing agreement with HOT Mobile, (ii) in international call expenses (in cost of service revenues), (iii) in bad debts and allowance for doubtful accounts expenses (in selling, marketing and administrative expenses), (iv) in advertising and marketing expenses (in selling, marketing and administrative expenses) and (v) in other expense items as a result of various efficiency measures. These decreases were partially offset by increases in expenses related to Partner TV service (in cost of service revenues) that was launched during 2017, and in expenses related to internet services (in cost of service revenues).

Including depreciation, amortization and impairment expenses and other expenses (mainly amortization of employee share based compensation), total operating expenses in 2017 amounted to NIS 2,548 million (US\$ 735 million). Without the impact of the early adoption of IFRS 15 in 2017, total operating expenses including depreciation, amortization and impairment expenses and other expenses (mainly amortization of employee share based compensation) would have been NIS 2,619 million, a decrease of 12% compared with 2016. See also note 22 to our consolidated financial statements.

Income with respect to settlement with Orange. In 2017, the Company recorded income with respect to the settlement agreement of the Orange brand agreement in an amount of NIS 108 million (US\$ 31 million) compared with NIS 217 million recorded in 2016. As set forth in the settlement agreement, the advance payments received from Orange were recognized and reconciled evenly on a quarterly basis over a period until the second quarter of 2017, against contingent marketing, sales, customer services and other expenses that were incurred over this period. See also "Item 5A.1c Settlement Agreement with Orange Brand Services Ltd.," "5D.2 Outlook" and note 18 to our consolidated financial statements.

Other income, net. Other income, net, totaled NIS 31 million (US\$ 9 million) in 2017, compared to NIS 45 million in 2016, a decrease of 31%, reflecting a decrease in income from the unwinding of trade receivables. See also note 23 to our consolidated financial statements.

Operating profit. Reported operating profit for 2017 was NIS 315 million (US\$ 91 million). Without the impact of the early adoption of IFRS 15 in 2017, operating profit would have been NIS 246 million, an increase of 27% compared

with reported operating profit of NIS 193 million in 2016.

Finance costs, net. Finance costs, net in 2017 were NIS 180 million (US\$ 52 million), an increase of 71% compared with NIS 105 million in 2016. The increase largely reflected the impact of the increase in early debt repayment expenses in 2017 of NIS 82 million which were mainly related to the early repayment of borrowings during 2017 in a total amount of NIS 1,283 million (US\$ 370 million). See also “Item 5B Liquidity and Capital Resources.”

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Profit (loss) before income tax. Profit before income taxes for 2017 was NIS 135 million (US\$ 39 million). Without the impact of the early adoption of IFRS 15 in 2017, profit before income taxes would have been NIS 66 million, a decrease of 25% compared with NIS 88 million in 2016, reflecting the increase in finance costs, net, which more than offset the increase in operating profit.

Income taxes on profit. Income taxes on profit for 2017 were NIS 21 million (US\$ 6 million). Without the impact of the early adoption of IFRS 15 in 2017, income taxes on profit would have been NIS 5 million, compared with NIS 36 million in 2016.

An income tax audit of the Company, concluded in 2017, resulted in a one-time income of NIS 10 million in income tax expenses and in an additional one-time deferred tax income of NIS 9 million, which was recognized in income tax expenses.

The effective tax rate of the Company in 2017 was 16% compared with 41% in 2016, largely reflecting the one-time factors in 2017 described above. The regular corporate tax rate in Israel for 2016 was 25% and for 2017 was 24%. The regular corporate tax rate for 2018 and thereafter will be reduced further to 23%.

The Company's effective tax rate is expected to continue to be higher than the corporate tax rate mainly due to nondeductible expenses. See also note 25 to our consolidated financial statements.

Profit. Reported profit in 2017 was NIS 114 million (US\$ 33 million). Without the impact of the early adoption of IFRS 15 in 2017, profit would have been NIS 61 million, an increase of 17% compared with NIS 52 million in 2016. Based on the weighted average number of shares outstanding during 2017, basic earnings per share or ADS was NIS 0.70 (US\$ 0.20). Without the impact of the early adoption of IFRS 15 in 2017, basic earnings per share or ADS would have been NIS 0.38 compared with NIS 0.33 in 2016.

For information regarding potential downward impacts on profits in 2018, see "Item 5D.2 Outlook."

Adjusted EBITDA. Adjusted EBITDA in 2017 totaled NIS 917 million (US\$ 264 million). Without the impact of the early adoption of IFRS 15 in 2017, Adjusted EBITDA would have been NIS 835 million, an increase of 0.1% from NIS 834 million in 2016. As a percentage of total revenues, Adjusted EBITDA in 2017 was 28%. Without the impact of the early adoption of IFRS 15 in 2017, Adjusted EBITDA as a percentage of total revenues would have been 26% compared with 24% in 2016.

5A.2a Cellular Services Segment

Total revenues. Total revenues for the cellular segment in 2017 were NIS 2,588 million (US\$ 746 million), a decrease of 8% from NIS 2,828 million in 2016.

Revenues from services. Service revenues for the cellular segment in 2017 totaled NIS 1,978 million (US\$ 571 million), a decrease of 6% from NIS 2,099 million in 2016. The decrease was mainly a result of the continued downward pressures on the prices of post-paid and pre-paid cellular services as a result of the continued competition in the cellular market. As an illustration of the level of competition in the cellular market, approximately 2.5 million cellular subscribers are estimated to have switched operators within the Israeli market (with number porting) in 2017, compared with approximately 2.3 million in 2016 and 2.5 million in 2015.

Significant price erosion continued to be caused by the amount of cellular subscribers who moved between different rateplans or airtime packages (generally with a lower monthly fee) within the Company.

In addition, cellular segment service revenues for 2017 were negatively affected by a decrease in revenues as a result of the termination of the Right of Use Agreement with HOT Mobile from the second quarter of 2016, for which the

Company recorded revenues in an amount of approximately NIS 51 million in 2016. See "Item 5A.1e Right of Use Agreement with HOT Mobile".

Pre-paid cellular subscribers contributed service revenues in a total amount of approximately NIS 146 million (US\$ 42 million) in 2017, a decrease of 19% from approximately NIS 180 million in 2016, as a result of the price erosion in pre-paid services and the decrease in the number of pre-paid subscribers, which was largely attributed to pre-paid subscribers moving to post-paid subscriber packages due to the significant price declines (and hence increased attractiveness) for these products.

Revenues from equipment. Revenues from equipment sales for the cellular segment in 2017 totaled NIS 610 million (US\$ 176 million), a decrease of 16% from NIS 729 million in 2016, reflecting a decrease in the volume of sales, mainly due to the impact of the tightening of the Company's customer credit policy, whereby stricter requirements were imposed for customers to be accepted for long term financing plans under which the customer pays for the equipment through monthly payments (generally between 12 and 36 months). The decrease in volume of sales was partially offset by an increase in revenues from the leasing of cellular handsets to both residential and business customers.

Gross profit from equipment sales. The gross profit from equipment sales for the cellular segment in 2017 was NIS 120 million (US\$ 35 million), compared with NIS 133 million in 2016, a decrease of 10%. This decrease mainly reflected both the decrease in the volume of equipment sales, as described above, partially offset by a small increase in profit margins from sales. See also "Item 5D.2 Outlook".

Cost of service revenues. The cost of service revenues for the cellular segment (excluding inter-segment costs) decreased by 11% from NIS 1,659 million in 2016 to NIS 1,470 million (US\$ 424 million) in 2017. This decrease mainly reflected decreases in operating lease, rent and overhead expenses and in cellular network and cable maintenance expenses, largely reflecting the impact of the network sharing agreement with HOT Mobile, as well as a decrease in expenses related to lower payments to transmission, communication and content providers. The early adoption of IFRS 15 in 2017 did not have any impact on the cost of service revenues for the cellular segment. See also note 22 to our consolidated financial statements.

Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses for the cellular segment in 2017 amounted to NIS 367 million (US\$ 106 million). Without the impact of the early adoption of IFRS 15 in 2017, selling, marketing, general and administrative expenses for the cellular segment would have been NIS 420 million, a decrease of 26% from NIS 571 million in 2016. The decrease mainly reflected decreases in payroll and related expenses, in bad debts and allowance for doubtful accounts expenses, which was principally due to the impact of the tightening of the Company's customer credit policy for handset sales, and in advertising and marketing expenses related, in part, to the marketing activities related to the rebranding of the Company in 2016. See also note 2(n) and note 22 to our consolidated financial statements.

Total operating expenses ("OPEX"). Total operating expenses for the cellular segment totaled NIS 1,525 million (US\$ 440 million) in 2017. Without the impact of the early adoption of IFRS 15 in 2017, total operating expenses for the cellular segment would have been NIS 1,589 million, a decrease of 18% or NIS 339 million from 2016. See also note 22 to our consolidated financial statements. Including depreciation and amortization expenses and other expenses (mainly amortization of employee share based compensation), total operating expenses totaled NIS 1,991 million. Without the impact of the early adoption of IFRS 15 in 2017, total operating expenses for the cellular segment including depreciation and amortization expenses and other expenses (mainly amortization of employee share based compensation) would have been NIS 2,044 million, a decrease of 16% compared with 2016.

Income with respect to settlement with Orange. In 2017, the Company recorded income with respect to the settlement agreement of the Orange brand agreement in an amount of NIS 108 million (US\$ 31 million) compared with NIS 217 million recorded in 2016. As set forth in the settlement agreement, the advance payments received from Orange were recognized and reconciled evenly on a quarterly basis over a period until the second quarter of 2017, against contingent marketing, sales, customer services and other expenses that were incurred over this period. See also "Item 5A.1c Settlement Agreement with Orange Brand Services Ltd." above and note 18 to our consolidated financial statements.

Operating profit. Overall, operating profit for the cellular segment in 2017 was NIS 244 million (US\$ 70 million). Without the impact of the early adoption of IFRS 15 in 2017, operating profit for the cellular segment would have been NIS 192 million, an increase of 182% compared with NIS 68 million in 2016, reflecting the impact of the reduction in total operating expenses which was partially offset by the decreases in service revenues, in income with

respect to settlement with Orange and in gross profits from cellular segment equipment sales.

Adjusted EBITDA. Adjusted EBITDA for the cellular segment was NIS 710 million (US\$ 205 million) in 2017. Without the impact of the early adoption of IFRS 15 in 2017, Adjusted EBITDA for the cellular segment would have been NIS 647 million, an increase of 15% from NIS 562 million in 2016, for the same reasons as the increase in operating profit. As a percentage of total cellular revenues, Adjusted EBITDA for the cellular segment in 2017 was 27%. Without the impact of the early adoption of IFRS 15 in 2017, Adjusted EBITDA for the cellular segment as a percentage of total cellular revenues would have been 25% compared with 20% in 2016.

5A.2b Fixed-Line Services Segment

Total revenues. Total revenues in 2017 for the fixed-line segment were NIS 853 million (US\$ 246 million), a decrease of 8% compared with NIS 929 million in 2016.

Revenues from services. Service revenues for the fixed-line segment totaled NIS 777 million (US\$ 224 million) in 2017, a decrease of 10% compared with NIS 866 million in 2016. This decrease mainly reflected a decrease in revenues from international calling services (including the market for wholesale international traffic) which were adversely affected both by the increased penetration of internet-based solutions and increased competition from other service providers, and a decrease in inter-segment revenues. See also "Item 3D.2o The telecommunications industry is subject to rapid and significant changes in technology and industry structure which could reduce demand for our services." It is estimated that the Company's subscriber market share in the ISP segment continues to be eroded as a result of the strong competition in the market. The launches of Partner TV service and the commercial phase and accelerated deployment of our fiber optic network did not have a significant impact on fixed-line segment revenues in 2017.

Revenues from equipment. Revenues from equipment sales for the fixed-line segment in 2017 totaled NIS 76 million (US\$ 22 million), an increase of 21% compared with NIS 63 million in 2016, mainly reflecting an increase in revenues recorded from sales of audio visual and related equipment and devices.

Gross profit from equipment sales. The gross profit from equipment sales for the fixed-line segment in 2017 was NIS 22 million (US\$ 6 million), compared with NIS 11 million in 2016, an increase of 100%, again largely a reflection of the impact of an increase in gross profit recorded from sales of audio visual and related equipment and devices.

Cost of service revenues. The cost of service revenues (excluding inter-segment costs) for the fixed-line segment decreased by 1% from NIS 617 million in 2016 to NIS 613 million (US\$ 177 million) in 2017. This decrease reflected decreases in international call expenses, and in operating lease, rent and overhead expenses, partially offset by increases in expenses related to Partner TV service that was launched during 2017, and in expenses related to internet services. See also note 22 to our consolidated financial statements.

Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses for the fixed-line segment in 2017 amounted to NIS 98 million (US\$ 28 million). Without the impact of the early adoption of IFRS 15 in 2017, selling, marketing, general and administrative expenses for the fixed-line segment would have been NIS 116 million, a decrease of 2% from NIS 118 million in 2016. The decrease largely reflected decreases in payroll and related expenses, partially offset by an increase in advertising and marketing expenses related in part, to the marketing activities related to the launch of the Company's television services during 2017. See also note 22 to our consolidated financial statements.

Total operating expenses ("OPEX"). Total operating expenses for the fixed-line segment totaled NIS 594 million (US\$ 171 million) in 2017. Without the impact of the early adoption of IFRS 15 in 2017, total operating expenses for the fixed-line segment would have been NIS 614 million, an increase of 1% or NIS 5 million from 2016. See also note 22 to our consolidated financial statements. Including depreciation, amortization and impairment expenses and other expenses (mainly amortization of employee share based compensation), total operating expenses totaled NIS 730 million. Without the impact of the early adoption of IFRS 15 in 2017, total operating expenses for the fixed-line segment including depreciation and amortization expenses and other expenses (mainly amortization of employee share based compensation) would have been NIS 748 million, a decrease of 1% compared with 2016.

Operating profit. Operating profit for the fixed-line segment was NIS 71 million (US\$ 20 million) in 2017. Without the impact of the early adoption of IFRS 15 in 2017, operating profit for the fixed-line segment would have been NIS 54 million, a decrease of 57% compared to NIS 125 million in 2016, mainly reflecting the impact of the decrease in service revenues and the increase in total operating expenses, partially offset by the increase in gross profit from

equipment sales, as explained above. The launches of Partner TV service and the commercial phase and accelerated deployment of our fiber optic network did not have a significant impact on fixed-line segment operating profit in 2017.

Adjusted EBITDA. Adjusted EBITDA for the fixed-line segment was NIS 207 million (US\$ 60 million) in 2017. Without the impact of the early adoption of IFRS 15 in 2017, Adjusted EBITDA for the fixed-line segment would have been NIS 188 million, a decrease of 31% from NIS 272 million in 2016, for the same reasons as the decrease in operating profit. As a percentage of total fixed-line revenues, Adjusted EBITDA for the fixed-line segment in 2017 was 24%. Without the impact of the early adoption of IFRS 15 in 2017, Adjusted EBITDA for the fixed-line segment as a percentage of total fixed-line revenues would have been 22% compared with 29% in 2016.

5A.3 RESULTS OF CONSOLIDATED OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2016, COMPARED TO THE YEAR ENDED DECEMBER 31, 2015

	New Israeli Shekels			
	Year ended December 31, 2015			
	In millions			
	Cellular segment	Fixed-line segment	Elimination	Consolidated
Segment revenue – Services	2,275	717		2,992
Inter-segment revenue – Services	22	189	(211)	
Segment revenue – Equipment	1,051	68		1,119
Total revenues	3,348	974	(211)	4,111
Segment cost of revenues – Services	1,856	736	(*)	2,592
Inter-segment cost of revenues – Services	187	24	(211)	
Segment cost of revenues – Equipment	832	48		880
Cost of revenues	2,875	808	(211)	3,472
Gross profit	473	166		639
Operating expenses (1)	506	134	(*)	640
Income with respect to settlement agreement with Orange	61			61
Other income, net	44	3		47
Operating profit	72	35		107
Adjustments to presentation of Segment Adjusted EBITDA				
–Depreciation and amortization (including impairment charges)	510	243		753
–Other (2)	15	1		16
Segment Adjusted EBITDA (3)	597	279		876
Reconciliation of loss for the year to Adjusted EBITDA				
Loss for the year				(40)
Depreciation and amortization (including impairment charges)				753
Finance costs, net				143
Income tax expenses				4
Other (2)				16
Adjusted EBITDA (3)				876

(*) Includes impairment charges in the fixed-line segment, see note 13 to our consolidated financial statements.

(1) Operating expenses include selling and marketing expenses and general and administrative expenses.

(2) Mainly amortization of employee share based compensation.

(3) Adjusted EBITDA as reviewed by the CODM represents Earnings Before Interest (finance costs, net), Taxes, Depreciation and Amortization (including amortization of intangible assets, deferred expenses-right of use and impairment charges) and Other expenses (mainly amortization of share based compensation). Adjusted EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. Adjusted EBITDA may not be indicative of the Group's historic operating results nor is it meant to be predictive of potential future results. See "Item 5A.1a - NON-GAAP MEASURES" above. The usage of the term "Adjusted EBITDA" is to highlight the fact that the Amortization includes amortization of deferred expenses – right of use and amortization of employee share based compensation and impairment charges.

Total revenues. In 2016, total revenues were NIS 3,544 million, a decrease of 14% from NIS 4,111 million in 2015.

Revenues from services. Service revenues in 2016 totaled NIS 2,752 million, a decrease of 8% from NIS 2,992 million in 2015.

Revenues from equipment. Equipment revenues in 2016 totaled NIS 792 million, a decrease of 29% from NIS 1,119 million in 2015, largely reflecting a decrease in the volume of equipment sales. This decrease was mainly related to the tightening of the Company's customer credit policy, whereby stricter requirements were imposed for customers to be accepted for long term financing plans under which the customer pays for the equipment through monthly payments (generally between 12 and 36 months).

Gross profit from service revenues. The gross profit from service revenues in 2016 was NIS 476 million, compared with NIS 400 million in 2015, an increase of 19%. The trend in gross profit from service revenues was positively affected by expenses of NIS 88 million recorded in 2015 due to the impairment charge on the right of use on international fiber optic cables (NIS 76 million), on computers and information systems (NIS 7 million) and on the communication network (NIS 5 million). Compared with gross profit from service revenues excluding the impact of these impairment charges in 2015, gross profit from service revenues in 2016 decreased by 2%, largely reflecting the decrease in service revenues, partially offset by the decrease in the cost of service revenues. See also note 22 to our consolidated financial statements.

Gross profit from equipment sales. Gross profit from equipment sales in 2016 was NIS 144 million, compared with NIS 239 million in 2015, a decrease of 40%, mainly reflecting both the decrease in the volume of equipment sales, as described above, and lower profit margins from sales which resulted largely from the tightening of the Company's customer credit policy (since profit margins are higher for sales with long term financing plans), as well as a change in product mix towards products with lower profit margins.

Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses totaled NIS 689 million in 2016, an increase of 8% from 2015. Selling, marketing, general and administrative expenses for 2015 included expenses in the amount of NIS 10 million that were recorded following the impairment charge on customer relationships (NIS 8 million) and on the trade name (NIS 2 million). Compared with selling, marketing, general and administrative expenses excluding the impact of these impairment charges in 2015, selling, marketing, general and administrative expenses increased by 9%. This increase mainly reflected an increase in advertising and marketing expenses related, in part, to the marketing activities for the rebranding of the Company, and an increase in bad debts and allowance for doubtful accounts expenses which was mainly related to historical transactions. See also note 22 to our consolidated financial statements.

Total operating expenses ("OPEX"). Total operating expenses amounted to NIS 2,324 million in 2016, a decrease of 6% or NIS 139 million from 2015. Total operating expenses ("Opex") (not a financial measure under IFRS and not necessarily comparable to similarly titled measures for other companies) includes cost of service revenues (NIS 2,276 million in 2016) and selling, marketing, general and administrative expenses (NIS 689 million in 2016), and excludes depreciation, amortization and impairment expenses and other expenses (mainly amortization of employee share

based compensation) (NIS 641 million in 2016).

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Including depreciation, amortization and impairment expenses and other expenses (mainly amortization of employee share based compensation), total operating expenses in 2016 decreased by 8% compared with 2015. See also note 22 to our consolidated financial statements.

Income with respect to settlement with Orange. In 2016, the Company recorded income with respect to the settlement agreement of the Orange brand agreement in an amount of NIS 217 million compared with NIS 61 million recorded in 2015. As set forth in the settlement agreement, the advance payments received from Orange were recognized and reconciled evenly on a quarterly basis over a period until the second quarter of 2017, against contingent marketing, sales, customer services and other expenses that were incurred over this period. See also Item 5A.1c Settlement Agreement with Orange Brand Services Ltd.”, 5D.2 Outlook and note 18 to our consolidated financial statements.

Other income, net. Other income, net, totaled NIS 45 million in 2016, compared to NIS 47 million in 2015, a decrease of 4%, mainly reflecting a decrease in income from the unwinding of trade receivables. See also note 23 to our consolidated financial statements.

Operating profit. Reported operating profit for 2016 was NIS 193 million, an increase of 80% compared with reported operating profit of NIS 107 million in 2015. Compared with operating profit for 2015 before the impairment charges described above (NIS 98 million), operating profit decreased by 6%.

Finance costs, net. Finance costs, net in 2016 were NIS 105 million, a decrease of 27% compared with NIS 143 million in 2015. The decrease reflected lower interest payment expenses due to the lower average level of debt, as well as gains from foreign exchange movements in 2016 compared with losses from foreign exchange in 2015 and lower early debt repayment expenses. This decrease in finance costs was partially offset by higher linkage expenses due to the higher CPI level. See also “Item 5B Liquidity and Capital Resources.”

Profit (loss) before income tax. Profit before income taxes for 2016 was NIS 88 million, compared with loss before income tax of NIS 36 million in 2015. Compared with profit before income tax in 2015 excluding the impact of the impairment charges described above (NIS 98 million), profit before income tax in 2016 increased by 42%, reflecting principally the decrease in finance costs, net which more than offset the decrease in operating profit excluding impairment charges.

Income taxes on profit. Income taxes on profit for 2016 were NIS 36 million, compared to income taxes on loss of NIS 4 million in 2015. In January 2016, the Law for the Amendment of the Income Tax Ordinance (No. 216) was published, enacting a reduction of corporate tax rate, from 26.5% to 25%, for the year 2016 and thereafter. In addition, in December 2016, the Economic Efficiency Law (Legislative Amendments for Implementing the Economic Policy for the 2017 and 2018 Budget Year), 2016 was published, enacting that the corporate tax rate will be 24% in 2017 and 23% in 2018 and thereafter. These reductions of the corporate tax rate resulted in a reduction of NIS 7 million in the Group's deferred tax assets in 2016, which was recognized as an income tax expense.

Profit (Loss). Reported profit in 2016 was NIS 52 million, compared with loss of NIS 40 million in 2015. Compared with profit in 2015 before impairment charges (NIS 72 million after income tax), profit in 2016 increased by 62%. Based on the weighted average number of shares outstanding during 2016, basic earnings per share or ADS, was NIS 0.33, compared to basic loss per share of NIS 0.26 in 2015.

Adjusted EBITDA. Adjusted EBITDA in 2016 totaled NIS 834 million, a decrease of 5% from NIS 876 million in 2015. As a percentage of total revenues, Adjusted EBITDA in 2016 was 24%, compared with 21% in 2015.

5A.3a Cellular Services Segment

The impairment charge on fixed-line assets in 2015 did not have any impact on the results for the cellular services segment.

Total revenues. Total revenues for the cellular segment in 2016 were NIS 2,828 million, a decrease of 16% from NIS 3,348 million in 2015.

Revenues from services. Service revenues for the cellular segment in 2016 totaled NIS 2,099 million, a decrease of 9% from NIS 2,297 million in 2015. The decrease was mainly a result of the continued downward pressures on the prices of post-paid and pre-paid cellular services as a result of the continued competition in the cellular market. As an illustration of the level of competition in the cellular market, approximately 2.3 million cellular subscribers are estimated to have switched operators within the Israeli market (with number porting) in 2016, only slightly fewer than the estimated 2.5 million switchers in 2014 and 2015.

Significant price erosion continued to be caused by the amount of cellular subscribers who moved between different rateplans or airtime packages (generally to obtain a lower monthly fee) within the Company.

In addition, cellular segment service revenues were negatively affected by a decrease in revenues from wholesale services provided to other operators hosted on the Company's network, and in particular as a result of the termination of the Right of Use Agreement with HOT Mobile starting from the second quarter of 2016. As a result, revenues arising from the Right of Use Agreement decreased from approximately NIS 120 million in 2015 to approximately NIS 51 million in 2016. See "Item 5A.1e Right of Use Agreement with HOT Mobile." This decrease was partially offset by the amortization to revenues of the Lump Sum payment from HOT Mobile under the Network Sharing Agreement in an amount of approximately NIS 23 million in 2016.

Pre-paid cellular subscribers contributed service revenues in a total amount of approximately NIS 180 million in 2016, a decrease of 22% from approximately NIS 230 million in 2015. This decrease was a result of the price erosion in pre-paid services and the decrease in the number of pre-paid subscribers, which was largely attributed to pre-paid subscribers moving to post-paid subscriber packages due to the significant price declines (and hence increased attractiveness) for these products.

Revenues from equipment. Revenues from equipment sales for the cellular segment in 2016 totaled NIS 729 million, a decrease of 31% from NIS 1,051 million in 2015, reflecting a decrease in the volume of sales, mainly related to the tightening of the Company's customer credit policy, whereby stricter requirements were imposed for customers to be accepted for long term financing plans, whereby the customer pays for the equipment through monthly payments (generally between 12 and 36 months).

Gross profit from equipment sales. The gross profit from equipment sales for the cellular segment in 2016 was NIS 133 million, compared with NIS 219 million in 2015, a decrease of 39%. This decrease reflected both the decrease in the volume of equipment sales, as described above, and lower profit margins from sales which was also a result of the tightening of the Company's customer credit policy (since profit margins are higher for sales with long term financing plans), as well as a change in product mix towards products with lower profit margins.

Cost of service revenues. The cost of service revenues for the cellular segment (excluding inter-segment costs) decreased by 11% from NIS 1,856 million in 2015 to NIS 1,659 million in 2016. This decrease reflected principally decreases in cellular network and cable maintenance expenses, in part related to the implementation of the cost sharing mechanism under the Network Sharing Agreement with HOT Mobile, and decreases in expenses related to payments to transmission, communication and content providers.

Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses for the cellular segment in 2016 amounted to NIS 571 million, an increase of 13% from NIS 506 million in 2015. The increase mainly reflected an increase in advertising and marketing expenses related, in part, to the marketing activities for the rebranding of the Company, and an increase in bad debts and allowances for doubtful accounts expenses which was mainly related to historical transactions. See also note 22 to our consolidated financial statements.

Total operating expenses ("OPEX"). Total operating expenses for the cellular segment totaled NIS 1,928 million in 2016, a decrease of 5% or NIS 96 million from 2015. See also note 22 to our consolidated financial statements. Including depreciation and amortization expenses and other expenses (mainly amortization of employee share based compensation), total operating expenses decreased by 5%.

Income with respect to settlement with Orange. In 2016, the Company recorded income with respect to the settlement agreement of the Orange brand agreement in an amount of NIS 217 million compared with NIS 61 million recorded in 2015. As set forth in the settlement agreement, the advance payments received from Orange were recognized and reconciled evenly on a quarterly basis over a period until the second quarter of 2017, against contingent marketing, sales, customer services and other expenses that were incurred over this period. See also Item 5A.1c Settlement Agreement with Orange Brand Services Ltd.” above and note 18 to our consolidated financial statements.

Operating profit. Overall, operating profit for the cellular segment in 2016 was NIS 68 million, a decrease of 6% or NIS 4 million compared with NIS 72 million in 2015, reflecting the impact of the decreases in service revenues and gross profits from cellular segment equipment sales, which were partially offset by the reduction in total operating expenses and the increase in income with respect to the settlement with Orange.

Adjusted EBITDA. Adjusted EBITDA for the cellular segment was NIS 562 million in 2016, decreasing by 6% from NIS 597 million in 2015, for the same reasons as the decrease in operating profit. As a percentage of total cellular revenues, Adjusted EBITDA for the cellular segment in 2016 was 20%, compared with 18% in 2015.

5A.3b Fixed-Line Services Segment

Total revenues. Total revenues in 2016 for the fixed-line segment were NIS 929 million, a decrease of 5% compared with NIS 974 million in 2015.

Revenues from services. Service revenues for the fixed-line segment totaled NIS 866 million in 2016, a decrease of 4% compared with NIS 906 million in 2015. The decrease mainly reflected a decrease in revenues from international calls (including in the market for wholesale international traffic) as well as decreases in revenues from other fixed line services including local lines and ISP services. Our subscriber market share in the ISP segment continues to be eroded as a result of the strong competition in the market from both existing and new service providers.

Revenues from equipment. Revenues from equipment sales for the fixed-line segment in 2016 totaled NIS 63 million, a decrease of 7% compared with NIS 68 million in 2015. The decrease mainly reflected a decrease in the sale of non-core fixed line equipment, including tablets, televisions, streamers and other audio visual devices, which was partially offset by an increase in fixed line equipment for business customers including sales of advanced business solutions.

Gross profit from equipment sales. The gross profit from equipment sales for the fixed-line segment in 2016 was NIS 11 million, compared with NIS 20 million in 2015, a decrease of 45%, mainly reflecting the decrease in the sale of non-core fixed line equipment, as described above.

Cost of service revenues. The cost of service revenues (excluding inter-segment costs) for the fixed-line segment decreased by 16% from NIS 736 million in 2015 to NIS 617 million in 2016. The cost of service revenues in 2015 was negatively affected by expenses in the amount of NIS 88 million that were recorded following the impairment charge on the right of use on international fiber optic cables (NIS 76 million), on computers and information systems (NIS 7 million) and on the communication network (NIS 5 million). Compared with the cost of service revenues in 2015, excluding the impact of the impairment charges taken for that year, the cost of service revenues in 2016 decreased by 5%, reflecting decreases in transmission and communication provider expenses, salaries and related expenses and in depreciation expenses, partially offset by increases in expenses related to payments to internet infrastructure and service providers. See also note 22 to our consolidated financial statements.

Selling, marketing, general and administrative expenses. Selling, marketing, general and administrative expenses for the fixed-line segment in 2016 amounted to NIS 118 million, a decrease of 12% from NIS 134 million in 2015. Selling, marketing, general and administrative expenses for 2015 included expenses in the amount of NIS 10 million that were recorded following the impairment charge on customer relationships (NIS 8 million) and on the trade name

(NIS 2 million). Compared with selling, marketing, general and administrative expenses excluding the impact of these impairment charges in 2015, the decrease in selling, marketing, general and administrative expenses in 2016 was 5%. See also note 22 to our consolidated financial statements.

Total operating expenses ("OPEX"). Total operating expenses for the fixed-line segment totaled NIS 609 million in 2016, a decrease of 6% or NIS 41 million from 2015. See also note 22 to our consolidated financial statements. Including depreciation, amortization and impairment expenses and other expenses (mainly amortization of employee share based compensation), total operating expenses decreased by 15%.

Operating profit. Operating profit for the fixed-line segment was NIS 125 million in 2016, an increase of 257% compared to NIS 35 million in 2015. Operating profit for 2015 included impairment charges, as described above, in the amount of NIS 98 million. Compared with operating profit excluding the impairment charges in 2015, operating profit in 2016 decreased by 6%, mainly reflecting the impact of the decreases in service revenues and in gross profit from equipment sales, partially offset by the reduction in total operating expenses, as explained above.

Adjusted EBITDA. Adjusted EBITDA for the fixed-line segment decreased by 3% from NIS 279 million in 2015 to NIS 272 million in 2016, for the same reasons as the decrease in operating profit. As a percentage of total fixed-line revenues, Adjusted EBITDA for the fixed-line segment in 2016 was 29%, unchanged from 2015.

5A.4 SEASONALITY

Our service revenues and profitability show some seasonal trends over the year, resulting mainly from revenues from roaming services which tend to increase during Jewish holiday periods and during the summer months.

Whilst most of our post-paid cellular tariff plans for private customers are bundles including unlimited amounts of call minutes and SMS, for other cellular subscribers in plans which charge according to usage, airtime minutes and consequently airtime revenues are affected by the number of monthly work days and daylight hours in the day, which varies throughout the year. In addition, airtime revenues for such subscribers are lower in February, which is a shorter than average month. However, due to the increased penetration of bundled plans which offer unlimited or fixed amounts of airtime and SMS usage, the impact of such effects has significantly decreased over the last few years. There is no assurance that these trends will continue in the future.

	Three months ended			
	March	June	Sept.	Dec.
NIS in millions	31	30	30	31
	(Unaudited)			
Service Revenues				

2015