

Cellcom Israel Ltd.  
Form 20-F  
March 18, 2019

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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, 2018

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 001-33271

CELLCOM ISRAEL LTD.

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

ISRAEL

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(Jurisdiction of incorporation or organization)

10 Hagavish Street, Netanya 4250708, Israel

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(Address of principal executive offices)

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

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

Title of each class	Name of each exchange on which registered
<u>Ordinary Shares, par value NIS 0.01 per share</u>	<u>New York Stock Exchange ("NYSE")</u>

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

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(Title of Class)

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

None

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(Title of Class)

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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.

As of December 31, 2018, the Registrant had outstanding 116,196,729 Ordinary Shares, par value NIS 0.01 per share.

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

Yes      No

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

Yes      No

Indicate by check mark whether the Registrant has (1) 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 every Interactive Data File required to be submitted 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 such files)

Yes      No

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

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

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

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

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

U.S. GAAP

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

Other

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

Item 17

Item 18

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

Yes      No

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## INTRODUCTION

In this annual report, “Cellcom,” the “Company,” “we,” “us” and “our” refer to Cellcom Israel Ltd. and its subsidiaries. The terms “NIS” refers to new Israeli shekel, and “dollar,” “USD” or “\$” refers to U.S. dollars. The term “Companies Law” shall mean the Israeli Companies Law of 1999.

### Presentation of Financial and Share Information

We prepare our consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

Unless we indicate otherwise, U.S. dollar translations of the NIS amounts presented in this annual report are translated for the convenience of the reader using the rate of NIS 3.748 to \$1.00, the representative rate of exchange as of December 31, 2018 as published by the Bank of Israel. The translation is for the convenience of the reader only, and it does not represent the fair value of the translated assets and liabilities.

### Trademarks

We have proprietary rights to trademarks used in this annual report which are important to our business. We have omitted the “®” and “™” designations for certain trademarks, but nonetheless reserve all rights to them. Each trademark, trade name or service mark of any other company appearing in this annual report belongs to its respective holder.

### Industry and Market Data

This annual report contains information about our market share, market position and industry data. Unless otherwise indicated, this statistical and other market information is based on statistics prepared by the Ministry of Communications of Israel, Brandman Marketing Research and Consultancy Institute, Sapio Research & Development, Pyramid Research, and Meida Shivuki C.I. (survey institute). Industry publications generally state that the information they contain has been obtained from sources believed to be reliable, but the accuracy and completeness of such information is not guaranteed. We have not independently verified the accuracy of market data and industry forecasts contained in this annual report that were taken or derived from these industry publications.

### Special Note Regarding Forward-Looking Statements

We have made statements under the captions “Item 3. Key Information - D - Risk Factors,” “Item 4 – Information on the Company,” “Item 5. Operating and Financial Review and Prospects,” and in other sections of this annual report that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as “may,” “might,” “will,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential” or “continue,” the negative terms and other comparable terminology. These forward-looking statements, which are subject to risks, uncertainties and assumptions about us, may include projections of our future financial performance, our anticipated growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements, including those factors discussed under the caption entitled “Item 3. Key Information - D. Risk Factors.” You should specifically consider the numerous risks outlined under “Item 3. Key Information - D. Risk Factors.”

Although we believe the expectations reflected in the forward-looking statements contained in this annual report are reasonable, we cannot guarantee future results, level of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of any of these forward-looking statements. We assume no duty to update any of these forward-looking statements after the date of this annual report to conform our prior statements to actual results or revised expectations, except as otherwise required by law.

## PART I

### ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

### ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

### ITEM 3. KEY INFORMATION

#### A. SELECTED FINANCIAL DATA

You should read the following selected consolidated financial data in conjunction with the section of this annual report entitled “Item 5. Operating and Financial Review and Prospects” and our consolidated financial statements, the notes thereto, the independent registered public accounting firms’ report and the convenience translation of the consolidated financial statements as of and for the year ended December 31, 2018 into U.S. dollars solely for the convenience of the reader, included elsewhere in this annual report.

The selected data presented below under the captions “Income Statement Data” and “Statement of Financial Position Data” for, and as of the end of, each of the years in the five-year period ended December 31, 2018, are derived from the consolidated financial statements of Cellcom Israel Ltd. and subsidiaries. The consolidated financial statements as of December 31, 2017 and 2018, and for each of the years in the three-year period ended December 31, 2018, and the report thereon, are included elsewhere in this annual report. Data for 2015 and 2014, and the selected consolidated balance sheet data as of December 31, 2016, 2015 and 2014, have been derived from our previously reported audited consolidated financial statements, which are not included in this annual report. The selected financial data should be read in conjunction with our consolidated financial statements and accompanying notes and “Operating and Financial Review and Prospects” appearing in Item 5 of this annual report, and are qualified entirely by reference to such consolidated financial statements.

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The information presented below under the caption “Other Data” contains information that partly is not derived from the financial statements.

For your convenience, the following tables also contain U.S. dollar translations of the NIS amounts presented at December 31, 2018, translated using the rate of NIS 3.748 to \$1.00, the representative rate of exchange on December 31, 2018 as published by the Bank of Israel.

	Year Ended December 31,					
	2014	2015	2016	2017	2018	2018 (In US\$ millions)
	(In NIS millions, except where indicated otherwise)					
Income Statement Data:						
Revenues	4,570	4,180	4,027	3,871	3,688	984
Cost of revenues	2,727	2,763	2,702	2,680	2,661	710
Selling and marketing expenses	672	620	574	479	567	151
General and administrative expenses	463	465	420	426	360	96
Other (income) expenses, net	46	22	21	(11 )	26	7
Operating profit	662	310	310	297	74	20
Financing expense, net	198	177	150	144	144	39
Tax benefit(tax on Income)	110	36	10	40	(6 )	(2 )
Net income (loss)	354	97	150	113	(64 )	(17 )
Basic earnings (loss) per share (in NIS)	3.51	0.95	1.47	1.11	(0.58 )	(0.15 )
Diluted earnings(loss) per share (in NIS)	3.48	0.95	1.47	1.10	(0.58 )	(0.15 )
Weighted average ordinary shares used in calculation of basic earnings per share (in shares)	99,924,306	100,589,458	100,604,578	100,654,935	107,499,543	107,499,543
Weighted average ordinary shares used in calculation of diluted earnings per share (in shares)	100,706,282	100,589,530	100,698,306	100,889,661	107,499,543	107,499,543

(\*) The results at and for the years 2017 and 2018, include the impact of the adoption of IFRS 15 with effect as of January 1, 2017.

Statement of  
Financial Position Data:

Cash and cash equivalents	1,158	761	1,240	527	1,202	321
Working capital	837	625	1,074	692	1,269	339



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Total assets	7,240	6,278	6,662	6,087	6,749	1,800
Total equity	1,092	1,185	1,340	1,441	1,677	448
Other Data:						
Adjusted EBITDA(1)	1,282	872	858	853	660	176
Capital expenditures	487	396	382	550	647	173
Dividends declared per share	-	-	-	-	-	-
Net cash from operating activities	1,557	836	781	774	770	205
Net cash used in investing activities	(350)	(96)	(364)	(644)	(631)	(168)
Net cash from (used in) financing activities	(1,106)	(1,136)	62	(843)	537	143
Cellular Subscribers (in thousands)(2)	2,967	2,835	2,801	2,817	2,851	2,851
Churn rate of cellular subscribers(4)	44.0	% 42.0	% 42.4	% 45.8	% 43.2	% 43.2
Cellular ARPU (in NIS)(5)	72	65	63	57	51	14
Internet customers (households) (end of period) (in thousands)(3)		95	156	222	269	269
TV customers (households) (end of period) (in thousands) (3)		63	111	170	219	219

Adjusted EBITDA is a non-IFRS measure and is defined as income before financing income (expenses), net; other income (expenses), net (excluding gain from the sale of a subsidiary and expense related to employee retirement plans); income tax; depreciation and amortization and share based payments. We present adjusted EBITDA as a supplemental performance measure because we believe that it facilitates operating performance comparisons from period to period and company to company by backing out potential differences caused by variations in capital structure (most particularly affecting our interest expense given our significant debt), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses) and the age of, and depreciation expenses associated with property, plant and equipment. Adjusted EBITDA should not be considered in isolation or as a substitute for operating income or other statement of operations or cash flow data prepared in accordance with IFRS as a measure of our profitability or liquidity. Adjusted EBITDA does not take into account our debt service requirements and other commitments, including capital expenditures, and, accordingly, is not necessarily indicative of amounts that may be available for discretionary uses. In addition, adjusted EBITDA, as presented in this annual report, may not be comparable to similarly titled measures reported by other companies due to differences in the way that these measures are calculated.

The following is a reconciliation of net income to adjusted EBITDA:

	Year Ended December 31,					
	2014	2015	2016	2017	2018	2018
	(In NIS millions)					(In US\$ millions)
Net income (loss)	354	97	150	113	(64 )	(17 )
Financing expense, net	198	177	150	144	144	38
Other expenses (income), net (excluding expense related to employee retirement plans and gain from the sale of a subsidiary );	7	(3 )	8	(1 )	-	-
Tax benefit (tax on income) income	110	36	10	40	(6 )	(2 )
Depreciation and amortization	610	562	534	555	584	156
Share based payments	3	3	6	2	2	1
Adjusted EBITDA	1,282	872	858	853	660	176

Cellular subscriber data refers to active subscribers. We use a six-month method of calculating our cellular subscriber base, which means that we add post-paid subscribers to our subscriber base upon their joining our services and prepaid subscribers upon charging a prepaid card and we deduct subscribers from our subscriber base after six months of no revenue generation and activity on our network and no data usage or less than NIS 1 of accumulated revenues for M2M (machine to machine) subscribers. The six-month method is, to the best of our knowledge, consistent with the methodology used by other cellular providers in Israel. The 2017 cellular subscriber base includes subscribers added as part of our purchase of the operations of an Israeli Mobile Virtual Network Operator, or MVNO, during the third quarter of 2017. As of the third quarter of 2018, we add M2M subscribers to the cellular subscriber base only upon first use instead of at the time of joining our service as was done until the change. This change did not have a material effect on M2M prior subscriber data.

Internet and TV customers refer to active subscribers. Internet households receive end-to-end internet service, including infrastructure (based on the wholesale landline market) and connectivity services.

Churn rate is defined as the total number of voluntary and involuntary permanent deactivations of cellular subscribers in a given period expressed as a percentage of the number of cellular subscribers at the beginning of the period. Involuntary permanent deactivations relate to cellular subscribers who have failed to pay their arrears for the period of six consecutive months. Voluntary permanent deactivations relate to cellular subscribers who terminated their use of our cellular services. Churn rate data is excluding the above mentioned removals of subscribers.

Average monthly revenue per cellular subscriber (ARPU) is calculated by dividing revenues from cellular services for the period by the average number of cellular subscribers during the period and by dividing the result by the number of months in the period. Revenues from inbound roaming services and hosting and network sharing services are included even though the number of cellular subscribers in the equation does not include the users of those roaming, hosting and network sharing services. Inbound roaming services, hosting and network sharing services are included because ARPU is meant to capture all service revenues generated by a cellular network. Revenues from repair services pursuant to a monthly subscription, or Subscription Repair Services, are included because they represent recurring revenues generated by cellular subscribers, but revenues from sales of handsets (which for purposes of this report may include other types of cellular end user equipment, such as tablets), non-subscription repair services carried out on a random basis, or Random Repair Service, and other services are not included. We and industry analysts treat ARPU as a key performance indicator of a cellular operator because it is the closest meaningful measure of the contribution to service revenues made by an average subscriber.



We have set out below the calculation of cellular ARPU for each of the periods presented:

	Year Ended December 31,					2018
	2014	2015	2016	2017	2018	(In US\$ millions)
	(In NIS millions, except number of subscribers and months)					millions)
Revenues	4,570	4,180	4,027	3,871	3,688	984
less revenues from equipment sales	1,005	1,048	994	952	904	241
less other revenues*	941	869	881	949	1,061	283
Revenues used in cellular ARPU calculation	2,624	2,263	2,152	1,971	1,723	460
Average number of cellular subscribers	3,034,946	2,898,987	2,832,407	2,797,341	2,826,013	2,826,013
Months during period	12	12	12	12	12	12
Cellular ARPU (in NIS, per month)	72	65	63	57	51	14

\*Other revenues include revenues from other communications services mainly fixed-line revenues and repair services.

## B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

## C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

## D. RISK FACTORS

We believe that the occurrence of any one or some combination of the following factors could have a material adverse effect on our business, financial condition or results of operations.

### Risks Related to our Business

We operate in a heavily regulated industry, which can harm our results of operations. Regulation in Israel has materially adversely affected our results.

A substantial part of our operations is subject to the Israeli communications laws and the licenses for the provision of different telecommunications services that we received from the Ministry of Communications in accordance with the Communications Law. The interpretation and implementation thereof are not certain and subject to change and disagreements have arisen and may arise in the future between the Ministry of Communications, or MOC, and us. The Communications Law and regulations thereunder grant the Ministry of Communications extensive regulatory and supervisory authority with regard to our activities. The MOC may modify our licenses without our consent and in a manner that could limit our freedom to conduct our business and harm our results of operations. Frequent changes, or changes made or on a timetable we cannot meet, to our licenses and legislation can increase the risk of noncompliance with our licenses or violation of such legislation and our exposure to lawsuits and regulatory sanctions. The MOC has the authority to impose substantial sanctions in the event of a breach of our licenses or the applicable laws and regulations and the authority to revoke them, in case we materially violate their terms.

Our licenses are limited in time and may be extended upon our request to the Ministry of Communications and its confirmation that we have complied with the provisions of our license and the applicable law, have continuously invested in the improvement of our service and network and have demonstrated the ability to do so in the future.



Our operations are also subject to the regulatory and supervisory authority of other Israeli regulators which have the authority to impose criminal and substantial administrative sanctions against us.

Further, our business and results of operations could be materially and adversely affected by new legislation and decisions by regulators or the courts that:

approve the annulment or further relaxation of the structural separation requirements imposed on the Bezeq communications group, given its monopolistic or duopolistic powers in most areas in which we compete, and also on the Hot communications group (though to a lesser degree, given that Hot already has substantial leniencies despite its monopolistic and duopolistic powers), especially if carried out before an effective landline wholesale market, which includes both telephony and infrastructure, is effected on both Bezeq's and Hot's infrastructure; set unfavorable regulation, including high tariffs for wholesale services, increasingly so in light of the rapidly growing demand for data capacity for both internet and television services; or insufficient mechanisms to prevent Bezeq and Hot from reducing their retail tariffs and thereby reducing the difference between the wholesale and retail tariffs ("margin squeeze"), or fail to enforce regulation with respect to the landline wholesale market resulting in our continued inability to use additional wholesale services. See also "– We face intense competition in all aspects of our business" below and "Item 4. Information on The Company – B. Business Overview "-Competition";

award our competitors certain benefits and leniencies not available to us, including through waiving, easing or not enforcing requirements set in their licenses, or not making similar demands or not imposing similar restrictions or any regulation, for example, on foreign participants in the TV market. See also "Item 4. Information on the Company – B. Business Overview – Competition", "– Government Regulations – Cellular Segment" and thereunder: – Mobile Virtual Network Operators" and "Government Regulations – Fixed-line Segment";

do not renew our licenses (or renew them on terms that are not favorable to us);

do not renew the allocation of our frequencies (where applicable) or limit our usage thereof or demand that we return frequencies allocated to us or not allow us to obtain additional frequencies, as such become necessary, or do so under unfavorable terms, or demand that we change frequencies on an unreasonable timetable or bear the costs of such an exchange;

publish frequencies tenders before we are in need of additional frequencies or before we have the means to participate in such tenders, or set deployment requirements for our network, using such new frequencies, given the substantial investments it would entail, without regard to our financial situation; see "As a result of substantial and continuing changes in our regulatory and business environment, our operating results, profitability and cash flow have decreased significantly in the past several years, with a loss for 2018. Further decline may adversely affect our financial condition" and "We may be adversely affected by the significant technological and other changes in the telecommunications industry "below and "Item 4. Information on the Company – B. Business Overview — Network and Infrastructure – Cellular Segment – Frequencies";

- allow additional competitors to enter the cellular market as 5G operators, which may further increase the competition in the market;
- impose new safety or health-related requirements;
- impose additional restrictions or requirements with respect to the construction and operation of cell sites or the networks;
- limit or prevent our ability to cooperate in deploying landline infrastructure with other operators or refuse to approve our recently announced investment in IBC Israel Broadband Company (2013) Ltd., or IBC. See also "Item 4. Information on the Company – B. Business Overview – Network and Infrastructure – Fixed-line Segment – Fixed-line Infrastructure – Investment in IBC";
- impose restrictions or demand we meet additional requirements on the provision of services or products we provide or regulate or otherwise intervene with the terms under which we advertise, market, price (including changes thereof) or provide them to our subscribers, credit terms, including in respect of existing agreements;
- allow other operators or other parties to provide services previously provided only by us to our subscribers;
- set higher service standards or costly requirements relating to the service we provide our customers, both in relation to our network quality and coverage and our customer service, including response times at our call centers;
- set a timetable for the implementation of new requirements in our license or other legislation which we cannot meet;
- impose a stricter policy or set stricter regulation with respect to privacy protection, such as with regard to data protection, collection, amelioration, segmentation or usage of data, including for commercial activities by us or for the benefit of third parties;
- impose regulation on our "over-the-top", or OTT, TV services, including the requirement to finance original productions, imposing or allowing unfavorable or discriminatory terms for the usage of the digital terrestrial television (DTT) broadcasting in Israel or applying such regulation to us and not to other OTT TV providers. See "– Item 4. Information on the Company – B. Business Overview – Government Regulations Fixed-line Segment – OTT TV"; and

limit or prohibit the renewal of our licenses and allocation of additional frequencies to us, as we are included in the list of concentrated entities (being a subsidiary of Discount Investment Corporation Ltd., or DIC) published annually according to the Law for the Promotion of Competition and the Mitigation of Concentration, or the Concentration Law.

If we fail to compensate for lost revenues, increased expenses (objectively or in comparison to our competitors) or additional investments resulting from past or future legislative or regulatory changes with alternative sources of income or otherwise, our results of operations may be materially adversely affected.

We face intense competition in all aspects of our business.

The Israeli telecommunications market is highly competitive in many of its elements. The competition level has increased substantially in recent years, following the entry of additional competitors and regulatory changes alleviating entry barriers and transfer barriers. We entered the TV market through our OTT TV service in December 2014 and the landline infrastructure market, through the landline wholesale market, in the first half of 2015, and in 2018 we commenced deployment of an independent fiber-optic infrastructure. In the other markets we operate in and specifically in the cellular market, price competition and erosion, high churn rate and high subscriber acquisition costs continue to materially affect our and other mobile network operators', or MNOs', revenues and profitability. The current level of competition in all the markets in which we operate and aggressive price plan offerings by our competitors may continue. See also the "Competition" section under "Item 4. Information on the Company - B. Business Overview", "—Competition – Fixed-line Segment– Internet infrastructure and Connectivity Business" and "– Telephony Business". Should the current level of competition continue, it will continue to adversely affect our results of operations. Any of the following developments materializing in our market, may result in increased competition and further materially adversely affect our profitability:

- tariffs maintained at their current level or decreasing even further, including as part of a bundle;

an ineffective landline wholesale market, including the de facto exclusion of telephony wholesale services, services provided not in line with the wholesale market criteria and not enforced by the MOC; unfavorable pricing harming our ability to provide competitive bundles and compete with the Hot and Bezeq groups, or change of current regulation to a less favorable one, given our dependence on the landline wholesale market in supplying our landline infrastructure services; or further escalation of the competition by Bezeq and Hot, given their dominance in the landline market, especially if the structural limitations on these groups are alleviated before an effective landline wholesale market is in effect. See also "Item 4. Information on The Company –B. Business Overview – Government Regulations – Fixed-line Segment – Landline";

annulment or further relaxation of the structural separation imposed on each of the Bezeq and Hot groups or further consolidation of Bezeq's subsidiaries and their operations as it will provide the Bezeq and Hot groups a competitive advantage, given their dominance in the landline telephony and infrastructure markets and TV market. More so, in respect of our triple and quatro offering, given the de facto creation of a unified company by Bezeq's subsidiaries with the strong financial support of Bezeq. See also "Item 4. Information on The Company –B. Business Overview – Competition - Communications groups and structural separation"; "-Government Regulations – Fixed-line Segment – Landline";



entrance of new competitors, including major global and local companies, such as Netflix, Amazon and other OTT participants in the TV market, to any of the markets we operate in, or complementary services becoming competitive to our services, or the entry of existing competitors to additional markets or segments where they are currently not or less active, or as a result of regulatory changes, allowing other operators to provide services currently provided only by us to our subscribers. See "Item 4. Information on The Company –B. Business Overview — Competition";

our failure to deploy widespread landline infrastructure or turn IBC into a widespread landline infrastructure provider from which we can procure such service or enter into cooperation to use such infrastructure with an operator which owns such infrastructure, given the growth of our TV and internet services, especially if one of our competitors which currently does not own such infrastructure deploys such infrastructure or enters into such cooperation. Further, this may limit our broadband bandwidth offering in comparison to our competitors, since currently our offering of such service is mainly dependent on the landline wholesale market services, See "Item 4. Information on the Company –B. Business Overview — Competition – Fixed-Line Segment";

our inability or failure to purchase additional frequencies or to purchase frequencies in an amount equal to our competitors, or to make the necessary investments in our networks or in our business in general, in order to maintain our competitive standing, given our financial situation or otherwise. See "- As a result of substantial and continuing changes in our regulatory and business environment, our operating results, profitability and cash flow have decreased significantly in the past several years, with a loss for 2018. Further decline may adversely affect our financial condition" above and "We may be adversely affected by the significant technological and other changes in the telecommunications industry" below;

regulatory or technological changes, such as implementation of an electronic SIM (e-SIM) in cellular end-user equipment, facilitating even further transfer of customers among operators;

the continued increased competition in the handsets market may result in decreased handset sales. See also "-We may not be able to maintain current handsets sales revenues and profitability." below and "Item 4. Information on The Company –B. Business Overview – Competition – Cellular Segment";

some of our competitors may be able to obtain better access and terms of engagement with international suppliers or foreign carriers, than we do, due to their affiliation with international groups; or

if our services are adversely affected by, or we are required to bear the costs of, a frequencies change, which do not affect our competitors. See "We may be adversely affected by the significant technological and other changes in the telecommunications industry" below.

As a result of substantial and continuing changes in our regulatory and business environment, our operating results, profitability and cash flow have decreased significantly in the past several years, with a loss for 2018. Further decline may adversely affect our financial condition.

Our operating profit in 2018 was NIS 74 million (\$20 million), a decrease of 75.1% from NIS 297 million (\$79 million) in 2017 and a decrease of 76.1% from NIS 310 million in 2016. We recorded a loss in 2018 of NIS 64 million (\$ 17 million), compared to net income of NIS 113 million (\$30 million) in 2017 and a net income of NIS 150 million in 2016. The Company's net cash from operating activities in 2018 amounted to NIS 770 million (\$205 million), a decrease of 0.5% from NIS 774 million (\$207 million) in 2017 and a decrease of 1.4% from NIS 781 million (\$208 million) in 2016. The principal factor leading to the continued decline in our 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, significant erosion in the prices charged for the provision of cellular services and a decrease from equipment sales.

As our business environment continues to be characterized by increased competition in the various markets in which we operate, these factors may continue to negatively impact our business, which may further adversely affect our results of operations and financial condition – that being more volatile than our competitors, due to our substantially larger amount of debt. Other impacts may include the need to reduce investments, in absolute terms and in comparison to our competitors, which may harm our competitive standing and potential future growth, . adversely affect our ability to raise additional debt and refinance our existing debt or adversely affect the terms and price of such debt raising, which in turn may further adversely affect our financial condition and may require equity capital raising, if possible. See also "- Our substantial debt increases our exposure to market risks, may limit our ability to incur additional debt that may be necessary to fund our operations and could adversely affect our financial stability" below.

We may not be able to obtain permits to construct and operate cell sites.

We depend on our network of cell sites to maintain and enhance network coverage for our cellular subscribers. We also deploy and operate microwave sites as part of our transmission network. The construction and operation of these various facilities are highly regulated and require us to obtain various consents and permits.

We have experienced difficulties in obtaining some of these consents and permits, particularly in obtaining building permits for cell sites from local planning and building authorities. As of December 31, 2018, we operated a small portion of our cell sites without building permits or applicable exemptions and approximately 33% of our cell sites without building permits in reliance on an exemption from the requirement to obtain a building permit, mainly for radio access devices. Such reliance had been challenged and under an interim order issued by the Supreme Court in September 2010, was reduced to replacing or relocating existing radio access devices under certain conditions. In October 2018, regulations setting procedures for the construction, changes and replacement of radio access devices exempt from building permits were enacted. Although these regulations reflect previous judicial limitations placed upon our ability to make changes and replace radio access devices, they also introduce a new licensing procedure that may further reduce our ability to construct new radio access devices based on such exemption. This may adversely affect our existing networks and our networks' build out. In addition, the Ministry of Justice expressed an opinion that such regulations and the exemption do not relate to the radio access devices' ancillary equipment. The Ministry of Justice is expected to publish further instructions in the matter. The exclusion of the ancillary equipment from the exemption, if adopted, could adversely affect our existing networks and our networks' build out. For additional details see "-Item 4.B – Business Overview – Government Regulations – Cellular Segment – Permits for Cell Site Construction”.

Additionally, District Court rulings adopted a narrower interpretation of 'rooftops' to which the exemption may be applied.

We also rely on the exemption for our rooftop microwave sites and signal amplifiers (known as 'repeaters'). It is unclear whether other types of repeaters require a building permit.

In addition, we may be operating a significant number of our cell sites in a manner that is not fully compatible with the building permits issued for these cell sites, which may, in some cases, also constitute grounds for termination of our lease agreements for those sites or claims for breach of such agreements.

Pursuant to the Israeli Non-Ionizing Radiation Law, 2006, the granting or renewal of an operating permit by the Commissioner of Environmental Radiation at the Ministry of Environmental Protection of Israel, or the Commissioner, for a cell site or other facility is subject to the receipt of a building permit or an exemption from such a permit.

Several local planning and building authorities are claiming that Israeli cellular operators may not receive building permits, in reliance on the Israeli National Zoning Plan 36, or the Plan, which regulates cell site construction and operation, for cell sites operating in frequencies not specifically detailed in the frequencies charts attached to the Plan and have refused to provide a building permit in a number of cases. Following conflicting district court decisions regarding this claim, the matter is expected to be decided by the Supreme Court. Some of the frequencies to which we may be required to transfer according to the MOC's instruction (see "We may be adversely affected by the significant technological and other changes in the telecommunications industry" below) are not specifically detailed in the Plan. Most of our cell sites and many cell sites operated by other operators also operate in frequencies not specifically detailed in the Plan.

Operation of a cell site or other facility without a building permit or operating permit or not in accordance with the permits or other legal requirements may subject us and our officers and directors to criminal, administrative and civil liability, to eviction orders in respect of the cell sites in breach, revocation or suspension of the operating permit, as well as to withholding the grant of operating permits to additional cell sites or demolition orders. As a result, we may be required to relocate cell sites to less favorable locations or stop operation of cell sites.

If we are unable to obtain or rely on exemptions from obtaining or to renew building or other consents and permits for our existing cell sites or other facilities, or if the Plan is changed to include additional restrictions and requirements on the construction and operation of cell sites or should the Supreme Court rule against the Company regarding the claim in relation to frequencies not specifically detailed in the Plan, it could adversely affect our existing network and its build-out, delay the deployment of our 4G network and future generations, negatively affect the extent, quality and capacity of our network coverage and our ability to continue to market our products and services effectively, all of which may have a material adverse effect on our results of operations and financial condition.

For additional details see “Item 4.B – Business Overview – Government Regulations – Cellular Segment – Permits for Cell Site Construction”.

We may be required to indemnify certain local planning and building committees in respect of claims against them.

Under the Israeli Planning and Building Law, 1965, by approving a building plan, local planning and building committees may be required to compensate for depreciation of properties included in or neighboring the approved plan.

As a precondition to obtaining a cell site construction permit from a planning and building committee, we are required to provide a letter to the committee indemnifying it for possible depreciation claims and have provided hundreds of such indemnification letters to local planning and building committees. Calls upon our indemnification letters may have a material adverse effect on our financial condition and results of operations. We may also decide to demolish or relocate existing cell sites to less favorable locations or not at all, due to the obligation to provide indemnification. As a result, our existing service may be impaired or the expansion of our network coverage could be limited.

Alleged health risks relating to non-ionizing radiation generated from cell sites and cellular devices may harm our prospects.

Handsets, accessories and various types of cell sites are known to be sources of non-ionizing radiation emissions and are the subject of an ongoing public debate and concern in Israel. Radio frequency electromagnetic fields were classified by the International Agency for Research on Cancer (an agency of the World Health Organization) as possibly carcinogenic to humans (Group 2B), based on an increased risk for glioma, a malignant type of brain cancer associated with wireless phone use, and research is being conducted in regards to cellular handsets use and cancer and other health risks. The Israeli Ministry of Health published recommendations to take precautionary measures when using cellular handsets, and increasing awareness of the possible risks of cellular phones usage, reducing usage thereof and introducing precautionary measures were the subject of several bills in recent years. While, to the best of our knowledge, the handsets that we market comply with the applicable legislation that relate to acceptable “specific absorption rate,” or 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, we have no information as to the actual level of SAR of the handsets throughout the lifecycle of the handsets, including in the case of handset repair. See also “Item 4. Information on the Company – B. Business Overview – Government Regulations – Cellular Segment – Handsets”.

Health concerns regarding cell sites have caused us difficulties in obtaining permits for cell site construction and obtaining or renewing leases for cell sites and even resulted in unlawful sabotage of a small number of cell sites and prompted proposed legislation aimed at increasing the minimum distance permitted between cell sites and certain institutions. Formal positions adopted by various Israeli government ministries with respect to radiation safety, include the 2009 position that cell sites constructed pursuant to a building permit are preferable to radio access devices, and that utilizing a cellular network to provide advanced services that can be provided through a landline network is not justified in light of the preventive care principle set forth in the Israeli Non-Ionizing Radiation Law.

If health concerns regarding non-ionizing radiation increase further, or if adverse findings in studies of non-ionizing radiation are published, non-ionizing radiation levels are found to be higher than the standards set for handsets and cell sites, we may be subject to health-related claims for substantial sums. Consumers may also be discouraged from using cellular handsets and regulators may impose additional restrictions on the construction and operation of cell sites or handset and accessories marketing and usage. As a result, we may experience increased difficulty in constructing and operating cell sites and obtaining leases for new cell site locations or renewing leases for existing locations, or be exposed to property depreciation claims; and we may lose revenues due to decreasing usage of our services and be subject to increased regulatory costs. We have not obtained insurance for these potential claims. An adverse outcome or settlement of any health-related litigation against us or any other provider of cellular services could have a material adverse effect on our results of operations, financial condition or prospects.

The unionizing of our employees may impede necessary organizational and personnel changes, result in increased costs or disruption to our operation.

In 2015, we entered into the first collective employment agreement with our employees' representatives and the Histadrut, an Israeli labor union, for a term of 3 years and in 2018 we entered into a new collective employment agreement for an additional 3 year term (2018-2020). The agreements have consistently increased our employment costs. The agreement defines employment policy and terms in various aspects, including payments to the employees, procedures relating to manning a position, change of place of employment and dismissal, including management's and the employees' representative's respective authority with regards to each. As a result, our day-to-day operations and our ability to execute organizational and personnel changes is more limited, cumbersome, costly and lengthy, as reflected in the voluntary retirement plans carried out in 2014 – 2016 and 2018, and requires more management attention that would otherwise be available for our ongoing business. In January 2019, the Histadrut announced a labor dispute at the Company, regarding the Company's intention to dismiss approximately 250 employees of the Company and failure to agree on other streamlining measures with the employees' union that do not include involuntary termination of employment. Under the announcement, the Company's employees would be entitled to take organizational steps (including a strike). We are negotiating a new collective employment agreement with our employees' representatives and the Histadrut but cannot guarantee the outcome of such negotiations.

Disagreements with the employees' representatives, may trigger work stoppages or other disruptions to our operation and an adverse impact on our services or customer service, changes may fail to be executed or be executed in a materially different way than planned, resulting in substantially lower savings than expected or requiring materially increased employment costs. Increased costs, inability or limited ability to make organizational and personnel changes, as well as work stoppages or other disruption to our operations and limitations on management's discretion, may damage the efficiency and quality of our operations, and may lead to damage to our reputation, increased customer churn, loss of market share and reduced profitability.

We are exposed to, and currently are engaged in, a variety of legal proceedings, including class action lawsuits.

We provide services to millions of subscribers on a daily basis. As a result of the scope and magnitude of our operations, as well as the multitude of pricing plans for stand-alone and bundles of services, the large amount of usage data our information systems need to process and record with relation to our subscribers according to their respective pricing plans, the frequent and multiple changes to our operation and pricing plans due to regulatory changes or in response to the changing market conditions, and the involvement of thousands of sales and customer service representatives in the sale process and after sale contacts with our existing or prospective customers - all increasing the risk of discrepancies occurring between a pricing plan and the information processed by our internal information systems or inadequate information provided, despite our continued efforts to the contrary - we are subject to the risk of a large number of lawsuits, including class action suits by consumers and consumer organizations. These actions are costly to defend and could result in significant judgments against us, which may materially and adversely affect our financial results. Recent years were characterized by a substantial increase in the number of purported class actions filed and approved in Israel, the greater involvement of consumer organizations and the Attorney General. In addition to eight class actions approved against us to date, we have entered into several settlement agreements, mostly for immaterial sums, and are currently engaged in dozens of purported class action suits as a defendant, many of which are for substantial amounts. For a summary of certain material legal proceedings against us, see “Item 8 – Financial Information - A. Consolidated Statements and Other Financial Information –Legal Proceedings”.

Further, predefined damages (set forth in the Consumer Protection Law) for a discrepancy from a customer's pricing plan, remedied after the customer complained, may aggregate to substantial amounts if paid to numerous customers on multiple occasions.

We employ thousands of employees and are therefore subject to the risk of employee lawsuits, including class action suits by employees.

We are subject to the risk of intellectual property rights claims against us, in relation to our products and services including TV service and other content related services, including video, photographs, music, music-related or other content we purchase from third party content providers. 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 product or service, which, if in substantial sums, could harm our results of operations. If we cannot obtain all necessary licenses on commercially reasonable terms, we may be forced to stop using or selling the products and services. We may not have insurance coverage for these types of claims.

Our operations are dependent on complex technology and information systems.

Our operations are dependent on a number of complex technological and information systems, including billing systems. The occurrence of malfunctions in such complex and ever changing and expanding systems is inevitable. In addition, we are in the process of implementing a unified customer relation management, or CRM, system for both our cellular and fixed-line operations, which may result in larger expenditures than anticipated, require significant management attention that would otherwise be available for our ongoing business, or lead to unforeseen operating difficulties and malfunctions. A malfunction in any of our systems which severely impacts our ability to provide products and services to our customers or adequately bill them, may result in loss of revenues to us, may adversely impact our brand and service perception, and expose us to legal claims and regulatory sanctions, all of which may adversely affect our results of operations.

Cyber attacks impacting our networks or systems could have an adverse effect on our business.

Cyber attacks, including through the use of malware, computer viruses, dedicated denial of services attacks, credential harvesting and other means for obtaining unauthorized access to or disrupting the operation of our networks and systems and those of our suppliers, vendors and other service providers, could have an adverse effect on our business. Cyber attacks may cause equipment failures, loss, disclosure, access, usage, corruption, destruction or the appropriation of information, including sensitive personal information of customers or employees, or valuable content and technical and marketing information, as well as disruptions to our or our customers' operations. Cyber attacks against companies, including Cellcom, have increased in frequency, scope and potential harm in recent years. Further, the perpetrators of cyber attacks are not restricted to particular groups or persons. These attacks may be committed by company employees and agents, advertently or inadvertently, or by external actors operating in any geography, including jurisdictions where law enforcement measures to address such attacks are unavailable or ineffective, and may even be launched by or at the behest of nation states. The preventive actions we take to reduce the risks associated with cyber attacks, including protection of our systems and networks, may be insufficient to repel or mitigate the effects of a major cyber attack in the future.

The inability to operate our networks and systems or those of our suppliers, vendors and other service providers as a result of cyber attacks, even for a limited period of time, may result in significant expenses to us and/or a loss of market share to other communications providers. The costs associated with a major cyber attack on us could include expensive incentives offered to existing customers and business partners to retain their business, increased expenditures on cybersecurity measures and the use of alternate resources, lost revenues from business interruption and litigation. The potential costs associated with these attacks could exceed the insurance coverage we maintain. Further, certain of our businesses, such as those offering security solutions and infrastructure and cloud services to business customers, could be negatively affected if our ability to protect our own networks and systems is called into question as a result of a cyber attack. In addition, a compromise of security or a theft or other compromise of valuable information, such as financial data and sensitive or private personal information, could result in lawsuits and government claims, investigations or proceedings. Any of these occurrences could damage our reputation and could further result in material adverse affect on our results of operation or financial condition.

There are certain restrictions in our licenses relating to the ownership of our shares.

Our cellular license restricts ownership of our ordinary shares and who can serve as our directors, as follows:

our founding shareholder, Koor Industries Ltd. (wholly owned by DIC), or Koor (or its transferee or transferees, if approved in advance by the Ministry of Communications as "founding shareholders"), must own at least 26% of each of our means of control;

Israeli citizens and residents among our founding shareholders (or their approved transferees) must own at least 5% of our outstanding share capital and each of our other means of control;

· a majority of our directors must be Israeli citizens and residents;

· at least 10% of our directors must be appointed by Israeli citizens and residents among our founding shareholders; and

· we are required to have a security committee of our Board of Directors that deals with matters relating to state security.

If these requirements are not complied with, we could be found to be in breach of our license and our license could be changed, suspended or revoked.

In addition, our license provides that, without the approval of the Ministry of Communications, no person may acquire or dispose of shares representing 10% or more of our outstanding share capital. Further, our directors and officers and any holder of ordinary shares representing 5% or more of our outstanding share capital may not own 5% or more of Bezeq or any of our competitors or serve as a director or officer of such a company, subject to certain exceptions, which require the prior approval of the Ministry of Communications.

To ensure that an unauthorized acquisition of our shares would not jeopardize our license, our articles of association provide that any shares acquired without approval required under our license will not be entitled to voting rights.

We may be adversely affected by the significant technological and other changes in the telecommunications industry.

The telecommunications market is known for rapid and significant technological changes and requires ongoing investments in advanced technologies in order to remain competitive. In recent years we have witnessed an immense growth of data traffic on both cellular and fixed-line networks which required us to upgrade our cellular and fixed-line networks and purchase increasingly large capacity for our fixed-line internet connectivity and infrastructure services to accommodate such demand. We estimate that data traffic will continue to rapidly grow in the future, among other things, due to high definition and 4K content and TV services provided over the internet (both cellular and landline). To meet the growing demand for cellular data traffic, we are required, among other things, to continue our investment in our 4G network and the upgrade of our transmission network to allow larger capacity and higher data speed rates. To meet the growing demand for landline data traffic and find more cost effective alternatives for the capacity we purchase from other landline operators who own a widespread landline broadband infrastructure, we have invested in deploying our own infrastructure and have entered into several agreements with IBC, including investment in IBC, indefeasible right of use, or IRU to IBC's infrastructure and sale to IBC of our independent fiber-optic infrastructure in residential areas (see also "Item 4. Information on the Company – B. Business Overview – Network and Infrastructure – Fixed-line Segment – Fixed-line Infrastructure – Investment in IBC"). Such endeavors are both costly and require management attention which could have been directed elsewhere.



Further, the Ministry of Communications determined that the replacement of our and another operator's 850 MHz frequencies with 900 MHz frequencies compatible with international standardization for our region will be effected no later than March 2021, and that our 850MHz frequencies allocation will expire on February 1, 2022. Such replacement, if effected, will entail a complex and sensitive engineering project, involving material investments in our networks, including the replacement of radio equipment in all of our cellular sites and may, during such project, adversely affect our products and services and impose a material hardship on the Company, both financially and operationally. Further, some of the frequencies to which we may be required to transfer are not specifically detailed in the Plan, which may impose additional hardship on such replacement. See "We may not be able to obtain permits to construct and operate cell sites". We informed the MOC that such replacement requires a much longer period and requires the fulfilment of certain conditions precedent which have not been fulfilled to date. Execution of such a replacement within a shorter timeframe, such as the timeframe set by the MOC, will increase the negative effects detailed above.

In addition, in December 2018 the MOC published principles for a frequencies tender the MOC intends to conduct in Q4/2019. According to the MOC's announcement, the tender is to include 25MHz in the 700Mhz frequencies band, up to 10Mhz in the 800Mhz frequencies band, 60MHz in the 2600 MHz frequencies band and 300 MHz in the 3500-3,800Mhz frequencies band with maximum allocation of 15MHz per network in the 700MHz frequencies band. As the 700MHz would serve as the main coverage enhancement frequency for 5G services (the 800MHz frequencies band shall become available sometime in the future and the 3500-3800MHz frequencies are limited and cannot provide large coverage), the limited amount of 700MHz frequencies included in the tender and the maximum allocation per network, the tender may result in not all MNOs winning such frequencies or winning less frequencies than their competitors, which may lead to a bidding war and harm the ability to provide 5G services. A frequencies tender will require us to make additional investments in purchasing the frequencies and thereafter to make additional investments in our networks while we aim to decrease our expenses and investments. Participating in a frequencies tender and the said additional investments, more so if a bidding war will result in higher consideration for the frequencies, may have a substantial adverse effect on our results of operations. Further, failing to win 700MHz at all or in a smaller amount than our competitors, may have an adverse effect on our competitive standing and as a result, on our results of operations. See "Item 4. Information on the Company – B. Business Overview — Network and Infrastructure – Cellular Segment – Frequencies".

Given the current low profitability of our business, we may be forced to decrease investments in our business and specifically in our networks, such as in relation to future generations and technologies, and the aforementioned frequencies tender which may adversely affect our future services, competitiveness and future results of operations. See also "As a result of substantial and continuing changes in our regulatory and business environment, our operating results, profitability and cash flow have decreased significantly in the past several years, with a loss for 2018. Further declines may adversely affect our financial condition".

If we fail to compensate for increased expenses or investments (especially in comparison to our competitors, not all of which will be required to make similar investments or pay increased expenses), due to, among other things, the competitive environment, our results of operations may be materially adversely affected.

Our handsets revenues and profitability decreased further in 2018 and may continue to decrease.

Handsets sales account for a substantial portion of our revenues and profitability. In recent years additional competitors have entered the handset market and increased the competition in this market and less successful launches of handset models and increased sales of handsets in the Israeli VAT free city (Eilat) have contributed to the decrease in our revenues from handsets. Our end user equipment revenues in 2018 were NIS 655 million (\$173 million), a decrease of 14.9% from NIS 770 million (\$205 million) in 2017 and a decrease of 21.6% from NIS 836 million (\$223 million) in 2016. Additional changes to this market, including the entry of additional competitors, including online retailers, both domestic and international, changes of distribution channels or customers purchasing habits, lack of successful launches of new less attractive handset models or any other reasons resulting in decreased sales by us or in general (for example, Apple, one of our major handsets vendor, has forecasted a slowdown in handsets sales), new legislation and decisions by regulators or the courts effecting our ability to market handsets or our profitability therefrom, may materially adversely affect our handset sales and profitability. See also "We face intense competition in all aspects of our business." above.

Our network sharing agreements consideration constitute a significant portion of our revenues

Under our network sharing agreement with Golan Telecom Ltd., or Golan, we are entitled to an average annual consideration of over NIS 200 million over the agreement term and under our network sharing agreement with Marathon 018 Xfone Ltd., or Xfone, we are entitled to the higher of a minimum annual consideration increasing over time or per user consideration (see "Item 4. Information on the Company – B. Business Overview — Network and Infrastructure – Cellular Segment – Network sharing agreements"). Should Golan or Xfone fail to make full and timely payments to us, due to financial difficulties, disagreements with us, or otherwise, this could materially adversely affect our results of operation.

Our substantial debt increases our exposure to market risks, may limit our ability to incur additional debt that may be necessary to fund our operations and could adversely affect our financial stability

As of December 31, 2018, our total indebtedness and long-term loans were approximately NIS 3,865 million (\$1,031 million), with our net debt at approximately NIS 2,263 million (\$604 million). For additional details see "Item 5. Operating and Financial Review and Prospects. – B. Liquidity and Capital Resources – General". The terms of our debentures and other credit facilities currently permit us to incur additional indebtedness (subject in some cases to certain limitations). Our substantial debt could adversely affect our financial condition by, among other things:

- increasing our vulnerability to adverse economic, industry or business conditions, including increases in the Israeli Consumer Prices Index, or CPI, as approximately NIS 1,326 million (\$354 million) is CPI linked;
- limiting our flexibility in planning for, or reacting to, changes in our industry and the economy in general;

requiring us to dedicate a substantial portion of our cash flow from operations to service our debt, thus reducing the funds available for operations and future business development, as well as for dividend distribution; and

limiting our ability to obtain, or resulting in less favorable terms and pricing for, additional financing to operate, develop and expand our business or for refinancing existing debt.

Israeli institutional investors must follow certain procedures and requirements before investing in non-governmental debentures. As a result, our series F and H through L indentures include certain limitations and covenants, including a covenant not to issue additional debentures if it involves a rating downgrade, certain financial covenants, negative pledge, cross default, limitation on the distribution of dividends, obligation to pay additional interest in case of certain rating downgrades (which occurred under our series F and G debentures in June 2013). For details regarding such limitations and covenants see "Item 5. Operating and Financial Review and Prospects. – B. Liquidity and Capital Resources – Debt Service". These limitations are expected to apply to any additional debt incurred by us. These procedures, limitations and covenants limit our freedom to conduct our business, may impose additional costs on us and may limit our ability to borrow additional debt from Israeli institutional investors as well as adversely affect the terms and price of such debt raising. Further, interest rates are currently very low and future increase of the interest may increase costs for future debt raising.

Any further downgrade in our rating, and any adverse change in our financial results, including any increase in our Net Leverage (defined in our series F and H through L indentures and other credit facilities as the ratio of net debt to EBITDA during a period of 12 consecutive months, excluding one-time events), may adversely affect the terms and price of debt raised, particularly through the issuance of debentures to institutional investors.

Under the Concentration Law, the Israeli Minister of Treasury must set limitations regarding the aggregate credit that may be provided by Israeli financial institutions to a corporation or a business group (defined as a controlling shareholder and the corporations under its control), which may adversely affect our ability to raise debt from Israeli financial institutions.

Under the "Guidelines for Sound Bank Administration" issued by the Israeli Supervisor of Banks, Israeli banks are subject to limitations on lending money to a single borrower and one group of borrowers and on the aggregate credit that may be provided to large borrowers and groups of borrowers. Under the relevant regulations, Israeli institutional investors are also subject to certain limitations on their total investments (including debt investments) in a single corporation and a group of corporations. This may limit our ability to obtain additional financing to operate, develop and expand our business or to refinance existing debt because, for such purposes, we are deemed to be included in the same group as DIC.

Our business results may be affected by currency fluctuations, by our currency hedging positions and by changes in the Israeli Consumer Price Index

A portion of our cash payments are incurred in, or linked to, foreign currencies, mainly U.S. dollars. In particular, in 2016, 2017 and 2018, payments denominated in, or linked to, foreign currencies, mainly U.S. dollars, represented approximately 14%, 16% and 17%, respectively, of our total cash outflow (including payments of principal and interest on our debentures). As almost all of our cash receipts are in NIS, any devaluation of the NIS against the foreign currencies in which we make payments, will increase the NIS cost of our foreign currency denominated or linked expenses and capital expenditures.

Furthermore, since the principal amount of and interest that we pay on our Series F, H and J debentures, are linked to the Israeli CPI, any increase in the Israeli CPI will increase our financing expenses and could adversely affect our results of operations.

We purchase derivative financial instruments in order to hedge part of the foreign currency risks and CPI risks deriving from our operations and indebtedness. Derivatives are initially recognized at fair value. Changes in the fair value of such derivatives are recognized through our income statement upon occurrence. These differences in the derivative instruments' designation could result in fluctuations in our reported net income on a quarterly basis.

We may not be able to fulfill our dividend policy in the future; implementation of our dividend policy will significantly reduce our future cash reserves.

Our dividend policy targets a payout ratio of at least 75% of our net income in each calendar year, subject to any applicable law, our license and contractual obligations and provided that such distribution would not be detrimental to our cash needs or to any plans approved by our Board of Directors. Our series F and H through L indentures and other credit facilities contain a covenant not to distribute more than 95% of the profits available for distribution according to the Israeli Companies Law, or Profits. Moreover, under such indentures and other credit facilities, if our Net Leverage exceeds 3.5:1, we may not distribute more than 85% of our Profits and if our net leverage exceeds 4.0:1, we may not distribute more than 70% of our Profits. For additional details see "Item 5. Operating and Financial Review and Prospects – B. Liquidity and Capital Resources – Debt Service". In addition, our license requires that we and our 10% or more shareholders maintain at least \$200 million of combined shareholders' equity. Dividend payments are not guaranteed and our Board of Directors may decide, in its absolute discretion, at any time and for any reason, not to pay dividends or to pay dividends at a ratio to net income that is less than that set in the policy. Since the fourth quarter of 2013, our board of directors chose not to declare dividends, given the intensified competition and its adverse effect on our results of operations and in order to strengthen our balance sheet. See "Item 8. Financial Information - A. Consolidated Statements and Other Financial Information - Dividend Policy".

Our dividend policy, to the extent implemented, will significantly reduce our future cash reserves and may adversely affect our ability to fund unexpected capital expenditures. As a result, we may be required to borrow additional money or raise capital by issuing equity securities, which may not be possible on attractive terms or at all.

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

We rely on certain suppliers for key equipment and services. We do not own a widespread infrastructure in the landline market and are dependent on infrastructure providers.

We depend upon a small number of suppliers to provide us with key equipment and services. For example, Nokia Networks Israel, or NSN, provides our GSM/GPRS/EDGE/UMTS/HSPA/LTE core system, radio access network and related products and services and Carrier Ethernet network (previously provided by Alcatel Lucent Israel Ltd.); LM Ericsson Israel, or LM Ericsson, supplies part of our radio access network and related products and services based on UMTS/HSPA technology and our OTT TV services platform (recently sold); Cisco Systems, Inc., or Cisco, provides our SDH equipment for our transmission and ISP network; and Be'eri Printers provides our printing supplies and invoices as well as the distribution, packaging and delivery of invoices and other mail to the postal service distribution centers. In addition, we lease a small portion of our cellular related transmission capacity from Bezeq, the incumbent landline operator. Our OTT TV services are further dependent on the Israeli Second Radio and Television Authority, the authority responsible for linear channels of the digital terrestrial television (DTT) broadcasting in Israel.

We are further dependent on infrastructure providers for our internet connectivity, broadband infrastructure (using the landline wholesale market), International Long Distance calls, or ILD, landline telephony (using Voice over Broadband, or VOB, technology), and OTT TV services. Those providers include Bezeq and Hot, which provide broadband infrastructure in Israel, TI Sparkle Ireland Telecommunications Ltd. (formerly Mediterranean Nautilus Ltd.) and TI Sparkle (Israel) Ltd. (formerly Mediterranean Nautilus (Israel) Ltd.), or collectively TI Sparkle, which connects the Israeli internet network to the global internet network, as well as Israeli telephony, via an underwater communications cable. We are dependent on Bezeq for the provision of our wholesale broadband infrastructure services as well as for the deployment of our independent infrastructure using Bezeq's infrastructure. Should an effective telephony service be provided under the wholesale market and the wholesale market effectively apply to Hot as well, we would be dependent on them for such services as well (the wholesale market over Hot's infrastructure is in its early stages). Bezeq has breached certain regulatory obligations in the equal provision of wholesale services to its retail customers or refused to provide them at all, and has prevented and delayed the deployment of our independent infrastructure, including through labor disruptions by its employees, and such occurrences may adversely affect us in the future as well. See also "Item 4. Information on The Company – B. Business Overview – Fixed-line Segment".

In addition, our cellular end-user equipment sales have been dominated in recent years by Apple and Samsung products, representing over half of our handset sales. See "Item 4. Information on the Company – B. Business Overview – Cellular Segment – Handsets" for additional details.

Vubiquity Management Ltd., or VU, provides us international content and content operation services for our OTT TV services. RGE Group Ltd., or RGE, ONE Sport TV services Ltd., or ONE, and Charlton Ltd., or Charlton, each provides us with unique sports content. Keshet Broadcasting Ltd. and Reshet Media Ltd. provide us each with a linear channel and the right to include certain of such content in our VOD catalogue.

We rely on agreements with foreign carriers to provide cellular roaming capabilities to our cellular subscribers, ILD services to our cellular and landline subscribers, as well as international voice hubbing (providing ILD services to foreign operators) services. We cannot control or compel the improvement of the quality of the service that they provide and it may be inferior or less advanced than the service that we provide.

In general, if these suppliers fail or refuse to provide equipment, content or services to us that meet requisite quality standards or on a timely basis, at unfavorable terms to us or provide our competitors more favorable terms and conditions, or if these suppliers fail to produce successful and desirable products or content when no equivalent alternatives are available, or if such suppliers raise the pricing of their products or content (for example, TV sports content prices in Israel have substantially increased with the entry of additional competitors), or if a regulatory change prevents our OTT TV customers from using the DTT or condition such usage on unfavorable terms or degradation of service quality, we may be unable to provide services or products to our subscribers in an optimal manner until an alternative source, if one is available, can be found or the situation is rectified, which may harm our ability to compete and result in loss of customers and revenues or place our licenses at risk of revocation for failure to satisfy the required service standards and subject us to customers' lawsuits.

Our investment in new businesses involves many risks.

We have invested and expect to continue to invest in exploration and development of new business opportunities in order to extend and complete our capabilities and offerings, such as the investment in IBC or deployment of a wide-spread landline infrastructure, and our entrance into the Internet of things (IOT) field. In addition to substantial investments in IBC (if materializes) in order to comply with its deployment obligations, we would be obligated to purchase 10-15% of IBC's fiber optics connected to buildings. Such endeavors may involve significant risks and uncertainties, including shift of management attention from our ongoing business, loss of focus of our sales and marketing efforts on our main businesses due to attention given to new businesses, insufficient revenues to offset liabilities assumed and expenses associated with these new investments, adversely affecting our cash flow, inadequate return of capital on our investments, regulatory changes which may impose additional burdens than planned, inability to effectively compete with incumbent providers or new competitors entering the market, and unidentified issues not discovered in our due diligence of such strategies and offerings, such as unforeseen implementation obstacles and large expenditures. Because these new ventures are inherently risky, no assurance can be given that such strategies and offerings will be successful and will not materially adversely affect our reputation, financial condition, and operating results. Moreover, entry into such new ventures may trigger increased competitive pressure by the incumbent providers of competing services on our core business, aiming at preventing our efforts to compete with them at the relevant market.

We are controlled by a single shareholder who can significantly influence matters requiring shareholders' approval.

As of January 31, 2019, Koor held, directly and indirectly, approximately 44.08% of our outstanding share capital (including 5% of our share capital held through a lending transaction by Koor to two Israeli shareholders, which are considered joint controlling shareholders with Koor and who undertook, among others, to vote with Koor in all shareholders resolutions) and the voting rights in respect of an additional approximately 2.94% of our share capital, pursuant to shareholders agreements among Koor and certain of our minority shareholders. Accordingly, subject to legal limitations, Koor has control (as the term "control" is defined in the Israeli Securities Law, 1968, or the Israeli Securities Law, namely the ability to direct a company's activities) over all matters requiring shareholder approval, including the election and removal of our directors (other than external directors) and the approval of significant corporate transactions. This concentration of ownership could delay or prevent proxy contests, mergers, tender offers, open-market purchase programs or other purchases of our ordinary shares that might otherwise give our shareholders the opportunity to realize a premium over the then-prevailing market price for our ordinary shares.

## Risks Relating to Operating in Israel

We conduct our operations in Israel and therefore our results may be adversely affected by political, economic and military instability in Israel.

Our operations, our network, our customers and some of our suppliers are located in Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business. Any armed conflicts, terrorist activities or political instability in the region or hostilities involving Israel or the interruption or curtailment of trade within Israel or between Israel and its trading partners could adversely affect our operations, including due to a decrease in the number of tourists visiting Israel and increasing criticism of Israel in the international community (such as the increasing international pressure to boycott Israeli companies, including through the United Nations' Human Rights Council "name and shame list", especially when such companies operate in territories held by Israel in Judea and Samaria, as we and other Israeli operators are required to do under our license), and could make it more difficult for us to raise capital. Further, a substantial part of our network and information systems is located within range of missile strikes from the Gaza Strip and Lebanon. Any damage to our network or information systems may damage our ability to provide service, in whole or in part or otherwise damage our operation and could have an adverse effect on our business, financial condition or results of operations.

In addition, in the event that the State of Israel relinquishes control over certain territories currently held by it to the Palestinian Authority, we will not be able to provide service from our cell sites located in Israeli populated areas and on connecting roads in these territories. This may result in the loss of subscribers and revenues and in a decrease in our market share.

Our freedom and ability to conduct our operations may be limited during periods of national emergency.

Israeli law permits the Prime Minister of Israel, for reasons of state security or public welfare, to order a telecommunications license holder to provide services to or to establish a telecommunications facility for the security forces, and entitles the Israel Defense Forces to register or take engineering equipment and facilities as may be required for the security forces to carry out their duties. Israeli law also permits the Israeli Government, during national emergencies or for reasons of national security, to take all necessary actions in order to ensure state security, including taking control of our network. If national emergency situations arise in the future and if we are to be subject during such time to any of the foregoing actions, this could adversely affect our ability to operate our business and provide services during such national emergencies and adversely affect our business operations. Our other licenses contain similar restrictions.

Provisions of Israeli law and our license may delay, prevent or impede an acquisition of us, which could prevent a change of control.

The Companies Law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. Further, the provisions of our licenses require the prior approval of the Ministry of Communications for changes of control in our Company.

Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to our shareholders whose country of residence does not have a tax treaty with Israel exempting such shareholders from Israeli tax. With respect to mergers, Israeli tax law allows for tax deferral in certain circumstances but makes the deferral contingent on the fulfillment of numerous conditions, including a holding period of two years from the date of the transaction during which sales and dispositions of shares of the participating companies are restricted. Moreover, with respect to certain share swap transactions, the tax deferral is limited in time, and when the time expires, tax then becomes payable even if no actual disposition of the shares has occurred.

These provisions could delay, prevent or impede an acquisition of us, even if such an acquisition would be considered beneficial by some of our shareholders.

#### Risks Relating to Our Ordinary Shares

A substantial number of our ordinary shares could be sold into the public market, which could depress our share price.

Our largest shareholder, Koor, holds approximately 44.08% of our outstanding ordinary shares, as of January 31, 2019 (of which 5% are held (through a lending transaction) by two Israeli shareholders, which are considered joint controlling shareholders with Koor). The market price of our ordinary shares could decline as a result of future sales by Koor or other existing shareholders or the perception that these sales could occur. Sales may be made pursuant to a registration statement, filed with the U.S. Securities and Exchange Commission, or the SEC, pursuant to the terms of a registration rights agreement or otherwise, or in reliance on an exemption from the registration requirements of the Securities Act, including the exemptions provided by Rule 144. Any decline in our share price could also make it difficult for us to raise additional capital by selling shares.

In addition, pursuant to our capital offering effected in June 2018, we have issued 3,030,300 Series 2 options which may be exercised until June 24, 2019. See "Item 5. Operating and Financial Review and Prospects. – B. Liquidity and Capital Resources – General".

In addition, under our 2015 option plan, options are subject to vesting schedules but vesting will be accelerated upon certain events including any sale or other disposition of all, or substantially all, of our outstanding shares. As of December 31, 2018 we had 780,332 shares reserved for issuance upon the exercise of options. See "Item 6. Directors, Senior Management and Employment – E. Share Ownership – Share Incentive Plans".

### ITEM 4. INFORMATION ON THE COMPANY

#### A. HISTORY AND DEVELOPMENT OF THE COMPANY

##### Our History

Cellcom Israel Ltd. was incorporated in 1994 in Israel. Our principal executive offices are located at 10 Hagavish Street, Netanya 4250708, Israel and our telephone number is (972)-52-999-0052. Our authorized U.S. representative, Puglisi & Associates, is located at 850 Library Avenue, Suite 204 Newark, Delaware 19711 and our agent for service of process in the United States, CT Corporation System, is located at 111 Eighth Avenue, New York, NY 10011.



In February 2007 we listed our shares on the NYSE and in July 2007 we dual listed our shares on the Tel Aviv Stock Exchange, or TASE, and began applying the reporting leniencies afforded under the Israeli Securities Law to companies whose securities are listed both on the NYSE and the TASE.

As of January 31, 2019, Koor, wholly owned by DIC, currently directly and indirectly holds approximately 44.08% of our share capital (including through being joint controlling shareholder together with two Israeli shareholders of 5% of our outstanding share capital held by them through a lending transaction as of January 2018) and the voting rights in respect of an additional approximately 2.94% of our share capital.

As of the date of this Annual Report on Form 20-F, there has been no indication of any public takeover offer by any third party, in respect to our ordinary shares, or by us, with respect to another company's shares.

In December 2014 and May 2015 we entered the TV and internet infrastructure markets, respectively, which completed our communications offering to include all communications services in Israel.

In 2017 we completed a reorganization of our subsidiaries, following which all our landline operations are unified under our wholly owned subsidiary Cellcom Fixed Line Communications, Limited Partnership.

In 2017, our network sharing and hosting agreements with Golan and Xfone, and a third agreement combining the 4G network arrangements in the previous two agreements into a three-way agreement (the Xfone agreement, Golan agreement and the three-way agreement shall be referred to as the Sharing Agreements) came into force. For details of our network sharing and hosting agreements with Golan and Xfone, see "B. Business Overview – Network and Infrastructure – Cellular Segment – Network sharing agreements" below.

In March 2019, we entered into a transaction for investment in IBC. "Item 4. Information on the Company – B. Business Overview – Network and Infrastructure – Fixed-line Segment – Fixed-line Infrastructure – Investment in IBC"

We hold a general license for the provision of cellular telephone services in Israel, granted by the Ministry of Communications in 1994 and valid until 2022. We also hold a unified general license for the provision of fixed-line services, granted by the MOC in 2015 and valid until 2026.

The SEC maintains an internet website that contains reports and other information about issuers, like us, that file electronically with the SEC. The address of that website is [www.sec.gov](http://www.sec.gov). The Company's website address is [www.cellcom.co.il](http://www.cellcom.co.il). The information contained on, or that can be accessed through, the Company's website is not part of, and is not incorporated into, this Annual Report.

## Principal Capital Expenditures

Our accrual capital expenditure in 2016, 2017 and 2018 amounted to NIS 382million, NIS 550 million and NIS 648 million, respectively. Accrual capital expenditure is defined as investment in fixed assets and intangible assets, such as investments in our communications networks, information systems, software and TV set-top boxes and capitalization of part of the customer acquisition costs as a result of the adoption of IFRS15.

## B. BUSINESS OVERVIEW

### General

We operate in two main segments, “Cellular” and “Fixed-line”. The cellular segment includes the cellular communications services, end user cellular equipment and supplemental services. The fixed-line segment includes landline and long distance telephony services, internet infrastructure and connectivity services, television services, transmission services and end user fixed-line equipment and supplemental services.

### Services and Products

#### Cellular Segment

##### General

We are the largest provider of cellular communications services in Israel based upon number of subscribers and estimated market share as of December 31, 2018. As of December 31, 2018, we provided cellular communications services to approximately 2.851 million subscribers in Israel with an estimated market share of 27%. We offer a broad range of cellular services through our 2G, 3G and 4G network. These services include basic cellular telephony services, text and multimedia messaging, advanced cellular content and data services and other value-added services. We also offer international roaming services, a wide selection of handsets from various leading global manufacturers and repair services on most handsets we offer. Not all services are supported by all handsets or by all of our networks.

We offer our cellular subscribers a variety of usage and sector pricing plans and bundles combining cellular services with other communications services our group offers, including quatro bundles (internet infrastructure service and connectivity, landline telephony, TV service and cellular services). We offer two methods of payment: post-paid and pre-paid . Post-paid services are offered to subscribers who are willing to pay for our services through banking and credit arrangements, such as credit cards and direct debits. Pre-paid services are offered to cellular subscribers who pay for our services prior to obtaining them, usually by purchasing our “Talkman” pre-paid cards or “virtual” Talkman cards. The majority of our sales are post-paid. Price erosion and the marketing of packages have resulted in a constant decline in our pre-paid subscriber base. In line with regulation, our pricing plans do not include a commitment to purchase our services for a predefined period, other than in large business agreements.

We provide Golan and Xfone national roaming services under our Sharing Agreements and we provide the Joint Corporations services as a subcontractor. See “-Networks and Infrastructure - Network sharing agreements” below.

### Basic cellular services

Our principal cellular service is basic cellular telephony and data transfer, upload and download (in supporting handsets). Both are included in our packages price plans. In addition, we offer many other services with enhancements and additional features to our basic cellular telephony service, including voice mail, cellular fax, call waiting, call forwarding, caller identification and conference calling.

Data services can be used with handsets (in supporting models), cellular modems and tablets. We provide our customers with a variety of "internet data packages" for that purpose.

We also offer both an outbound roaming service to our subscribers when traveling outside of Israel and an inbound roaming service to visitors to Israel who can "roam" on our network. As of December 31, 2018, we had commercial roaming relationships with 553 operators in 180 countries based on the standard agreements of the GSM organization (an umbrella organization in which all the cellular operators operating with GSM technology are members). In addition, as of December 31, 2018, we had 3G roaming arrangements with 382 of these operators in 114 countries (part of them for 4G as well), enabling our 3G and 4G roamers to use data services in the respective countries and visiting roamers in Israel of these operators to use our 3G and 4G services, respectively.

### Value-added services

In addition to basic cellular telephony and data services, we offer many value-added services, such as Short Message Services, or SMS, and Multimedia Messaging Services, or MMS, cloud backup, content services such as "Cellcom Volume" our music application and "Cellcom tv" application and other applications such as a cyber security application and a parents' application against bullying on the Internet. We offer those services that we believe are likely to be popular with subscribers and benefit our business. Some of the value-added services that we offer are available only to subscribers who have supporting handset models and some are offered only to business subscribers.

To our business subscribers we also offer multi SMS, M2M, "Double Net" services allowing combined usage of cellular and landline networks in order to ensure continuous service, work force management, vehicles management applications and IOT (internet of things) solutions such as "smart city" end-to-end cellular and fixed line solutions. We are constantly considering and evaluating the possibility of introducing additional products and services to our customers.

### Handsets

We sell a wide selection of handsets (which for purposes of this report may include other types of communications end-user equipment, such as tablets) designed to meet individual preferences. Prices of handsets vary based on handset features and special promotions. We offer a variety of installment plans for handsets and discounts for short term installment plans, although in most cases, handsets are to be paid for in 36 monthly installments. We offer a variety of handsets from world-leading brands such as Samsung, Apple, Xiaomi, LG, Sony and Nokia. The vast majority of our handset sales in 2018 have been by Samsung and Apple. The handset models we sell offer Hebrew language displays in addition to English, Arabic and Russian (in most of the models). We are also required to provide cellular services to subscribers who did not purchase their handsets from us, provided that the handset model complies with the standards set by the Ministry of Communications. For details regarding end user equipment repair services see "Customer Care" below.

We also sell tablets, streamers and added value products to our customers, such as smart watches and home security cameras.

### Fixed line Segment

Our main fixed line services include our internet infrastructure (for private customers based mostly on the landline wholesale market and increasingly on our independent fiber-optic infrastructure and for business customers based on our landline infrastructure) and connectivity services, OTT TV services, ILD services, landline telephony services and transmission services (for business customers). We also offer bundles of these services, including a triple offering (internet service including infrastructure and connectivity, landline telephony, TV service) and quatro offering (internet services, landline telephony, TV service and cellular services). We also offer landline transmission and data services to selected business customers and telecommunications operators (including transmission revenues from Golan according to the network sharing agreement as of April 2017), using our fiber-optic infrastructure and complementary microwave links, IP switchboard services and operation and management of business telecommunications systems. Additional services include cloud services and data protection products based on products and services offered by us and by third party vendors and IOT solutions such as "smart city" end-to-end cellular and fixed line solutions.

### Internet infrastructure and Connectivity

We are a major provider of internet connectivity services. Prior to the formation of the landline wholesale market, the Israeli internet market was characterized by a separation between the internet infrastructure providers (mainly Bezeq and Hot) and the internet connectivity service providers. Consequently, the internet customer was required to enter into a contractual arrangement with both types of these providers. The infrastructure provider is responsible for the connection of the customer from his computer or other device to the infrastructure provider's operator. The internet service provider is responsible for providing access to the customer from the infrastructure provider's operator, through its own operator, to the local and global internet network. As of May 2015, following the inception of the landline wholesale market, we (and other operators) provide end-to-end internet service (infrastructure and connectivity) using Bezeq's infrastructure and more recently, over our independent fiber-optic internet infrastructure with first steps towards using Hot's infrastructure as well. We sell internet infrastructure services bundled with internet connectivity, as well as with our other services. For details regarding the landline wholesale market see "Business Overview – Competition – Fixed-line Segment – Landline" and "Government Regulation – Fixed-line Segment – Landline".

As of December 31, 2018, we provide end-to-end internet service, to approximately 269,000 households.

In addition, we offer our internet subscribers value added services, such as data protection services to our private subscribers and connectivity integration solutions and global communications solutions to our business customers, including firewalls, anti-virus and anti-spam software, overseas internet connectivity services and server hosting services. In addition, we provide internet connectivity services that offer the ability to filter the content viewed by the internet users. We are constantly considering and evaluating the possibility of introducing additional products and services to our customers.

#### OTT TV services

As of December 2014, we offer OTT-TV services, branded 'Cellcom tv' mostly to private customers. Cellcom tv is an hybrid OTT-DTT TV service provided to the Israeli market. The service includes a set-top box that enables linear channels, including based on the Israeli digital terrestrial television (DTT) broadcasting, other commercial channels and Video on Demand library subscription (SVoD), music streaming service and additional advanced features such as cloud recording and VoD playlist channels, for a highly competitive price. Cellcom tv service can generally also be accessed by smartphones, tablets, Smart TV and additional TV services' equipment like Apple TV and Android TV devices (TV anywhere). Our VoD catalogue and linear channels offer international and local content from top content suppliers. As of December 31, 2018, we provide OTT TV services to approximately 219,000 households.

#### ILD services

We are one of the major players in the Israeli ILD market. Our principal service in the ILD market is the provision of outgoing and incoming telephone calls with substantially worldwide coverage. We provide these services mostly to post-paid customers, but also to pre-paid customers mainly through the sale of calling cards. Most of the customers of the pre-paid services are foreign workers who reside in Israel.

In addition, we provide "Hubbing" services to non-Israeli international operators. Hubbing services are bridging services between two non-Israeli international operators. Such services are provided by us where there is no direct connection between two non-Israeli international operators or where pricing differences in different locations make such bridging service desirable.

#### Landline telephony services

We offer advanced, voice and data landline services to selected business customers. We also offer basic landline telephony services to private customers by VOB technology. Landline telephony service enables an end user to conduct a telephone conversation with another end user who uses either another landline or a cellular telephone or computer, either in Israel or overseas.

We estimate that our current market share in the Israeli landline telephony market is not material.

#### Internet of Things

IOT solutions provide the ability to connect various devices to the internet. We, together with strategic partners, offer IOT solutions based on a variety of communications solutions, including landline (WiFi) and cellular. We offer smart city solutions which include a central management and control system to manage the various solutions, water and electricity meter readout from a-far, smart parking, smart and efficient street lighting, smart cameras which include analytic capabilities for security solutions, smart sensors for efficient waste disposal, various environmental factors and flood alert, stress buttons for educational institutions as well as WiFi and broadband communication capabilities in public areas.

## Networks and Infrastructure

### Cellular Segment

#### General

We have built an extensive, durable and advanced cellular network system, enabling us to offer high-quality services to substantially the entire Israeli populated territory, while using a cost-effective design, utilizing shared components for our networks, where applicable. We seek to satisfy quality standards that are important to our subscribers, such as high voice quality, high data throughput rate, low “blocked call” rate (average rate of call attempts that fail due to insufficient network resources), low “dropped call” rate (average rate of calls that are terminated not in the ordinary course) and deep indoor coverage. Therefore, we have made substantial capital expenditures and expect to continue to be required to make substantial capital expenditures on our network system, though, pursuant to our Sharing Agreements, radio capital expenditures for the shared networks will be divided among the sharing parties.

#### Cellular Infrastructure

Our cellular network has developed over the years since we commenced our operations in 1994.

Our “fourth generation” LTE, or Long Term Evolution technology, was launched in August 2014, offers data throughput of up to 150 Mbps on the downlink path and up to 50 Mbps on the uplink path (voice services are provided through our 3G network). Our LTE network covers most of the population of Israel and in 2019 we intend to continue the deployment of this network in order to enable higher data throughput rate. The average throughput indicator is not set in our license. Our 4G network is shared with Golan and Xfone and operates in Multi Operation Core Network, or MOCN, mode.

Our “third generation” UMTS/HSPA+, or high-speed packet data access, technology, offers full interactive multimedia capabilities with current data rates of up to 42 Mbps on the downlink path and up to 5 Mbps on the uplink path. In 2019 we intend to continue to support the increasing demand for data traffic, while maintaining its quality of services. This network, considered to be a “3.9” technology, uses the same core as our GSM/GPRS/EDGE network and covers substantially all of the populated territory in Israel. Moreover, our UMTS/HSPA+ network supports types of services that require higher throughput and lower delay, such as video conferencing, and provides an adequate fallback for our LTE network by means of smart features and network load sharing. Our 3G network is shared with Golan and operates in MOCN mode.

Our “second generation” GSM/GPRS/EDGE 1800MHz network allows for voice calls, data transmission and multimedia services, although at slower speeds than our LTE and UMTS/HSPA+ networks, and covers substantially all of the populated territory in Israel. Our GSM/GPRS/EDGE technology is an advanced second-generation technology and considered to be a “2.75G” technology. It enables us to deliver multimedia and services at speed rates that are higher than the rates offered through regular “second generation” digital cellular technology. Packet data rates vary from 50 Kbps to 200 Kbps, depending mainly on handset capabilities. In addition, in the case of coverage gaps and for voice services supported by our GSM/GPRS/EDGE technology, the network provides a partial voice fallback for our LTE and UMTS networks.

Most of our traffic uses the UMTS/HSPA+ network with a continuous growth of data using our LTE network.

Our primary objective going forward is to continue deploying our LTE network and to continue to support the increasing demand for data traffic of our high speed UMTS/HSPA+ network and to continue to perform extensive optimization work to provide our subscribers with maximum capability to support video and other broad-bandwidth content. See "Item 3. Risk Factors – We may be adversely affected by significant technological and other changes in the telecommunications industry".

We provide connectivity for our cellular network mainly through our independent transmission network (based on our fiber-optic network and complementary microwave infrastructure), in substantially all of the populated territory of Israel. We lease complementary capacity from Bezeq. For additional details regarding our transmission network see "- Fixed-line segment – Fixed-line Infrastructure" below.

Pursuant to the requirements of all telephony service providers in Israel, our cellular network is interconnected, either directly or indirectly, to the networks of all other telephony service providers in Israel. Our network monitoring system provides around-the-clock surveillance of our entire network. The network operations center is equipped with sophisticated systems that constantly monitor the status of all switches and cell sites, identify failures and dispatch technicians to resolve problems. Operations support systems are utilized to monitor system quality and identify devices that fail to meet performance thresholds. These same platforms generate statistics on system performance such as dropped calls, blocked calls and handoff failures. Our network operations center is located in our Netanya headquarters. In addition, we have a duplicate back-up center in a separate location and a disaster recovery plan, or DRP, for all our engineering systems. The DRP also provides our network with additional advantages, including increased capacity in some cases and also provides us better durability and resilience. We also adopted a business continuity plan and a disaster recovery plan to ensure our ability to continue our operation in emergency situations in accordance with our license.

#### Spectrum allocation

Spectrum availability in Israel is limited and is allocated by the Ministry of Communications through a licensing process. We have been allocated 2 X 20 MHz in the 850 MHz frequency band previously used by our TDMA network and currently by our UMTS/HSPA base stations, 2 X 20 MHz in the 1800 MHz frequency band, 5 - 15 MHz (varying dependent on usage required in different areas), which are used by our LTE network and our GSM/GPRS/EDGE network (varying dependent on usage required in different areas) and 2 X10 MHz in the 2100 MHz frequency band used by our UMTS/HSPA network. We believe that our available spectrum is sufficient for our current needs.

Out of the 20 1800 MHz, 3MHz were allocated to us in August 2015 by the Ministry of Communications for 4G technologies (such as LTE, LTE Advanced). Unlike our other frequencies allocated to us for the duration of our license, these frequencies were awarded to us for a period of 10 years only.

The shared networks further use additional 2X10 MHz in the 1800 MHz frequency band. See "- Network sharing agreements" for additional details.

We pay frequency fees to the State of Israel.

The MOC has informed us that it has received an instruction from the International Telecommunications Union to commence a process to accord the frequencies used by Israeli cellular operators with European standards. As a result, we and another cellular operator that use some frequencies according to American standards, were required by the MOC to migrate to 900 MHz frequencies compatible with international standardization for our region no later than March 22, 2021, replacing our 850MHz frequencies allocation which shall expire on February 1, 2022. The MOC has yet to provide the method and schedule in which such replacement will be executed, including interim frequencies allocations as required. The MOC noted that we may use an interim leniency to the Planning and Building Law, allowing, under certain conditions, replacement of cell sites without obtaining a building permit. Such frequencies replacement will entail a complex and sensitive engineering project, involving material investments and replacement of radio equipment in all our cellular sites and may, during such project, adversely affect our products and services or quality thereof. See "Item 3. Key Information – D. Risk Factors – We operate in a heavily regulated industry, which can harm our results of operations. Regulation in Israel has materially adversely affected our results", "-We may not be able to obtain permits to construct and operate cell sites" and "- We may be adversely affected by significant technological and other changes in the telecommunications industry".

In addition, in December 2018 the MOC published principles for a frequencies tender the MOC intends to conduct in Q4/2019. The MOC expects to publish the tender itself for a public hearing in Q2/2019. As per the MOC's announcement, the tender is to include 25MHz in the 700Mhz frequencies band, up to 10Mhz in the 800Mhz frequencies band, 60MHz in the 2600MHz frequencies band and 300 MHz in the 3500-3800Mhz frequencies band. The tender will be open for MNOs only, other than 100Mhz in the 3500MHz frequencies band which will be open for any contender. MNO which shall not win 3500-3800 frequencies shall not be able to provide 5G services. MNOs sharing a network shall provide a joint bid (subject to the MOC's prior approval) and maximum allocation of frequencies will be as follows: in the 700MHz frequencies band - 15MHz per network; in the 2600MHz frequencies band - 40MHZ per network; in the 3500-3800MHz frequencies band - 80MHZ per MNO and 120MHZ per network. The result being that at present the 700MHz would be the main coverage enhancement frequency for 5G services (the 800MHz frequencies band becoming available sometime in the future and the 3500-3800MHz frequencies are limited and cannot provide large coverage), but given the amount available and maximum amount per network, not all MNOs may win 700MHz frequencies or may win less frequencies than their competitors. See "Item 3. Key Information – D. Risk Factors – - We may be adversely affected by significant technological and other changes in the telecommunications industry".

#### Cell site construction and licensing

We construct cell sites based on our strategy to expand the geographical coverage and improve the quality of our network and as necessary to replace cell sites that need to be removed. Our acquisition teams survey the area in order to identify the optimal location for the construction of a cell site. In urban areas, this would normally be building rooftops. In rural areas, masts are usually constructed. Our transmission teams also identify the best means of connecting the base station to our network, based on our independent transmission network, either by physical optical fiber, microwave link or Bezeq landlines. Once a preferred site has been identified and the exact equipment configuration for that site decided, we begin the process of obtaining all necessary consents and permits. The construction of cell sites requires building permits from local or regional authorities, or an applicable exemption, as well as a number of additional permits from governmental and regulatory authorities, such as construction and operating permits from the Ministry of Environmental Protection in all cases, permits from the Civil Aviation Authority in most cases and permits from the Israeli Defense Forces in some cases. In special circumstances, additional licenses are required. See "Item 4. Information on the Company – B. Business Overview – Government Regulations – Cellular Segment – Permits for Cell Site Construction."



## Network sharing agreements

In March and April 2017 our Sharing Agreements came into effect – (1) the 4G network sharing and 2G and 3G hosting services agreement with Xfone (which commenced operating in the cellular market in April 2018), (2) the 3G and 4G network sharing and 2G hosting services agreement with Golan (originally entered into with Electra and adopted by Golan, after being acquired by Electra) and (3) an agreement combining the 4G network sharing arrangements of the Xfone agreement and the Golan agreement into one three-way agreement.

The Sharing Agreements set the terms under which the sharing networks operate, including:

Usage of the parties' relevant frequencies, management and operation by separate entities, or the Joint Corporations, possession of equal parts of the shared network active elements, investment in equal parts in future active elements and IRU of each sharing party to the other sharing parties and IRU by us to the other sharing parties and the Joint Corporations to our passive elements of the shared networks, services provided by us to the Joint Corporations, as a subcontractor and certain arrangements for separation of the parties and adding another sharing party.

The agreements are for a term of ten years, and will be extended for additional periods, unless either party notifies otherwise. The termination of the Golan Agreement prior to the lapse of the first 10 years due to a breach by Golan will entitle us to liquidated damages of NIS 600 million plus VAT. In addition to standard termination causes, Xfone may terminate its agreement by prior written notice if it decides to cease operating in the cellular market in Israel.

The average annual consideration to be received by us under the Golan agreement (starting with lower annual payments and increasing over the term) is expected to be in a range of approximately NIS 210-220 million plus VAT, depending on Golan's number of subscribers and their usage of the shared network and our 2G network.

The consideration for us under the Xfone agreement includes substantially similar arrangements (mutatis mutandis to its sharing and hosting agreement), but during a period of up to five years beginning April 2018, Xfone will be entitled to replace its payments for IRU to the passive network and operating costs with a monthly payment per subscriber, but in any case not less than certain minimum annual amounts (ranging between approximately NIS 20 million in the first year and approximately NIS 110 million in the fifth year).

Under the Golan Agreement (which replaces the former national roaming services agreement), in April 2017, we provided a loan to Golan in the sum of NIS 130 million for a period of 10 years.

## Fixed-line Segment

### Fixed-line infrastructure

We launched our SDH transmission network in 1999 and our Carrier Ethernet network in 2010. In 2015 we launched an MBH network intended to support all our cellular traffic. These networks cover the central populated areas in Israel and business parks. These networks enable us to provide our business customers with telephony and high speed and high quality transmission and data services and provides us with our own wireline connectivity / backhaul services for our cellular networks while reducing our need to lease capacity from Bezeq, the incumbent landline operator in Israel.

Our optical transmission network is strategically deployed in order to cover the major portion of Israel's business parks from Nahariya in the north to Beer Sheva in the south and Afula and Jerusalem in the east, consisting of approximately 1,980 kilometers. The fiber-optic network is monitored by a fault-management system that performs real-time monitoring in order to enable us to provide high quality service. In order to efficiently complete our transmission network's coverage to the majority of our cell sites and business landline and transmission subscribers, we use a microwave network as a complementary solution in those areas that are not served by our fiber-optic network. As of December 31, 2018, we had approximately 2,808 microwave links to both our cell sites and our landline and transmission subscribers.

Additional transmission capacity required for our fixed line services to business customers is leased from Bezeq and Hot.

We pay frequency fees for frequencies used by our microwave network to the State of Israel.

In 2017, in light of the growing demand for data capacity by our fixed-line subscribers, mainly in the private sector, which we purchased from Bezeq, we commenced expanding our fiber-optic network into residential areas, using certain physical infrastructure of Bezeq and in 2018 we continued deploying our independent fiber-optic infrastructure in residential areas. In addition, in March 2019, we entered into agreements for the investment in IBC, the purchase of an indefeasible right of use in IBC's fiber-optic network and a term sheet for the sale of our independent fiber-optic infrastructure in residential areas to IBC. See "- Investment in IBC" below. Deployment of independent fiber-optic infrastructure or through our investment in IBC, will require material investments. It may, however, allow us to reduce investments in independent fiber-optic infrastructure and reduce our costs and our dependency on Bezeq and Hot and may improve our ability to provide quality services and compete in the fixed-line services market. There is no assurance that the requisite regulatory approvals for our investment in IBC will be received and the agreement will be implemented, or even if implemented, will have the expected benefits.

In 2018, we continued to expand our Carrier Ethernet network and our ISP network backbone in Israel and abroad in order to support growing demand for capacity, upgraded the capabilities and capacity of our customer Quality of Experience systems and upgraded and improved the capabilities of our central system for the protection of our network against cyber attacks.

Our internet infrastructure is currently comprised of connectivity sites in two locations in Israel (Haifa and Petah-Tikvah), which provide our customers, through overseas connectivity points in London and Frankfurt, with connectivity to the global internet network. This internet infrastructure contains backup capability in order to ensure continuity of service.

#### Investment in IBC

In March 2019 we entered into the following definitive agreements, or the Transaction, which in addition to standard and customary conditions, include the following:

**Purchaser Agreements** - We and the Israel Infrastructure Fund, or IIF, entered into partnership agreements for the purchase of 70% of IBC's share capital by a jointly and equally owned limited partnership (to be formed), or the Purchaser. The Purchaser Agreements contain an undertaking for an additional investment of up to NIS 200 million by both the Company and IIF, pro rata to their holdings in the Purchaser, over a period of 3 years and certain arrangements regarding a party's failure to make its share of the committed investment and regarding dead lock situations.

**Share Purchase Agreement, or SPA** - The Purchaser, IBC, the Israeli Electric Company, or IEC and the other shareholders and main creditors of IBC entered an agreement for the purchase of 70% of IBC's share capital, through investment of the Purchaser in IBC, for a total amount of NIS 103.5 million (subject to certain consideration adjustment mechanism, with respect to IBC's net working capital at closing), or the "Consideration, to be provided partly as investment and partly as shareholders' loan. The other 30% of IBC's issued and outstanding share capital will be owned by IEC. The Consideration shall be used to settle generally all of IBC's debts (other than a certain amount to IEC). The SPA contains certain precedent conditions to the closing of the transaction, including regulatory approvals, the receipt of updated licenses with reduced deployment obligations, as well as the effectiveness of the other agreements.

**Shareholders Agreement** - The Purchaser and IEC (holding 70% and 30% of IBC's share capital, respectively) entered into a shareholders agreement. The agreement regulates the management of IBC, including certain arrangements regarding funding of IBC and dilution (and anti-dilution in certain circumstances) of non-participating shareholders.

**IRU Agreement** - We and IBC entered into an agreement granting us an indefeasible right of Use, or IRU to a 10-15% percentage of IBC's fiber optics 'home pass' (i.e. fiber-optic actually reaching / connected to the building), as shall be deployed by IBC in the next 15 years (and may be extended to additional periods with no additional consideration other than annual maintenance payments). The undertaking is subject to certain conditions which should be satisfied at the closing of the SPA and certain amount is available immediately. The IRU consideration is subject to actual IBC's 'home pass' deployment, and is expected to increase each quarter based on the actual addition of 'home passes' deployed during such quarter and shall be paid in 40 quarterly installations (10 years), in addition to annual maintenance payments.

IEC Services Agreement - IBC and IEC entered into an agreement updating IBC's existing right of use and services agreement for IBC's fiber-optic network when deployed over IEC's infrastructure. The IEC Services Agreement includes improved pricing and arrangements for IBC's exclusive right to deploy its fiber-optics over the IEC's electricity network and other services provided by IEC to IBC in relation thereof.

The Shareholders Agreement and the IEC Services Agreement shall become effective at, and are subject to, the completion of the SPA. The Purchaser Agreements and the IRU Agreement became effective upon signing.

The completion of the Transaction is not expected to have a material effect on our Company's results of operations. The execution of the Transaction will be subject to the said conditions precedent, including regulatory approvals. IBC has already filed a request with the Ministry of Communications for an updated license with reduced deployment obligations. There is no assurance that the Transaction will be approved and executed, nor as to its timing and terms. In addition, there is no assurance whether we will be able to gain the expected results from the implementation of these transactions.

#### Term Sheet for the sale of Residential fiber-optic

In addition, we and IIF entered a term sheet for the sale of our independent fiber-optic infrastructure in residential areas as shall be at the end of 2019, to IBC, for the sum of NIS180-200 million (subject to the rate of the fiber-optic deployment and the number of actual 'home pass' connected at the end of 2019 and certain adjustments). The consideration for the sale is expected to be partly financed by IBC's shareholders' loans, including by us. The Fiber-optic sale TS is not part of the Transaction. Once the sale is completed, the IRU Agreement, including our obligation to purchase percentage of IBC's fiber optics 'home pass' (as detailed above), shall apply to the infrastructure purchased from us (the combined amount of fiber-optic deployed at street level, is expected to surpass 400,000 potential customers, at the end of 2019). The transaction is conditioned on the parties entering a definitive agreement, further agreement with the IEC, closing of the SPA and regulatory approvals. There is no assurance that the parties will reach a definitive agreement, that the sale will be approved and executed, nor as to its timing and terms.

For additional details see "Item 3. Key Information – D. Risk factors – Risks related to our business - We face intense competition in all aspects of our business", "- Our investment in new businesses involves many risks" and "Item 4. Information on the Company –B. Business Overview – Competition – Fixed-Line Segment- Fixed-Line Infrastructure".

#### Suppliers

In April 2014, we entered into a framework agreement with NSN Israel, of Nokia Networks group, a worldwide leading network manufacturer, for the purchase of an LTE network, which also supports LTE Advanced technology (4.5 generation) and related services. This agreement also governs the purchase and services provided under our previous agreement with NSN, in relation to our GSM/GPRS/EDGE /UMTS /HSPA core system, radio access network and related products and services. We have an option to purchase maintenance services on an annual basis until March 2030.

In September 2005, we entered into an agreement with LM Ericsson for the purchase of UMTS radio access network and ancillary products and services and in December 2011 for the purchase of upgraded UMTS /HSPA products and related services. We have an option to purchase additional maintenance services on an annual basis until 2026.

We use Telcordia's (which was acquired by Ericsson) intelligent platform, or IN, which provides services to our networks and allows us, at minimal cost, to internally develop sophisticated services with a short time-to-market that are customized to local market requirements.

In addition, we have agreements with several Israeli engineering companies for the construction of our cell sites. We also purchase certain network components from other suppliers.

Samsung International Co. Ltd. provides us Samsung handsets and spare parts for such products, under terms, including price of products, agreed between us and Samsung from time to time.

In October 2016, we entered into an agreement with Apple Sales International for the purchase and distribution of iPhone handsets in Israel. Under the terms of the agreement, we have committed to purchase a minimum quantity of iPhone products over a period of three years, which are expected to represent a significant portion of our total cellular handsets purchase amounts over that period.

We have entered into a number of agreements with TI Sparkle between 2003 and 2019 for the purchase of rights of use of certain telecommunications capacities on TI Sparkle's underwater communications cables, which connect the Israeli internet network to the "entry points" of the global internet, as well as maintenance and operation services relating to these cables. Over the last few years we have increased the capacity purchased for significantly lower prices, as well as reduced maintenance costs. The term of the agreement with respect to capacity purchased from TI Sparkle is in effect until May 2032. We have the option to terminate agreements with respect to parts of the capacity in 2027.

We have also entered into agreements with Bezeq and Hot, the primary internet infrastructure providers in the Israeli market, for the provision of our connectivity services. Due to the increase in customer demand for broadband width in recent years, we are required from time to time to increase the capacity we purchase from Bezeq and Hot. The terms of the wholesale landline infrastructure service we purchase from Bezeq and Hot are mainly set in the landline wholesale market regulation. For additional details see "Government Regulation – Fixed-line Segment – Wholesale landline market".

In November 2009, we entered into an agreement with Alcatel Lucent for the purchase of our Carrier Ethernet network. We have an option to purchase maintenance services until 2022.

Under our agreement with Alcatel Lucent, we purchased an SDH transmission network. We purchase maintenance services for the network on an annual basis.

In February 2015, we entered into an agreement with Bynat Communications Computers Ltd., or Bynat, for the purchase and maintenance of an MBH transmission network by Cisco. In the agreement we agreed to purchase maintenance services for a term of 5 years from final acceptance (until 2019), and we may stop purchasing such services subject to the provision of a prior written notice. Thereafter we have an option to purchase maintenance services for a term of 8 years (until 2027).

In June 2004, we entered into an agreement with Nortel Networks Israel (Sales and Marketing) Ltd., or Nortel, , for the provision of our international communications switch, on which we base our ability to provide international calling service, as well as related equipment and services. From 2010, Genband Inc. (which acquired Nortel's relevant business) provides us with support and maintenance services for the equipment provided under this agreement.

We have entered into an agreement with ECI Telecom Ltd. for the provision of transmission switches by ECI Telecom among our various location sites in Israel and overseas, used for our internet connectivity and ILD operations.

Our system for the provision of advanced centrex services based on cloud solutions to our business landline customers, is supplied by Broadsoft Ltd.

Our principal suppliers in the ILD market are Bezeq, Hot and the Israeli cellular operators. We have entered into interconnect agreements with them for facilitating inbound and outbound international traffic to and from their networks, as well as for billing and collection services for our services, for certain customers. We have also entered into agreements with more than 100 foreign carriers. These agreements regulate and facilitate our ILD services, as well as our international voice hubbing services.

In 2011, we entered into an agreement with LM Ericsson, for the purchase of our OTT TV services system and ancillary products and services. In 2018, LM Ericsson's media operations were purchased by MK Systems USA Inc., and MK Systems' Israeli subsidiary which continue to provide us with maintenance services for our system. We are currently negotiating a new maintenance agreement. Our OTT TV service also uses the Israeli DTT infrastructure. The DTT infrastructure may be used freely by our customers.

In 2013, we entered into an agreement with VU (recently purchased by Amdocs (Israel) Limited), a leading international supplier of multiplatform video services and solutions, for the supply of international video content and content operation and management services for our OTT TV service. Under our agreement with VU, we have committed to pay certain fixed amounts for such content and services. The Agreement is valid until the end of 2020; thereafter, it is renewable for additional periods of one year each, unless terminated by either party, subject to prior notice.

In October 2015, January 2016 and December 2016, we entered into agreements with RGE, ONE and Charlton, respectively, for the provision of sport channels, in which each of these suppliers holds exclusive broadcasting privileges. Each of the agreements is for a period of 5 to 6 years, during which time we are committed to pay each supplier certain minimum amounts.

We maintain a variety of information systems that enable us to deliver superior customer service while enhancing our internal processes.

Our billing and CRM systems are supported mostly internally. We also use a customer care system provided by PeopleSoft and supported mostly internally, inventory and suppliers management systems by Priority/Eshbel and SAP, a financial system by Coda and infrastructure integrations systems by Microsoft BizTalk and Oracle OSB.

In May 2016, we entered into several agreements aiming to provide us with a comprehensive CRM SAAS solution, on a cloud 'software as a service', or SAAS, basis, which, when completed, will gradually replace all our current CRM systems with one CRM solution. These agreements include the following main agreements:

An agreement with salesforce.com EMEA Limited, or Salesforce, for the provision of Salesforce's CRM SAAS platform, including various products and services and support for the agreement term. The agreement is valid until August 2019. We also have an option to renew the agreement for two additional periods of 5 years each under certain terms.

Two agreements with Vlocity UK Ltd., or Vlocity, as follows: (i) an agreement for the provision of Vlocity's telecom-CRM SAAS solution, based on Salesforce platform, including support for such services for the agreement term. This agreement is valid until November 2019 and (ii) an agreement for the development and customization for Salesforce's and Vlocity's CRM solution. This agreement will be valid until the project is completed, and may be terminated by us subject to prior written notice.

We use Nortel's CTI system for the management of incoming calls to our telephonic call centers.

We also use a knowledge management system relating to our various services and products by Aman, branded "Cellclopedia".

We use ERP solutions provided by SAP. We use a data warehouse based on an Oracle database system and various data mining tools, ETL by Informatica and reports generated by Cognos. The data warehouse contains data on our subscribers' usage and allows for various analytical segmentation of the data.

Cisco provides us maintenance proactive malfunction detection and consultant services for our IP networks equipment. The agreement is effective until the end of 2019.

We entered into an agreement with Be'eri Printers for our printing supplies and invoices as well as the distribution, packaging and delivery of invoices and other mail to the postal service distribution centers in 2003. The agreement is effective until the end of 2022.

## Sales and Customer Care and Marketing

### Sales and customer care

As part of our strategy to fully penetrate every part of the Israeli market, we combine our sales and customer care efforts in order to maximize sales opportunities and achieve cost efficiency alongside accessible and quality customer service. Our customer service unit is our main channel for preserving the long-term relationship with our subscribers and we focus on customer retention through the provision of quality service and customer care. In addition, subscribers are encouraged to subscribe to additional value-added and content services as well other communications services, in order to enhance customer satisfaction and increase revenues, with a specific focus on bundles of services. We offer pricing plans, value-added services, handsets, accessories and related services through a broad network of direct and indirect sales personnel. We design pricing plans and promotional campaigns aimed at attracting new subscribers and enhancing our ability to retain our existing subscribers. In order to achieve this goal, we systematically monitor and analyze our subscribers' preferences, characteristics and trends.





We pay our independent dealers commissions on sales, while our direct, employee sales personnel receive base salaries plus performance-based incentives. All of our, and our dealers', sales, customer care representatives and other customer-facing staff go through extensive training prior to commencing their work and thereafter regularly undergo training, and review of their performance in order to assure the quality of our services and to identify areas where we can improve.

We provide our customer facing representatives with a continually updated database, thus shortening the interaction time required to satisfy the customer's needs and preventing human errors. We constantly review our performance by reviewing customers applications and conducting surveys among our subscribers in order to ensure their satisfaction with our services and to improve them as necessary. In addition, we constantly apply preventive and preemptive measures aimed at reducing churn.

In our efforts to adjust our costs to market conditions, we have closed or unified points of sale and service in neighboring locations and reduced or relocated call centers, operating them in a more cost effective fashion, while placing greater focus on self-service channels and proactive malfunction resolution, identifying and solving problems ahead of customer complaint.

Our sales and customer care operation is conducted primarily through the following channels:

Points of sale/Walk-in centers. We distribute our products and services through a broad network of physical points of sale providing us with nationwide coverage of our existing and potential subscriber base.

As of December 31, 2018, we independently operated approximately 22 service and sales centers, with approximately 200 additional sale and service points operated by our dealers (including our wholly owned dealer, Dynamica), covering almost all the populated areas of Israel. These centers generally offer the entire spectrum of products and services that we provide to our subscribers and potential subscribers. These stores are mostly located in central and other frequently visited locations to provide our subscribers with easy and convenient access to our products and services. In our efforts to penetrate certain sectors of our potential subscriber base, we select dealers with proven expertise in marketing to such sectors. Our walk-in centers also offer handset repair service or serve as a contact point for depositing the handsets for repair and receiving the repaired handset (in the same center or at a location of their choice by a courier), with the repair services conducted in a central lab.

In 2018, we continued reducing the space of several additional points of sale, and we may continue to do so in 2019.

Telephonic sales/Call centers. Telephonic sales efforts target existing and potential subscribers. Our sales representatives (both in-house and outsourced) offer our customers a variety of products and services, both in proactive and reactive interactions. Our call-center services are divided into several sub-centers: general services; technical services; billing; sales; international roaming; and data, internet and TV. We are constantly reviewing the effectiveness of our service and also operate a multi-function call center providing all our services. We currently operate call centers in nine locations throughout Israel, five of which are outsourced. In 2018, we witnessed an additional decrease in calls to our calls centers. During peak hours our call centers have the capability to respond to 600 customer calls simultaneously. We are making efforts to reduce the number of calls to our call centers by using our new CRM system to provide a more complete service and promoting our self-service channels.

Account managers. Our direct sales force for our business customers maintains regular contact with our mid-sized and large accounts. We provide small and mid-sized business customers one focal point to both sales and services by phone. Our account managers are aided by our various back office experts in determining customers' needs and making suitable offers, including tailor-made solutions, when required. We offer our business customers handsets repair services by a dispatch service. Sales to larger business customers or governmental and local authorities sometimes involve participation in the customer's tender process.

Online sales/Self service. We offer our customers the ability to purchase our products and services and receive various information through our internet site (and our OTT TV service dedicated internet site) and our smartphone application. We provide our subscribers and potential subscribers with various self-service channels, such as interactive voice response, or IVR, internet site, automatic and live chat and live sms chat, facebook chat and our mobile phone application which enables our customers to monitor data usage, obtain digital monthly invoices, includes self-service tutorials, online assistance with internet service problems and chat with a service representative. We invest efforts in directing our customers toward self-service channels.

Customer service for our OTT TV and internet infrastructure market services (including our independent deployment of fiber-optic infrastructure) are provided also through technicians providing services at the customers' homes.

We constantly invest time and efforts making our services compatible to persons with disabilities, including as required by law. We provide customers with disabilities convenient accessibility to our premises and adapted services, including free dispatch services, text to speech services as well as support services through chat. We also train our representatives to provide accessible service to all our customers.

## Marketing

Our marketing strategy emphasizes our position as a communications group and cellular market leader, our value for money and our provision of a comprehensive solution for our customers' communication needs, by offering bundles of services. We believe the provision of bundles, including triple and quatro play packages of our services strengthen loyalty and increase customer satisfaction. We aim to provide our customers with a comprehensive quality experience through the various means of communications that they use, including their mobile handset, tablet, laptop and television.

From surveys that we conduct from time to time, we learn that subscribers base their choice of communications provider primarily on the following parameters: the services included in the bundle; perceived price of services and handsets; level of customer service; perceived quality of the network; general brand perception; with regards to the cellular provider - selection of handsets and their compatibility with their needs and with regards to the TV service provider – the quality and variety of content. Our marketing activities take into consideration these parameters and we invest efforts to preserve our subscriber base and attract new subscribers.

We leverage our extensive interactions with our customers to provide the requested services and also to cross- and up-sell cellular and fixed line products and services according to customer needs, usage trends and profitability, mostly by using advanced CRM system models, to increase customer satisfaction, loyalty and revenues.

We regularly advertise in all forms of media, specifically in digital media and television, using our familiar and loved advertising language which contributes to our brand's strength and popularity.

We believe that our strong brand recognition gives us the high level of market exposure required to help us achieve our business objectives.

## Competition

### Competition – General

The principal competitive factors in the telecommunications market include the services included in the bundle, perceived price, general brand perception and customer service.

In response to the enhanced competition in the Israeli telecommunications market, we have implemented various steps and strategies, including:

- identifying new opportunities to maximize our advantages as a communications group, such as our successfully launched OTT TV services, internet infrastructure services through the landline wholesale services and our investment in fiber-optic and IOT;

- focusing on the offering of bundles of services such as our successfully launched triple and quatro play offerings, as it strengthens customer retention and on enlarging customer purchases from us;

- entering network sharing and hosting agreements with Golan and Xfone, facilitating a more efficient cost structure in relation to our networks and operations thereof and investments therein;

- deploying fiber-optic infrastructure independently or advancing the investment in IBC , in relation thereof, in order to reduce our costs and dependency on Bezeq and Hot;

investing in our network to ensure our ability to offer quality and advanced cellular and fixed line services, and providing our customers with advanced services; and

taking aggressive efficiency measures through adjustments to our existing head count, reducing overhead expenses and improving work processes, in order to reduce costs and improve our agility.

Our ability to compete successfully will depend, in part, on our ability to anticipate and respond to trends and events affecting the industry, including the introduction of new services and technologies, changes in consumer preferences, demographic trends, economic conditions, pricing strategies of competitors and changes to the legal and regulatory environment.

Competition may intensify further as a result of the occurrence of any of the events described under “Item 3. Key Information – D. Risk Factors – Risks Related to our Business – We face intense competition in all aspects of our business.”

#### Communications groups and structural separation

The Israeli telecommunications market is currently dominated by four communications groups: Bezeq, Hot, Partner and Cellcom. Each of the Bezeq and Hot groups are subject to certain structural separation requirements in relation to sale of bundles of services by each of them and their respective subsidiaries, as a result of being the incumbent and monopoly in their respective core business – landline and multichannel television services. Those requirements include Bezeq's obligation to offer some of the services in its bundle separately under the same terms as in the bundle, and the requirement that Bezeq allow its competitors to participate in a similar bundle (if it includes internet connectivity, VOB or ILD services) under the same terms and equally markets such bundles as its own bundle (though the second requirement does not apply to the sale of the bundle by a subsidiary of Bezeq). The same requirements apply to Hot in the case of bundles that include internet connectivity services, with respect to the internet connectivity service component of the bundle.

Following a certain relaxation of the structural separation imposed on the Bezeq group, Bezeq is allowed to offer bundles of services with its subsidiaries under certain conditions, and in 2015 Bezeq merged with Yes (a company providing multichannel pay-TV) (detailed under “-Fixed line Segment – Television services” below). Bezeq's subsidiaries are allowed to sell and market each other's services, including through bundles of their services. Although the Hot group is also subject to structural separation limitations between its multi-channel television, connectivity, cellular and landline services, it was allowed to offer a bundle of landline telephony, multichannel television and internet infrastructure services and under certain conditions connectivity services as well, and Hot and Hot Mobile are also allowed to sell and market each other's services and exchange information. In January 2016 the Ministry of Communications announced its intention to annul Bezeq and Hot's structural separation as part of its plan to ensure massive investment in fiber optics infrastructure in Israel and in December 2016 the Ministry of Communication informed Bezeq that it intends to hold a public hearing regarding a possible annulment of the corporate separation and thereafter the structural separation in the Bezeq group and Bezeq has announced the commencement of a full merger process with Yes, including full integration of Yes into Bezeq. In 2018 Bezeq partially merged the operation of its subsidiaries – Pelephone, Yes and Bezeq International - thereby reinforcing their ability to compete with our triple offering, and withdrew its application for the MOC's approval of their re-organization, asking the MOC to accelerate its decision regarding the cancelation of the structural separation limitations on the Bezeq group. In February 2019, Bezeq filed a petition with the Supreme Court of Justice, against the MOC, requesting the immediate cancellation of the structural separation imposed on Bezeq.

In February 2019, the MOC published a hearing proposing further relaxation of Hot's structural separation regarding marketing for business customers.

The current regulation may change. See also "Item 3. Risk Factors - We face intense competition in all aspects of our business".

### Cellular Segment

There is intense competition in all aspects of the cellular communications market in Israel, with a penetration rate (the ratio of cellular subscribers to the Israeli population) of approximately 120%, representing approximately 10.4 million cellular subscribers at December 31, 2018, and the average annual churn rate in Israel in 2018 is estimated to be 37%, higher than the churn rates in other developed economies. We expect this intensified competition to continue in the future. We currently compete for market and revenue share with nine other cellular communications operators: five MNOs (Partner, Pelephone, Hot Mobile, Golan and Xfone) and four MVNOs (Rami Levy Hashikma Communications Marketing Ltd., or Rami Levy, Azi Communications Ltd., or Azi, Free Telecom Ltd., or Free Telecom and Cellact Communications Ltd., or Cellact). The competition in the cellular market further increased after the entry of Xfone into the market in April 2018. Under the 4G tender terms, Xfone, Golan and Hot Mobile are eligible for up to a 50% discount on the license fees paid for the 4G frequencies, 10% for each 1% addition to their market share, obtained over a period of 5 years. For details of our network sharing and hosting agreements with Golan and Xfone, see "– Network and Infrastructure – Cellular Segment – Network sharing agreements" above.

Our estimated market share based on number of subscribers was approximately 27% as of December 31, 2018. The market shares at such time of Partner, Pelephone, Hot Mobile, Golan and Xfone were estimated to be approximately 25%, 21%, 15%, 8.6% and 1%, respectively, and the MVNOs' collective market share was estimated to be 2.2%. These estimates are based on the public reports of other operators and our estimate of the market share of the operators who do not publish reports.

Hot Mobile and Golan commenced their UMTS operations in 2012. Rami Levy, Azi, Free Telecom and Cellact, all MVNOs, commenced operations in 2011 - 2013. Xfone commenced its operations in 2018.

Partner started operations in 1998 and is controlled by S.B. Israel Telecom Ltd. (indirectly controlled by the media entrepreneur Haim Saban). In March 2011, Partner purchased the outstanding shares of 012 Smile Telecom Ltd., or Smile Telecom, an ISP and ILD operator, now also serving as Partner's cellular low cost brand dealer, and in 2015, its network sharing agreement with Hot Mobile was approved and the two companies began joint operation through a joint subsidiary.

Pelephone is a wholly-owned subsidiary of Bezeq, and started operations in 1986. As of January 2015, its low cost brand services are sold by another subsidiary of Bezeq – Walla Communications Ltd., an internet portal. Bezeq is controlled by B Communications Ltd., or B Communications. B Communications is an Israeli company traded on the NASDAQ and the TASE. Currently, B Communications' controlling shareholder is in the process of a debt restructuring in the Israeli court.

Hot Mobile operated in the cellular market as of 2001. In 2012 it began its UMTS operation. Hot Mobile is owned by Hot, which is owned by the French businessman Mr. Patrick Derhy. In 2015, its network sharing agreement with Partner was approved and the two companies began joint operation through a joint subsidiary.

Golan is owned by Electra, a public Israeli company that distributes and retails consumer products and is part of a large Israeli business group. Golan began to operate in 2012. For details of our network sharing and hosting agreements with Golan and Xfone, see "-Network and Infrastructure – Cellular Segment – Network sharing agreements" above.

Xfone is controlled by Xfone Communications Ltd., an Israeli ISP, which is owned by the Israeli businessman Hezi Bezalel.

Rami Levy is a subsidiary of a major Israeli discount supermarket chain. Azi is owned by Telzar, an ILD operator. Cellact is owned by Cellact Ltd., a content provider. Free Telecom is owned by an Israeli business man.

Israel is a small country (approximately 9 million residents) with 10 cellular operators and aggressive competition and regulation which led to some of the lowest cellular prices worldwide. Competition may remain in its current heightened condition or even increase and prices shall remain low, unless the market undergoes substantial changes.

#### Handsets

In the handsets market, we compete with numerous vendors, chain stores and importers' stores, and expect this trend to continue and include also global companies. Competition in this market has increased significantly in recent years and decreased sales for us. See "Item 3.Risk Factors - Our handsets revenues and profitability decreased further in 2018 and may continue to decrease" for additional details. Competition in this market may increase further.

#### Fixed-line Segment

The only groups having their own nation-wide landline infrastructure in Israel are Bezeq and Hot. We are dependent on Bezeq and Hot's broadband services for the supply of our internet services. The growing demand for data capacity increased our dependency on Bezeq's wholesale services. In 2014, a third competitor – IBC - commenced deployment of its infrastructure on the IEC's fiber optic infrastructure in selected areas, and in 2016 and 2017, respectively, Partner and we began extending our existing independent fiber optic infrastructures into residential areas. Should our investment in IBC and IBC becoming a widespread alternative to Bezeq be effected, this would improve our competitiveness in the fixed-line services market as this is likely to reduce our dependency on Bezeq and reduce our costs. For more details, see " – Networks and Infrastructure – Fixed-line Segment – Fixed-line Infrastructure " and thereunder "- Investment in IBC" above.

A landline wholesale market was formally launched in Israel in 2015 but to date, only internet infrastructure (BSA) and to some extent physical infrastructure services are provided on Bezeq's infrastructure and the wholesale market on Hot's infrastructure is in initial stages. See "-Government Regulations – Fixed-line Segment – Wholesale Landline Market" below.

An effective wholesale landline market, specifically one providing both telephony and infrastructure services, would enhance our ability to compete and extend our service offering. However, an annulment or substantial alleviation of corporate or structural separation and Bezeq's tariffs supervision, or further consolidation of Bezeq's subsidiaries, may have a material adverse effect on our competitive capabilities and results of operation, especially if effected before an effective wholesale market is in place. The consolidation of Bezeq's subsidiaries may have an adverse effect on our ability to grow in our triple and quatro offering. Further, the entry of new competitors to the fixed-line market, through the wholesale market, has increased competition in the fixed-line market and may trigger further escalation in the competition in other markets in which we operate.

#### Internet Infrastructure and Connectivity Business

The two main internet infrastructure providers for the private sector in Israel and offering internet infrastructure services to both ISPs and end-users are Bezeq and Hot. Bezeq, and as of 2018 Hot as well, are also providing internet infrastructure services to operators that do not own their own infrastructure under the landline wholesale market, who, in turn, provide this service to the end customer. IBC provides broadband services in selected areas through agreements entered into with some of the smaller ISPs. IBC's licenses allow the provision of broadband infrastructure services to other licenses holders as well as directly to large business customers. Bezeq, Hot, we and Partner provide transmission services to business customers over each operator's respective independent transmission network. Partner started offering internet infrastructure services over its independent fiber optic infrastructure to the private sector in 2017. In 2018, we started offering internet infrastructure services in residential areas in which we deployed our independent fiber optic infrastructure as a stand alone service or as part of our triple and quatro offerings.

As of September 30, 2018, internet infrastructure services were provided by Bezeq and Hot to approximately 1.05 million and 711,000 households in Israel, respectively, with an immaterial quantity by IBC. As of the first half of 2015, internet infrastructure services were provided by other operators, including us, through the landline wholesale market, using Bezeq's infrastructure and as of 2018 also using Hot's infrastructure. Based on Bezeq and Hot reports, at the end of September 2018, the internet infrastructure services household penetration rate was approximately 94%. We bundle this service with our internet connectivity service and also as part of our triple and quatro play offering. As of December 31, 2018, we had approximately 269,000 households subscribed to our end-to-end internet services. In 2018, Hot commenced providing wholesale landline services (maximum tariffs for Hot's wholesale internet infrastructure services are higher than those set for Bezeq's services). Effective inclusion of Hot's infrastructure in the wholesale market may increase the amount of potential subscribers to our triple and quatro play and bundle offerings.

Internet connectivity access is currently provided by three major ISPs: us, Bezeq International, Partner, and some other smaller players including Hotnet (a subsidiary of Hot) and Xfone Communications Ltd. (Xfone's controlling shareholder).

The Israeli internet connectivity market is highly competitive and saturated. As of the date of this report, there are a few dozen ISPs in Israel, though most of them do not hold significant market shares. Competition among the various players concentrates mainly on pricing.

The offering of bundles of services and the aggressive campaigns of both Bezeq and Hot offering substantially higher bandwidth for lower tariffs to end-users, resulted in a substantial decrease in internet connectivity service prices and led to increased demand for greater bandwidth, which required us to increase the capacity we purchase from Bezeq and Hot. Further, the offering of bundles of internet infrastructure and connectivity using the wholesale market increased the competition in this field, resulted in loss of some of our internet connectivity customers. Bezeq's breach of its obligation to market our connectivity services when proposing an internet infrastructure and connectivity bundle until April 2018 also resulted in a substantial loss of connectivity business. If competition remains at current levels and the regulatory environment remains unchanged, this trend is expected to continue to have a material adverse effect on our results of operations.

Global internet connectivity is provided by three underwater cables. The main provider, which also provides us with global internet connectivity, is TI Sparkle, and two additional underwater cables are owned by each of Tamares Telecom and the Bezeq group.

#### Television services

Multichannel pay-TV services are dominated by Hot (the incumbent TV provider and monopoly in this field) and YES (a subsidiary of Bezeq) with approximately 777,000 and 587,000 households, respectively, as of September 30, 2018. The multichannel pay-TV market is also highly penetrated. We successfully entered this market in December 2014, using an hybrid OTT-DTT television service and have approximately 219,000 households subscribed to our Cellcom tv services as of December 31, 2018. In June 2017 Partner launched its OTT TV solution and has approximately 106,000 households subscribers as of September 30, 2018. In August and October 2017, respectively, Hot and Yes each launched an OTT TV low cost brand solution – branded Hot Next and Sting, respectively (Hot's OTT TV solution is also marketed by Rami Levy). Partner's OTT TV solution includes Netflix's (internet based VOD content provider) application integration (and offering for a limited period). Hot's offer also includes Netflix's application integration. Also, Netflix and Amazon Prime, another internet based VOD content provider, provide their services to viewers in Israel, as complementary service to the existing competitors' content. We expect this trend to continue and include additional global players and also local participants.

Under the Israeli Antitrust Commissioner's 2014 instructions, aiming to facilitate the entry of new competitors to the TV market by reducing entry barriers, preconditions for the approval of any merger in the Bezeq group were published, including the requirements that Bezeq is to generally not bill ISPs for TV related internet infrastructure services and annul and not engage in any non-original production exclusivity arrangements.

#### ILD services

We are a major service provider in the Israeli ILD market. As of the date of this report, there are several ILD operators in the Israeli market. Our main competitors in this market are Bezeq (through its wholly-owned subsidiary Bezeq International) and Partner (through a wholly-owned subsidiary). Additional competitors include Xfone, Telzar International Communications Services Ltd., Rami Levy, Golan and Hot, through wholly-owned subsidiaries or affiliates. At the end of September 2018, our market share in the ILD market is estimated to be approximately 27%.



The Israeli ILD market is highly competitive, and the competition in the market is based mainly on the operator's ability to offer attractive pricing and to bundle this service with additional services such as cellular services.

In recent years the use of free of charge alternative technologies such as voice-over-IP has resulted in downsizing of the telephony market, especially the ILD services revenues. This trend is expected to continue in the future.

#### Landline telephony

The Israeli landline telephony market has been dominated for many years by Bezeq, the incumbent landline monopoly, which held as of December 31, 2017 (according to the Ministry of Communications report) approximately 2/3 of the landline telephony market (and an even larger revenues market share in the business landline telephony sector). Hot, the incumbent TV monopoly, was the second entrant to this market. Other players include us, Partner's subsidiary and Bezeq International.

We offer landline telephony to selected business customers and landline telephony using VOB technology to private customers. We estimate that our current market share in the Israeli landline telephony market is not material. In case landline telephony is effectively included in the landline wholesale market, we may also offer landline home telephony services to private customers based on the wholesale market.

The landline wholesale market was to allow wholesale landline telephony service as of May 2015. In June 2017 the Ministry of Communications allowed Bezeq not to offer wholesale landline services until July 2018 and to provide a resale telephony service (at substantially higher tariffs) as a temporary substitute. In June 2018, the MOC resolved not to prolong Bezeq's temporary resale telephony as an alternative for its obligation to provide wholesale landline telephony services after the lapse of the temporary alternative period and to obligate Bezeq to provide wholesale landline telephony services as of August 1, 2018. Both Bezeq and Hot have expressed willingness to provide wholesale telephony services, but to date, no such service has been provided. For details, see "– Government Regulation – Fixed-line Segment – Wholesale landline market".

#### Other fixed-line services

Transmission and landline data services are provided by Bezeq, Hot, Partner and us. These services are provided to business customers and to telecommunications operators. During 2018, the competition in these fields of operation intensified following HOT's and Partner's offerings, and the usage of bandwidth of transmission increased.

IOT services are provided by Bezeq, Pelephone and other software integration companies and additional participants are entering this field. We offer a wide range of advanced IOT services and solutions, through cooperation with leading IOT technology and services vendors. The IOT market is characterized by intense competition and includes the offerings of communications providers which offer both connectivity solutions and end-to-end solutions and large software integration companies.

## Intellectual Property

We are a member of the GSM Association, together with other worldwide operators that use GSM technology. As a member of the association, we are entitled to use its intellectual property rights, including the GSM logo and trademark.

We are the proprietor of over 160 domain names and approximately 100 trademarks and trademarks applications, the most important of which are the star design, "Cellcom", "Talkman", "Cellcom Volume," "Cellcom tv," "Netvision" and "013 Netvision". We are also the proprietor of a few registered patents.

## Government Regulations

The following is a description of various regulatory matters that are material to our operations, including certain future legislative initiatives that are in the process of being enacted. There can be no certainty that the future legislation described here will be enacted or that it will not be subject to further change before its final enactment.

## General

A significant part of our operations is regulated by the Israeli Communications Law, 1982, the regulations promulgated under the Communications Law and the provisions of our licenses, which were granted by the Ministry of Communications pursuant to the Communications Law. We are required by the Communications Law and the Wireless Telegraph Ordinance (New Version), 1972, to have a license in order to provide certain communications services in Israel and be allocated the spectrum to do so.

See also "Item 3. Key Information – D. Risk Factors – We operate in a heavily regulated industry, which can harm our results of operations. Regulation in Israel has materially adversely affected our results. "

## Cellular Segment

### Our Cellular license

We provide our cellular services under a non-exclusive general license granted to us by the Ministry of Communications in June 1994, which requires us to provide cellular services in the State of Israel to anyone wishing to subscribe. The license expires on January 31, 2022, but may be extended by the Ministry of Communications for successive periods of six years, provided that we have complied with the license and applicable law, have continuously invested in the improvement of our service and network and have demonstrated the ability to continue to do so in the future. The main provisions of the license are as follows:

the license may be modified, cancelled, conditioned or restricted by the Ministry of Communications in certain instances, including: if required to ensure the level of services we provide; if a breach of a material term of the license occurs; if any of our managers or directors is convicted of a crime of moral turpitude and continues to serve; or if we and our 10% or greater shareholders fail to maintain combined shareholders' equity of at least \$200 million; it is prohibited for any of our office holders or anyone holding more than 5% of our means of control, to hold, directly or indirectly, more than 5% of the means of control in Bezeq or another cellular operator in Israel, or to serve as an office holder of one of our competitors, subject to certain exceptions requiring the prior approval of the Ministry of Communications;

the direct and indirect holdings of DIC and Koor (or a transferee or transferees approved by the Ministry of Communications), in the capacity as our founding shareholders, may not fall below 26% of our means of control (with “means of control” defined for these purposes as voting rights, the right to appoint a director or general manager, the right to participate in distributions, or the right to participate in distributions upon liquidation); the direct and indirect holdings of our founding shareholders who are Israeli citizens and residents may not fall below 5% of our means of control; at least 10% of our directors must be appointed by Israeli citizens and residents from among our founding shareholders and the majority of our directors must be Israeli citizens and residents;

we or our office holders or a 5% or greater holder of any of our means of control may not commit an act or omission that adversely affects or limits competition in the cellular communications market;

it is prohibited to acquire (alone or together with relatives or with other parties who collaborate on a regular basis) or transfer our shares, directly or indirectly (including by way of creating a pledge which if foreclosed, will result in the transfer of shares), in one transaction or a series of transactions, if such acquisition or transfer will result in a holding or transfer of 10% or more of any of our means of control, or the transfer of control over our company, without the prior approval of the Ministry of Communications. For the purpose of the license, “control” is defined as the direct or indirect ability to direct our operations whether this ability arises from our articles of association, from written or oral agreement or from holding any means of control or otherwise, other than from holding the position of director or officer;

we are subject to the guidelines of Israel’s General Security Services, which may include requirements that certain office holders and holders of certain other positions be Israeli citizens and residents with security clearance and the Minister of Communications is entitled under our license to appoint a state employee with security clearance to act as an observer in all meetings of our Board of Directors and its committees. If our service is to be determined by the Israeli Government to be an “essential service”, the Prime Minister and the Ministry of Communications could impose additional limitations, including a heightened requirement of Israeli ownership of our ordinary shares;

we are required to have agreements with a manufacturer of cellular network equipment for the duration of its intended operating period, which must include, among other things, a know-how agreement and an agreement guaranteeing the supply of spare parts for our network equipment for a period of at least seven years; we are required to interconnect our network to other public telecommunications networks in Israel, on equal terms and without discrimination and to provide national roaming services to Golan and Hot Mobile;

we generally may not give preference in providing infrastructure services to a license holder that is an affiliated company over other license holders;

there are certain general types of payments that we may collect from our subscribers, certain procedures and requirements for charging and collecting payments, general mechanisms for setting and raising tariffs, including the basic airtime charging units and prior notifications we must provide the MOC and our customers prior to increasing tariffs and the Ministry of Communications is authorized to intervene in setting tariffs in certain instances;

we must maintain a minimum standard of customer service, including, among other things, operation of call centers, maintenance of a certain service level (both coverage and performance) of our network, protection of the privacy of subscribers; and certain limitations and requirements regarding the process and documentation of our marketing and sale interaction with our customers;

we may not transfer, pledge or encumber the license or any assets used for implementing the license without the prior approval of the Ministry of Communications;

we are required to obtain insurance coverage for our cellular activities. In addition, the license imposes statutory liability for any loss or damage caused to a third party as a result of establishing, sustaining, maintaining or operating our cellular network. We have further undertaken to indemnify the State of Israel for any monetary obligation imposed on the State of Israel in the event of such loss or damage. For the purpose of guaranteeing our obligations under the license, we have deposited a bank guarantee in the amount of NIS80 million with the Ministry of Communications, which may be forfeited in the event that we violate the terms of our license;

we must maintain and follow additional requirements as to: business continuity plan and a disaster recovery plan and network sharing implementation, under which we may be accountable for violations attributed to the other sharing partners; and

we are required to provide the Ministry of Communications information and reports upon its request, as well as detailed annual reports regarding various aspects of our operations.

In the event that we violate the terms of our license, we may be subject to substantial penalties, including monetary sanctions under the Communications Law, the sum of which shall be calculated as a percentage of our income and based on the gravity of the breach. The maximum amount per violation that may be imposed is approximately NIS 1.6 million plus 0.225% of our annual revenue for the preceding year, subject to criteria published by the Ministry of Communications. In recent years the MOC has substantially increased its supervision activities and imposed monetary sanctions, including on us (in immaterial amounts). Substantial sanctions will harm our results of operations. In the event that we materially violate the terms of our licenses, the Ministry of Communications has the authority to revoke them.

In May 2018 and again in March 2019, the MOC amended our licenses to regulate the manner of response of call centers, including measurable parameters for response times. The amendment shall come into force in July 2019. Also in July 2019, an amendment to the Israeli Consumer Protection Law regulating the manner of response of call centers will also come into effect. The amendment includes measurable parameters for response times, which are partly incompatible with the said amendment to our licenses. These amendments had and are expected to continue to have an adverse effect on our results of operations.

#### Services in Judea and Samaria

The Israeli Civil Administration in Judea and Samaria granted us a non-exclusive license for the provision of cellular services to the Israeli-populated areas in Judea and Samaria. This license is effective until 2022. The provisions of the cellular license described above, including as to its extension, generally apply to this license.

#### Tariff supervision

Interconnect tariffs among landline operators, international call operators and cellular operators are subject to regulation.

In case of a disagreement as to the terms of a hosting service (including the consideration), whether for national roaming of a new MNO (currently Golan, Hot Mobile and Xfone) or hosting of an MVNO, the regulators may intervene in the terms of the agreement, including by setting the price of the service. Unfavorable terms and consideration for the hosting service, may result in material adverse effect on our results of operations. For additional details, see "– Mobile Virtual Network Operators" below.

The Minister of Communications is authorized to give instructions and to set interconnect tariffs and usage of another operator's network rates and supervised services prices, based not only on cost plus reasonable profit, but also on the basis of comparison to other licensees, comparable services or such services or interconnect tariffs in other countries. In addition, the Minister of Communications was authorized to give instructions in relation to structural separation for the provision of different services, including between services provided to a licensee and services provided to a subscriber.

#### Mobile virtual network operators

A mobile virtual network operator, or MVNO, is a cellular operator that does not own its own spectrum and usually does not have its own radio network infrastructure. Instead, MVNOs have business arrangements with existing cellular operators to use their infrastructure and network for the MVNO's own customers. See also "– Tariff Supervision" above.

To date, the Ministry of Communications has granted approximately 20 MVNO or unified licenses (which also allow the provision of cellular services as MVNO). Four MVNOs are currently active.

#### Network Sharing

Network sharing is conditioned upon certain conditions, including: (i) other operators may be allowed to join on terms similar to the terms granted to the sharing operator with the smallest market share; (ii) each sharing operator may host a MVNO without the other sharing operators' consent; (iii) the shared radio network must be operated through a joint entity held equally by the sharing operators, which entity will be required to obtain a license from the MOC and will use the frequencies allocated to sharing operators; and (iv) the radio elements of the shared network will be held in equal parts by the sharing operators, and each of the sharing operators will have the right to use other sharing operators' passive infrastructure including following termination of the agreement.



For details regarding our network Sharing Agreements, see "– Network and Infrastructure – Cellular Segment – Network sharing agreements".

## Permits for cell site construction

### General

In order to provide and improve network coverage to our subscribers, we depend on cell sites located throughout Israel. The regulation of cell site construction and operation are primarily set forth in the Israeli National Zoning Plan 36 for Communications, or the Plan, and in the Communications Law.

The construction and operation of cell sites are subject to permits from various government entities and related bodies, including:

- building permits from the local planning and building committee or the local licensing authority (if no exemption is available);
- approvals for construction and operation from the Commissioner of Environmental Radiation of the Ministry of Environmental Protection;
- permits from the Civil Aviation Authority (in most cases);
- permits from the Israel Defense Forces (in certain cases); and
- other specific permits necessary where applicable, such as for cell sites on water towers or agricultural land.

### National Zoning Plan 36

The Plan includes guidelines for constructing cell sites in order to provide cellular broadcasting and reception communications coverage throughout Israel, while preventing radiation hazards and minimizing damage to the environment and landscape and sets forth the considerations that the planning and building authorities should take into account when issuing building permits for cell sites. The Plan also determines instances in which the public must be informed of requests for building permits prior to their issuance, so that they may submit objections to the construction of a site. Following contradicting decisions by appeal and national zoning committees, in November 2018 the Supreme Court resolved that amelioration charges may be charged in relation to building permits issued in reliance on a national zoning plan. Such decision limits our ability to oppose the charges of amelioration charge in connection to our cell sites and may substantially increase the costs of constructing a site.

If the Plan is amended so as to include additional restrictions and requirements on the construction and operation of cell sites, this will harm our ability to construct new cell sites, make the process of obtaining building permits for the construction and operation of cell sites more cumbersome and costly, and could adversely affect our existing network and delay the future deployment of our network.

## Site licensing

We have experienced difficulties in obtaining some of the permits and consents required for the construction of cell sites, especially from local planning and building authorities. The construction of a cell site without a building permit (or applicable exemption) constitutes a violation of the Planning and Building Law, which is criminal in nature. The Planning and Building Law contains enforcement provisions to ensure the removal of unlawful sites. As of December 31, 2018, we were subject to three criminal and administrative legal proceedings alleging that some of our cell sites were built and have been used without the relevant permits or not in accordance with the permits. As of the same date, a small portion of our cell sites operated without building permits or applicable exemptions. Although we are continually seeking to obtain building permits for these sites, we may not be able to obtain them and in several instances we may be required to relocate these sites to alternative locations or to demolish them without any suitable alternative. In addition, we may be operating a significant number of our cell sites, in a manner which is not fully compatible with the building permits issued for them, although they are covered by permits from the Ministry of Environmental Protection in respect of their radiation level. In some cases we will be required to relocate these cell sites to alternative locations, to reduce capacity coverage or to demolish them without any suitable alternative.

Based on advice received from our legal advisors and consistent with most court rulings on the matter and the Israeli Attorney General's opinion on the matter that the exemption from obtaining a building permit applies to cellular radio access devices, we have not requested building permits under the Planning and Building Law for rooftop radio access devices. In the course of petitions against the Attorney General's opinion and our and other operators' appeals against certain contrary decisions of the District Court against us and other operators, the Attorney General concluded that the application of the exemption does not balance properly the different interests involved and therefore cannot continue forward. At the Attorney General's request, the Israeli Supreme Court issued in 2010 an interim order which prevents cellular operators from constructing further radio access devices in cellular networks in reliance on the exemption until the enactment of regulations setting conditions for the application of such an exemption or other decision by the court, other than the replacement of existing radio access devices under certain conditions. In October 2018, regulations setting procedures for the construction, changes to and replacement of radio access devices exempt from building permits, or the 2018 Regulations, were enacted. Although these regulations reflect previous judicial limitations placed upon our ability to make changes and replace radio access devices in 2010, they also introduce a new licensing procedure that may further reduce our ability to construct new radio access devices based on such exemption. This may adversely affect our existing networks and our networks' build-out. In December 2018, following the enactment of the 2018 Regulations, petitions against the Attorney General's opinion were dismissed and our and other operators' appeals against certain contrary decisions of the District Court were accepted.

Other legal proceedings relating to the exemption, including as to its application to rooftops located at the same level as a place of residence or otherwise regularly frequented, were decided against our position, and others, including as to the requirement to obtain an extraordinary usage permit in certain circumstances, including as to the radio access devices' ancillary equipment, are still under consideration. While the Company is of the opinion that the exemption relates to such ancillary equipment and the 2018 Regulations supports its position, the Ministry of Justice expressed an opinion that such regulations and the exemption do not relate to the radio access devices' ancillary equipment. The Ministry of Justice is expected to publish further instructions in the matter. Other claims asserting that those cell sites and other facilities do not meet other legal requirements, continue.



Inability to rely on, or substantial limitation of, the exemption, the dismantling of radio access devices and cell sites due to reasons out of our control and the objection of some local planning and building authorities to grant due permits where required, or the exclusion of the ancillary equipment from the exemption, if adopted, could have a negative impact on our ability to obtain environmental permits for these sites, could negatively affect the extent, quality, capacity and coverage of our network (specifically in urban areas), and our ability to continue to market our products and services effectively and may have a material adverse effect on our results of operations and financial condition.

Radio access devices do receive the required permits from the Ministry of Environmental Protection. Several local planning and building authorities argue that Israeli cellular operators may not receive building permits in reliance on the current Plan, for cell sites operating in frequencies not specifically detailed in the frequencies charts attached to the Plan, although most of our and other operators' cell sites (including all 4G cell sites) operate in frequencies not specifically detailed in the Plan. In a number of cases, these authorities have refused to issue a building permit for such new cell sites, arguing that building permits for such cell sites should be sought through other processes (which are longer and cumbersome), such as an application for an extraordinary usage or under existing local specific zoning plans. Following conflicting district decisions regarding this claim, the matter is expected to be decided by the Supreme Court. Some of the frequencies to which we may be required to transfer (see " – Networks and Infrastructure – Cellular Segment – Spectrum Allocation") are not specifically detailed in the Plan. We believe that the Plan applies to all cell sites, whether or not they operate in specific frequencies.

If this approach escalates or should the Supreme Court rule against the Company, it would have a negative impact on our ability to deploy additional cell sites, which could negatively affect the extent, quality and capacity of our network coverage and our ability to continue to market our products and services effectively.

In addition to cell sites, we provide repeaters (also known as bi-directional amplifiers) and femto-cells to subscribers seeking a solution to weak signal reception within specific indoor locations. Based on advice received from our legal advisors, we have not requested building permits under the Planning and Building Law for outdoor rooftop repeaters, which are a small part of the repeaters that have been installed. It is unclear whether other types of repeaters and femto-cells require building permits. Some repeaters and femto-cells require specific permits and we receive such permits, and others require a general permit from the Ministry of Environmental Protection in respect of their radiation level, and we ensure that each repeater functions within the parameters of the applicable general permit. Should it be established that the installation of repeaters and femto-cells requires a building permit, we will perform cost-benefit analyses to determine whether to apply for permits for new and existing repeaters and femto-cells or to remove them.

In addition, we construct and operate microwave sites as part of our transmission network. The majority of microwave sites are exempted from receiving permits from the Ministry of Environmental Protection (due to their low output) or require a general permit in respect of their radiation level. Based on advice received from our legal advisors, we have not requested building permits for such microwave facilities on rooftops. 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 sites and could hinder the extent, quality and capacity of our transmission network coverage and our ability to continue to market our landline services to our business customers (based on our own infrastructure) effectively.

Operating a cell site or a facility without the requisite permits or not in accordance with permits granted could subject us and our officers and directors to criminal, administrative and civil liability. Should any of our officers or directors be found guilty of an offence, although this has not occurred to date, they may face monetary penalties and a term of imprisonment. In addition, our sites or other facilities may be the subject of demolition orders and claims of breach of contract and we may be required to relocate cell sites to less favorable locations or stop operation of cell sites. This could negatively affect the extent, quality and capacity of our network coverage and adversely affect our results of operations.

#### Indemnification obligations

Under the Planning and Building Law, local building and planning committees require letters of indemnification from cellular operators indemnifying the committees for possible depreciation claims against the committees, as a condition for issuing a building permit for a cell site. The limitation period within which depreciation claims may be brought under the Planning and Building Law is the later of one year from receiving a building permit under the Plan and six months from the construction of a cell site. The Minister of Interior Affairs retains the general authority to extend such period further.

To date we have provided approximately 420 indemnification letters in order to receive building permits. Local planning and building committees have sought to join cellular operators, including us, as defendants in depreciation claims made against them even though indemnification letters were not provided. We were joined as defendants in a small number of cases. We expect that we will be required to continue to provide indemnification letters as the process of deploying our cell sites continues. As a result of the requirement to provide indemnification letters, we may decide to construct new cell sites in alternative, less suitable locations, to reduce capacity coverage or not to construct them at all, which could impair the quality of our service in the affected areas.

#### Environmental radiation issues

Under the Non-Ionizing Radiation Law, it is prohibited to construct and operate cell sites without construction and operating permits from the Ministry of Environmental Protection. Receiving a construction permit is a precondition to receiving a building permit from the planning and building committee and receiving a building permit or an exemption therefrom is a precondition for the receipt of an operating permit. For both permits, the applicant must present the means taken (including technological means) to limit exposure levels from each cell site or facility.

The validity of a construction permit is for a period not exceeding three months, unless otherwise extended by the Commissioner, and the validity of an operating permit is for a period of five years, subject to the submission of annual reports regarding radiation surveys of our cell sites and other facilities by third parties that were authorized to conduct such surveys by the Commissioner. These permits contain various conditions that regulate the construction and/or operating of cell sites, as the case may be. Our cell sites routinely receive both construction and operating permits from the Commissioner within the applicable time frames. In addition, Cellular operators are required to provide the Commissioner with online, ongoing data regarding the radiation level on each of their cell sites and other facilities. We provide the Commissioner with the requested data. See "– Site licensing" above for additional details in regards to obtaining a building permit or relying on an exemption.

The Non-Ionizing Radiation Law also regulates permitted exposure levels and provisions for supervision of cell site and other facility operation and grants the Commissioner authority to issue eviction orders if a cell site or other facility operates in conflict with its permit, and it imposes criminal sanctions on a company and its directors and officers for violations of the law. Failure to comply with the Non-Ionizing Radiation Law or the terms of a permit can lead to revocation or suspension of the permit, as well as to withholding the grant of permits to additional cell sites of that operator.

Positions of the Ministries of Communications, Health and Environmental Protection published in 2012 in relation to the various aspects of the provision of 4G services in Israel, include proposed limitations on usage and deployment in order to reduce exposure to non-ionizing radiation. Such limitations were not included in later documents issued by the MOC, allowing the provision of 4G services and awarding 4G frequencies to the cellular operators.

Any amendment to the Non-Ionizing Radiation Law and the Planning and Building Law that will prohibit or substantially limit the grant of permits under such laws, will, among other things, limit our ability to construct new sites (and if applied to existing cell sites, it will also limit our ability to renew operating permits for many of our existing sites), will adversely affect our existing networks and networks build out, specifically in urban areas, and could adversely affect our results of operations.

#### Handsets

The Israeli consumer protection regulations regulate the maximum permitted level of non-ionizing radiation from handsets, according to the European and the American standards. They also require cellular operators to attach an information leaflet to each handset package that includes explanations regarding non-ionizing radiation, the maximum permitted level of non-ionizing radiation and the level of radiation of that specific model of equipment. The Radiation Regulations further require that such information also be displayed at points-of-sale, service centers and on the Internet sites of cellular operators.

SAR levels are a measurement of non-ionizing radiation that is emitted by a hand-held cellular handset at its specific rate of absorption by living tissue. SAR tests are performed by the manufacturers on prototypes of each model of handset, not for each and every item. We include the information published by the manufacturer regarding SAR levels as we do not perform independent SAR tests for equipment and rely for this purpose on information provided by the manufacturers. As the manufacturers' approvals refer to a prototype handset, we have no information as to the actual SAR level of each specific item and throughout its lifecycle, including in the case of equipment repair. We inform our customers that there may be changes in the SAR levels in the event of equipment repair.

We obtain certain approvals from the Ministry of Communications and the Office of Standards in connection with the importation of handsets.

We are required to provide a warranty during the first year and maintain spare parts for certain end user equipment purchased from us, for certain malfunctions for certain periods. We are also required to annul equipment sales in certain circumstances, at the request of the customer.

#### Fixed-line Segment

##### Our Fixed-line Licenses

##### Our Unified license

The establishment and operation of fixed-line communications networks, and allocation of spectrum if relevant, requires a license.

We provide landline telephone, ILD, internet connectivity and infrastructure services as well as a "network end point" services, under a non-exclusive unified license granted to our wholly owned subsidiary - Cellcom Fixed Line Communications Limited Partnership - in 2015. The license expires in 2026 but may be extended by the MOC for successive periods of 10 years. The license requires a bank guarantee in the amount of NIS 5 million deposited with the Ministry of Communications. The provisions of our cellular license, including as to its extension, generally apply to the unified license, subject to certain modifications, including a 20% minimum Israeli holding requirement which can be waived by the Minister of Communications when the unified license operator is controlled by a general license holder (as was done in our case).

##### Services in Judea and Samaria

The Israeli Civil Administration in Judea and Samaria granted us a non-exclusive unified license for the provision of internet connectivity and infrastructure, ILD, landline and 'network end point' services to the Israeli-populated areas in Judea and Samaria. This license is effective until 2026. The provisions of the cellular license described above, including as to its extension, generally apply to this license, subject to certain modifications.

##### Data and transmission services

We hold a non-exclusive special license for the provision of local data communications services and high-speed transmission services only to Cellcom Fixed Line Communications Limited Partnership, effective until April 2021. Data and transmission services are being provided to our customers by Cellcom Fixed Line Communications Limited Partnership. The provisions of our cellular and unified licenses described above, including as to their extension, generally apply to this license, subject to certain modifications.

##### Fiber-optic network

The Communication Law provides operators certain privileges in the deployment of fiber-optic cables and exempts them (including auxiliary facilities) from the requirement to obtain building permits. The deployment in a public domain is subject to advanced notification to the occupier of the land and coordination with other infrastructure owners, and on private land, the consent of the owner of the land.

In addition, operators that do not own their own nation-wide landline infrastructure may use certain physical infrastructure of Bezeq and Hot, based on the wholesale landline market, and certain wholesale obligations are applied on all landline operators, including us. See "- Wholesale landline market" below.

See also "- Cellular Segment – Permits for cell site construction - Site Licensing" above for a discussion regarding microwave sites forming a part of our transmission network.

#### Wholesale landline market

A policy document regarding landline wholesale services published by the MOC in 2012 provided for the creation of an effective wholesale telecommunications access market in Israel and the gradual annulment of the structural separation in the Bezeq and Hot groups and its replacement with an accounting separation and change of the supervision on Bezeq retail tariffs to maximum tariffs rather than the current setting of fixed tariffs. The latter generally depends on the development of a wholesale market and the state of competition in the market, and with relation to television services, if there is a reasonable possibility of providing a basic package of OTT services providers without a national landline infrastructure.

In 2015, a wholesale landline market was formally launched in Israel in regards to internet infrastructure services and use of certain physical infrastructure by operators who do not own such infrastructure, following amendments to Bezeq's and Hot's licenses so as to include certain wholesale landline services, such as internet infrastructure services and wholesale landline telephony services and use of certain of their physical infrastructure by operators who do not own such infrastructure and promulgation of regulations setting the maximum tariffs of the wholesale landline services to be provided by Bezeq.

Although the wholesale market was formally applicable to Hot's infrastructure as well, Hot's infrastructure had been effectively excluded from the wholesale market, initially as the maximum tariffs for Hot's wholesale infrastructure service were not published by the MOC until June 2017 (and are higher than those set for Bezeq's service) and thereafter, due to disagreements with Hot as to the implementation of the service, which were resolved by the MOC. The Ministry of Communications resolved not to interfere with the tariffs Hot has set for its wholesale telephony service. Effective inclusion of Hot's infrastructure in the wholesale market may increase the potential subscribers to our triple play and bundle offerings.

In June 2017, the Ministry of Communications published regulations setting Bezeq's resale telephony service to be provided by Bezeq as of July 2017, as a temporary 14 month alternative for wholesale landline telephony service, and postponed Bezeq's obligation to offer wholesale telephony service until the lapse of said resale telephony service period. In June 2018, the MOC resolved not to prolong Bezeq's temporary alternative further and to obligate Bezeq to provide wholesale landline telephony services as of August 1, 2018. As of the date of this report, Bezeq does not provide the wholesale landline telephony services.

A hearing published by the MOC in 2014, which was further elaborated in 2017, proposing a method of inspecting whether Bezeq and Hot reduce their retail tariffs and thereby reduce the difference between the wholesale and retail tariffs ("margin squeeze") for certain landline services, aiming at reducing the profit of operators who do not own landline infrastructure and preventing their operation in the market, has not been concluded yet by the MOC.

An amendment to the Communications Law applies certain wholesale obligations on all landline operators, including us, and requiring all landline operators to grant all other landline operators access to their passive infrastructure (except IBC's passive infrastructure), the terms of which (with the exclusion of Bezeq and Hot, whose terms are set by the regulator) will be negotiated by the parties. For details of the Minister of Communications' authority to give instructions and set usage of another operator's network rates, see "-Government Regulation – Cellular Segment - Tariff supervision" above.

## OTT TV

Television services over the Internet are currently not subject to specific regulation in Israel.

Pursuant to the 2016 recommendations of a committee for the regulation of broadcasting nominated by the Ministry of Communications, in July 2018, a new bill for the regulation of broadcasting was published and includes classification of audio visual providers into four categories and determination of the regulation applied to each category as follows: (i) a provider with annual revenues of up to NIS 350 million from subscription fees – no license is required and no specific regulation applied; (ii) license of a medium size operator - a provider with annual revenues over NIS 350 million from subscription fees, but under NIS 700 million, requires a license, which includes a gradual mandatory investment in original Israeli content in an amount of up to 8 percent of the provider's annual revenues from subscription fees, as well as regulation, inter alia, in regards to minor and minorities protection, forbidden broadcasts and cross ownership limitations and prohibition on the provision of advertisement; (iii) license of a large size operator - a provider with annual revenues over NIS 700 million from subscription fees, requires a license, which includes a mandatory investment in original Israeli content in an amount not less than 8% of its annual revenues from subscription fees, prohibition on the provision of advertisements as well as regulation, inter alia, in regards to minor and minorities protection, forbidden broadcasts, regulation relating to consumer protection, cross ownership limitations, limitation regarding owning and producing channels and providing basic channel package; and (iv) license of a significant operator - a provider that owns a managed network for the provision of contents will be bound, inter alia, in regards to broadcasting open channels and specific channels of audio-visual license holders. The bill includes limited regulation regarding sports broadcasting and is focused on audio-visual providers, where the content provided is mainly aimed at the audience in Israel and therefore is expected not to apply to foreign TV content providers operating in Israel, such as Netflix and Amazon prime video. The Company does not expect the bill, if enacted, to materially change the regulation that applies to the Company. The bill requires legislative proceedings in the Israeli parliament, which may include material changes to the bill. If the legislation adopted requires us to make additional investments or impose unfavorable regulation on our OTT TV service, or apply such regulation to us and not to other OTT TV providers, or usage of the DTT infrastructure, it may adversely affect our OTT TV business.

As of November 2017, the regulator allowed three TV commercial channels (two of which later merged into one channel) to broadcast their content in high definition over the internet and to Hot and Yes but not over the DTT broadcasting system. As a result, our TV customers and other DTT customers in Israel cannot obtain these three specific channels in HD (but rather in standard definition). We believe this decision is discriminatory and unreasonable and have filed a petition against this decision with Israel's High Court of Justice. See also "– Competition – Fixed-line Segment – Television services" above.

## Securities administrative enforcement

Under the Israeli Securities Law, certain violations of certain securities and securities-related laws supervised by the Israeli Securities Authority, or ISA, may be enforced through administrative measures. The ISA may impose various civil enforcement measures, including financial sanctions, payment to the injured party, prohibition of the violator from serving as an officer or a director for a specified period of time, annulment or suspension of licenses, approvals and permits granted under such laws and agreed settlement mechanism as an alternative to a criminal or administrative proceeding. In case of a violation by a corporation, vicarious responsibility could be attributed to the chief executive officer in some cases, unless certain conditions have been met, including the adoption and implementation of procedures for the prevention of the violation. We adopted such procedures for the prevention of violations. In recent years, significant monetary sanctions, ranging up to several million NIS in individual cases, have been imposed by the Israeli Securities Law Administrative Enforcement Committee on several publicly traded companies and their affiliates for breach of the provisions of the Israeli Securities Law.

## Contributing to the Community and Protecting the Environment

We and our employees have been contributing to the community since our inception. We consider contribution to the community in Israel an important component of our business vision and believe we have a responsibility toward the Israeli community, as we acknowledge that business leadership goes hand in hand with social leadership.

During 2018, 20% of our employees participated in volunteering activities in the community. Since 2016, we have partnered with an association supporting ALS patients and family members in various voluntary activities, including our employees' participation in a fundraising race for ALS patients and donation in said race, the donation of a service workshop to the ALS association social workers and employees regarding the importance of service and provision of excellent service and familiarizing ALS patients with mitigating advanced technologies.

We are aware of the importance of environmental protection. We seek to operate responsibly to continuously reduce negative impacts on the environment and the landscape, aiming at a better environmental performance than required by local law. We dedicate personnel, funds and technologies to reduce our ecological footprint, through activities such as efficient deployment of infrastructure subject to the applicable standards, recycling of electronic components and packages, reduction of paper usage by managed printing, reduction of pollutants' emissions and energy usage, collection of used batteries, provision of a monthly bill and other correspondence to our subscribers via e-mail or SMS, transfer to usage of environment friendly raw materials and separation between different types of waste in our repair services and purchasing of electricity produced by a private natural gas based power station.

## C. ORGANIZATIONAL STRUCTURE

Our largest shareholder, Koor, is a wholly-owned subsidiary of DIC. DIC is a public Israeli company traded on the Tel-Aviv Stock Exchange, one of Israel's largest business groups. See footnote no. 1 to the table under "Item 7.A – Major Shareholders" for information on the holdings of DIC.

We and Cellcom Fixed Line Communications Limited Partnership (see "- Government Regulations - Fixed-line Segment - Our Fixed-line Licenses - Our Unified Licenses"), are incorporated in Israel. Cellcom Fixed Line Communications Limited Partnership and Dynamica Communications Chain Stores Ltd., our wholly owned dealer, are our significant subsidiaries.

#### D. PROPERTY, PLANT AND EQUIPMENT

##### Headquarters

In 2003, we entered into an agreement for the lease of our headquarters in Netanya, Israel. The leased property covers approximately 57,800 square meters, of which approximately 26,000 square meters consist of underground parking lots. The lease is in effect until December, 2022 and is renewable for two additional periods of five years each, upon our notice. As of 2015, we started subleasing part of the property, which currently amounts to a quarter of our headquarters to several sub-lessees for a period of up to five years, following the reduction in headcount in our headquarters. The sub-lessees have options to renew the lease for additional periods.

##### Netanya Property

In 2010, we entered into a lease agreement for our techno-logistic center, in Netanya, Israel. The leased property covers approximately 11,000 square meters. The lease is for a term of ten years from August 2011 and is renewable for an additional period of 5 years, at our option. In case we do not exercise the option we shall be required to pay approximately NIS 11 million. As of 2015, we started subleasing part of the property, which currently amounts to approximately 6,100 square meters of the leased property, for a period of five to six years. The sub-lessees have an option to renew the leases for an additional period subject to certain conditions.

##### Haifa and Rosh-Ha'ayin Properties

We lease a property in Haifa and a property in Rosh-Ha'ayin. We use these properties for offices, for call centers, for network servers and for equipment storage. The Haifa lease covers approximately 8,900 square meters, is in effect until December 2019, and is renewable for three additional periods of two years each, upon our notice. The Rosh-Ha'ayin lease covers approximately 3,300 square meters, is in effect until December 2019 and is renewable for four additional periods of two years each, upon our notice. We sublease part of the property in Rosh-Ha'ayin to our wholly-owned dealer and another subsidiary.

##### Electricity

In December 2010, we entered into an agreement with Ramat Negev Energy Ltd., which constructed a private power plant fueled by natural gas in Israel, and we commenced purchasing a portion of our electricity from it in 2014. Under the agreement, we committed to purchase electricity for the earlier of a period of 15 years from commencement of operations of the power plant or until January 2028, subject to our right to terminate the agreement after six years from the commencement of operations of the power plant under certain conditions.



#### Service Centers, Points of Sale and Cell Sites

As of December 31, 2018, we leased 74 service centers, points of sale and other facilities (including those operated by our wholly-owned dealer), which are used for sales and customer service. Such lease agreements are generally for periods of two to three years, with extension options that vary by location.

In addition, we lease from various parties, including the Israeli Land Authority, or ILA, municipalities and private entities sites for the establishment, maintenance and operation of cell sites for our cellular network. The duration of these lease agreements are generally for two to five years, with an option to extend the lease for successive similar periods and exit windows that enable us to terminate the agreement prior to its scheduled expiration. In some of the agreements, the lessor is entitled to terminate the agreement at any time without cause, subject to prior notice. Based on our past experience, we encounter difficulties in extending the term of approximately 5% of the lease agreements for cell sites, which at times results in our having to pay higher rent in order to remain in the same locations or to find alternative sites. This may aggravate given our network sharing agreements.

In addition, we lease a number of points of presence in Israel that are used for equipment and servers storage and other communications equipment for the provision of landline services, and storage space for our servers and equipment in London and Frankfurt.

#### Authorization Agreement with Land Regulatory Authorities

In June 2013, we renewed an authorization agreement with the ILA that authorizes us to use lands managed by the ILA for the establishment and operation of cell sites. The authorization agreement is effective until December 2019. The authorization agreement provides that subject to the receipt of approval from the ILA, we will be entitled to establish and operate cell sites on the lands leased to third parties throughout the agreement's term. We undertook to vacate at the end of the agreement's term all facilities installed in the authorized area unless the authorization period is extended. Under the authorization agreement, the ILA is entitled to revoke authorizations granted to us in certain circumstances.

#### ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

## ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following operating and financial review and prospects should be read in conjunction with “Item 3. Key Information – A. Selected Financial Data” and our consolidated financial statements and accompanying notes appearing elsewhere in this annual report. Our financial statements have been prepared in accordance with International Financial Reporting Standards, or IFRS, as issued by the IASB which differ in certain respects from U.S. Generally Accepted Accounting Principles, or U.S. GAAP.

This discussion contains forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many important factors, including those set forth under “Item 3. Key Information – D. Risk Factors” and elsewhere in this annual report.

### A. OPERATING RESULTS

#### Overview

#### General

We are one of the four major communications groups in Israel and the largest provider of cellular communications services in Israel with approximately 2.851 million cellular subscribers as of December 31, 2018, with an estimated market share of 27%. In recent years we have increased our presence in the fixed line market, adding TV and internet infrastructure services (the latter through the landline wholesale market and, as of 2018, also over our independent fiber-optic infrastructure), to our veteran ISP and landline telephony (both inland and long distance).

We earn revenues and generate our primary sources of cash by offering a broad range of communications services, including cellular, Internet services (connectivity and infrastructure), TV services and fixed-line telephony services (inland and international), as well as by selling handsets and other end-user equipment.

As of 2016, as a result of business and regulatory changes, as well as the Group’s entry into new fields of operation in the fixed-line market, the Group’s management attention in general and its chief operating decision maker’s attention in particular, have shifted to focus on two main fields of operations, “Cellular” and “Fixed-line.” Accordingly we adjusted our operating segments for reporting prior periods as of January 1, 2014, on a retroactive basis.

Our cellular segment’s services include basic cellular communications services and data transfer, download and upload, as well as text and multimedia messaging services and advanced cellular content services, which we provide through our 2G and 3G networks, covering substantially all of the populated territory of Israel, and our 4G network covering most of the population of Israel. We also provide international roaming services to our subscribers in 180 countries as of December 31, 2018 as well as to subscribers of foreign networks visiting Israel. We offer our subscribers a wide selection of handsets of various leading global manufacturers as well as extended warranty services on most handsets we offer. A significant portion of our revenues is derived from our network sharing agreement with Golan.

Our fixed-line segment’s services include landline telephony services, internet infrastructure (since May 2015, through the landline wholesale market and, as of 2018, also over our own fiber-optic infrastructure), connectivity services (ISP), television services (since December 2014) (OTT TV), transmission services, international calling services (ILD), end user fixed-line equipment and IOT services.

We sell our various services on a stand-alone basis or bundled with certain other services offered by us, including a triple play bundle of end-to-end internet service, landline telephony and TV services and a quatro bundle which

includes the triple offering plus cellular services.

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Our management evaluates our performance through focusing on our key performance indicators, which include among others: cellular subscribers and average revenue per user of cellular, or ARPU, internet and TV subscribers (households) – both stand alone and as a part of a bundle, adjusted EBITDA (as defined in “Results of Operations”), adjusted EBITDA as percentage of revenues, operating income, net income, cash flow from operating activities, Free Cash Flow\*, , subscriber churn rate and handset sales and profitability. These key performance indicators are primarily affected by the competitive and regulatory landscape in which we operate and our ability to adapt to the challenges posed.

\*Free cash flow is a non-IFRS measure and is defined as the net cash provided by operating activities (including the effect of exchange rate fluctuations on cash and cash equivalents) excluding a loan to Golan Telecom, minus the net cash used in investing activities excluding short-term investment in tradable debentures and deposits and proceeds from sales of such debentures (including interest received in relation to such debentures) and deposits.

Our operating results, profitability and cash flow have decreased significantly in the past several years, with a loss for 2018, mainly due to the intense competition resulting largely from regulatory developments intended to enhance competition in the Israeli telecommunications market, which caused significant price erosion in the prices charged for the provision of cellular services and a decrease from equipment sales. Our operating income in 2018 was NIS 74 million (\$20 million), a decrease of 75.1% from NIS 297 million (\$79 million) in 2017 and a decrease of 76.1% from NIS 310 million in 2016. We recorded a loss in 2018 of NIS 64 million (\$ 17 million), compared to net income of NIS 113 million (\$30 million) in 2017 and a net income of NIS 150 million (\$40 million) in 2016. The Company's net cash from operating activities in 2018 amounted to NIS 770 million (\$203 million), a decrease of 0.5% from NIS 774 million (\$207 million) in 2017 and a decrease of 1.4% from NIS 781 million (\$208 million) in 2016. As our business environment continues to be characterized by increased competition in the various markets in which we operate, these factors may continue to negatively impact our business, which may further adversely affect our results of operations and financial condition. More over, our financial condition may be more volatile than our competitors, due to our substantially larger amount of debt. Other impacts may include the need to reduce investments, in absolute terms and in comparison to our competitors, which may harm our competitive standing and potential future growth, adversely affect our ability to raise additional debt and refinance our existing debt or adversely affect the terms and price of such debt raising, which in turn may further adversely affect our financial condition and may require equity capital raising, if possible.

We intend to drive revenue primarily by: maximizing the benefits of our position as a leading Israeli telecommunications group; offering our customers full and comprehensive mobile and wireline solutions and bundles of services (including triple/quatro play) and enhancing our competitive capabilities; retaining our existing subscribers and attracting new subscribers; offering new services that are synergetic to our core businesses like IOT and growing wireline service revenues. Entering a new and penetrated market may require substantial investment and additional expenses. We intend to continue our efforts to optimize our costs by implementing further efficiency measures and reducing our expenses, including through the network sharing and hosting agreements we entered into with Golan and Xfone and by our agreements for investment in IBC, contemplated sale of our independent fiber-optic residential infrastructure to IBC and IRU in IBC's fiber-optic infrastructure, as they are expected to allow us to reduce our current landline wholesale payments to Bezeq, and adjust our operations to the changing market conditions. We cannot guarantee the success of these measures. For details of our Sharing Agreements, see "Item 4. Information on the Company –B. Business Overview – Network and Infrastructure – Cellular Segment – Network sharing agreements". For details of our fiber-optic activity see" Item 4. Information on the Company – B. Business Overview – Networks and Infrastructure – Fixed-line Segment – Fixed-line infrastructure" and "– Investment in IBC" thereunder.

In 2018, we entered into a collective employment agreement with the Company's employees' representatives and the Histadrut for a term of three years (2018-2020). In March 2019, the Histadrut announced a labor dispute at the Company. We are negotiating a new collective employment agreement with our employees' representatives and the Histadrut but cannot guarantee the outcome of such negotiations. See also "Item 3. Key Information – D. Risk Factors – Risks Related to our Business – The unionizing of our employees may impede necessary organizational and personnel changes, result in increased costs or disruption to our operation."

The Israeli telecommunications market is currently dominated by four communications groups: Bezeq, Hot, Partner and Cellcom, with the first two having a full landline infrastructure.

The communications market is primarily regulated by the Ministry of Communications. Regulatory changes have had material adverse effects on our results of operations in recent years, including by facilitating the entry of additional competitors into the cellular market which dramatically increased competition. Recent consumer related amendments to our licenses had a material adverse effect on our results of operations. Such and other future amendments, if implemented, may continue to materially adversely affect our results of operations, should we not succeed to mitigate such effects. See "Item 4. Information on the Company – B. Business Overview – Government Regulations".

Competition may increase further if: current trends continue, the landline wholesale market, launched in 2015, is ineffective; the structural separation imposed on the Bezeq and Hot groups or Bezeq's tariffs supervision is annulled or further relaxed or other unfavorable regulatory changes relating to the Bezeq and Hot groups are effected; new competitors enter the communications markets; we do not procure or deploy a widespread landline infrastructure or enter into cooperation to use such infrastructure with an operator which owns such infrastructure; or we do not purchase additional frequencies or purchase frequencies in an amount equal to our competitors or make the necessary investments in our networks or in our business in general. We have continually implemented aggressive efficiency measures in order to mitigate those adverse effects, which included voluntary retirement plans for employees. We intend to continue to implement changes in order to continue our efforts to mitigate the adverse effects of the increased competition in many areas in which we operate. We cannot guarantee the success of these measures. Moreover, unionization of our employees may impede the execution of such measures. See "Item 3. Key Information – D. Risk Factors – Risks Related to our Business - We face intense competition in all aspects of our business" and "-The unionizing of our employees may impede necessary organizational and personnel changes, result in increased costs or disruption to our operation", and "Item 4. Information on the Company - B. Business Overview – Competition" for additional details.

The construction and operation of our cell sites and other transmission facilities are highly regulated and require us to obtain various consents and permits. See “Item 4. Information on the Company – B. Business Overview - Government Regulations – Cellular segment – Permits for Cell Site Construction.” We have experienced difficulties in obtaining some of these consents and permits and our ability to rely on an exemption from obtaining a building permit was severely limited. Also, we may be operating a significant number of our cell sites in a manner not fully compatible with the building permits issued for them. Additional restrictions on the construction and operation of cell sites and other facilities have been enacted recently and may be enacted in the future or we may be required to demolish or relocate these cell sites and facilities, which may adversely affect our existing networks and networks build out, specifically in urban areas, may prevent us from meeting our license requirements and could adversely affect our results of operations.

Our profitability is also affected by other factors, including changes in our cost of revenues and selling, marketing, general and administrative expenses, including depreciation and financing expenses.

Our results are also impacted by currency fluctuations. While substantially all of our revenues are denominated in NIS, for 2018, approximately 17 % of cash outflow was denominated in, or linked to, other currencies, mainly U.S. dollars. Changes to the Israeli CPI, may also impact our results as part of our debentures (Series F, H and J) and some of our expenses are linked to the Israeli CPI. Any devaluation of the NIS against the U.S. dollar or other foreign currencies will therefore increase the NIS cost of our expenses that are not denominated in NIS or are linked to those currencies and any increase in the Israeli CPI will increase the financial expenses associated with our debentures. We enter into derivative instruments to mitigate the effect of the various market risks associated with these expenses. See “Item 11 – Quantitative and Qualitative Disclosures About Market Risk.”

Further, we have incurred significant debt by issuing debentures and receiving loans, the aggregate outstanding principal amount of which as of December 31, 2018 was NIS 3,865 million. See “– Liquidity and Capital Resources– Debt Service” and “-Other Credit Facilities”.

Our dividend policy targets a distribution of at least 75% of our annual net income on a quarterly basis. In respect of 2016, 2017 and 2018, our board of directors chose not to declare dividends given the intensified competition and its adverse effect on our results of operations and in order to strengthen our balance sheet. We undertook limitations on our dividend distributions in connection to the issuance of our F through L debentures and other credit facilities. See “Item 8. Financial Information – A. Statements and Other Financial Information - Dividend Policy” and “- B. Liquidity and Capital Resources- Dividend payments” and “– Debt Service” and “– Other Credit Facilities”.

As of January 1, 2017, we apply International Financial Reporting Standard (IFRS) 15 following early adoption thereof, and capitalize part of the salaries expenses and commissions related to customer acquisition costs. The application of this standard had a material positive effect on the Company's financial results for the years 2017 and 2018. The standard was applied using the cumulative effect approach as from the initial date of application.

As from January 1, 2018 we apply IFRS 9 regarding financial instruments, which replaced IAS 39. The standard was applied using the cumulative effect approach as from the initial date of application without amendment of the comparative data, other than with respect to certain hedging items, with an adjustment to the balance of retained earnings and other components of equity as of the initial date of application. For additional details see note 2-F to our financial statements.

## Revenues

We derive our revenues in the cellular segment primarily from the sale of cellular network services (such as airtime and data surfing), including content and value added services, roaming services as well as revenues derived from network sharing and hosting services, handset sale and handset repair services. Roaming services include roaming charges that we bill to our subscribers for the use of the networks of our roaming partners outside Israel, to which we refer as outbound roaming, and charges that we bill to our roaming partners whose subscribers use our network, to which we refer as inbound roaming. Originating calls on our network and from interconnect revenues from other operators for calls terminating on our network.

Our revenues in the fixed-line segment are derived from the sale of fixed-line communications services which include: internet infrastructure (through the landline wholesale market, since February 2015 and, as of 2018, also based on our independent fiber-optic infrastructure) and connectivity services, OTT TV services (since December 2014), transmission services, provided to other operators and to Golan and Xfone according to our network sharing agreement, international calling services (ILD), landline telephony services, operator services and teleconferencing services and equipment sales that are related to this segment.

Our revenues from cellular services are usually affected by seasonality with the third quarter of the year characterized by higher roaming revenues due to increased incoming and outgoing tourism. Equipment sales of the fixed-line segment are usually higher in the fourth quarter.

## Cost of revenues

The principal components of our cost of revenues are the purchase of equipment, interconnect fees, content cost, cell site leasing costs, salaries, transmission services cost, internet connectivity services cost, purchase of call minutes related mainly to international calling services, outbound roaming services fees and cost of Internet infrastructure. Our cost of revenues also includes depreciation of the cost of our network equipment, tv set-top boxes, amortization of our spectrum licenses and rights of use of communications lines. As of April 2017, our cost of revenues decreased as a result of our sharing partners', participation in operating costs according to the Network Sharing Agreements.

## Selling and marketing expenses

Selling and marketing expenses consist primarily of sales force salaries and dealers' commissions, advertising, public relations and promotional expenses. We compensate our sales force through salaries and incentives. Since January 1, 2017 part of our customer acquisition costs (salaries and dealers commissions) are capitalized as a result of the early adoption of a new International Financial Reporting Standard (IFRS 15). Our selling and marketing expenses also include depreciation, mainly of leasehold improvements and equipment in our service centers and points of sales, and amortization of intangible assets related to the acquisition of subsidiaries.

## General and administrative expenses

General and administrative expenses consist primarily of salaries and compensation, professional and consultancy fees, leases and maintenance of our offices, bad debt and doubtful accounts allowance, and other administrative expenses. Our general and administrative expenses also include depreciation and maintenance fees, mainly for our billing and information systems.

## Other income and expenses

Other income and expenses consist primarily of expenses related to employee retirement plans in 2016 and 2018 and gain from the sale of a subsidiary in 2017.

## Financing income and expenses

Financing income and expenses consist primarily of interest expense on long-term loans and interest on our debentures and other credit facilities, the interest income component of handset long-term installment sales, the effects of fluctuations in currency exchange rates, Israeli CPI adjustments related to the Israeli CPI-linked debentures, and income or losses relating to financial derivative instruments that do not qualify for hedge accounting according to IFRS. Financing income and expenses also include interest income on deposits, discount amortization associated with our debentures, and gains and losses from our current investment in tradable securities.

## Income Tax

Generally, Israeli companies were subject to corporate tax on their taxable income at the rate of 25% for the 2016 tax year, 24% for the 2017 tax year and 23% for the 2018 tax year and onward.

Israeli companies are subject to capital gains tax at the corporate tax rate. A deferred tax asset or liability is created for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

## Results of Operations - Comparison of 2016, 2017 and 2018

The following table sets forth key performance indicators for the periods indicated:

	Year Ended December 31,			Change*	
	2016	2017	2018	2017 vs. 2016	2018 vs. 2017
Cellular subscribers at end of period(1) (in thousands)	2,801	2,817	2,851	0.6 %	1.2 %
Internet-customers (households) (end of period) (in thousands) (2)	156	222	269	42.3 %	21.2 %
TV - households (end of period) (in thousands) (2)	111	170	219	53.2 %	28.8 %
Churn rate of cellular subscribers(1)(3)	42 %	46 %	44 %	-	-
Average monthly revenue per cellular subscriber (ARPU) (1)(4) (in NIS)	63	57	51	(9.5 )%	(10.5 )%
Operating income (in NIS millions)	310	297	74	(4.2 )%	(75 )%
Net income(loss) (in NIS millions)	150	113	(64 )	(24.7)%	na
Adjusted EBITDA(5) (in NIS millions)	858	853	660	(0.6 )%	(22.6 )%
Operating income margin(6)	7.7 %	7.6 %	2.0 %	(0.1pp)	(5.6pp)
Adjusted EBITDA margin(7)	21.3 %	22.0 %	17.9 %	0.7pp	(4.1pp)



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\*pp denotes percentage points and this measure of change is calculated by subtracting the 2016 measure from the 2017 measure and the 2018 measure from the 2017 measure, respectively.

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- Cellular subscriber data refers to active subscribers. We use a six-month method of calculating our cellular subscriber base, which means that we add post-paid subscribers to our subscriber base upon their joining our services and prepaid subscribers upon charging a prepaid card and we deduct subscribers from our subscriber base after six months of no revenue generation and activity on our network and no data usage or less than NIS 1 of accumulated revenues from M2M (machine to machine) subscribers. The six-month method is, to the best of our knowledge, consistent with the methodology used by other cellular providers in Israel. The 2017 cellular subscriber base includes subscribers added as part of our purchase of the operations of an Israeli Mobile Virtual Network Operator, or MVNO, during the third quarter of 2017. As of the third quarter of 2018, we add M2M subscribers to the cellular subscriber base only upon first use instead of at the time of joining our service as was done until the change. This change did not have a material effect on M2M prior subscriber data.
- (1) TV and Internet customers (households) refer to active subscribers. Internet households receive end-to-end internet service, including infrastructure (based on the wholesale landline market) and connectivity services.
- (2)

- Churn rate is defined as the total number of voluntary and involuntary permanent deactivations of cellular subscribers in a given period expressed as a percentage of the number of cellular subscribers at the beginning of such period. Involuntary permanent deactivations relate to cellular subscribers who have failed to pay their arrears for the period of six consecutive months. Voluntary permanent deactivations relate to cellular subscribers who terminated their use of our services. Churn rate data is excluding the above mentioned removals of subscribers.
- (3)

- Average monthly revenue per cellular subscriber (ARPU) is calculated by dividing revenues from cellular services for the period by the average number of cellular subscribers during the period and by dividing the result by the number of months in the period. Revenues from inbound roaming services and hosting and network sharing services are included even though the number of subscribers in the equation does not include the users of those roaming, hosting and network sharing services. Inbound roaming services, hosting and network sharing services are included because ARPU is meant to capture all service revenues generated by a cellular network. Revenues from sales of Subscription Repair Services are included because they represent recurring revenues generated by subscribers, but revenues from sales of handsets (which for purposes of this report may include other types of cellular end user equipment, such as tablets), Random Repair Services, and other services are not. We and industry analysts, treat ARPU as a key performance indicator of a cellular operator because it is the closest meaningful measure of the contribution to service revenues made by an average subscriber.
- (4)

We have set out below the calculation of cellular ARPU for each of the periods presented:

	Year Ended December 31,		
	2016	2017	2018
	(In NIS millions, except number of subscribers and months)		
Revenues	4,027	3,871	3,688
less revenues from equipment sales	994	952	904
less other revenues not in ARPU*	881	949	1,061
Revenues used in ARPU calculation (in NIS millions)	2,152	1,971	1,723
Average number of subscribers	2,832,407	2,797,341	2,826,013
Months during period	12	12	12
ARPU (in NIS, per month)	63	57	51

\* Other revenues include revenues from other communications services, mainly fixed-line revenues and repair services.

Adjusted EBITDA is a non-IFRS measure and is defined as income before financing income (expenses), net; other income (expenses), net (excluding gain from the sale of a subsidiary and expense related to employee retirement plans); income tax; depreciation and amortization; and share based payments. We present adjusted EBITDA as a supplemental performance measure because we believe that it facilitates operating performance comparisons from period to period and company to company by backing out potential differences caused by variations in capital structure (most particularly affecting our interest expense given our significant debt), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses) and the age of, and (5) depreciation expenses associated with fixed assets. Adjusted EBITDA should not be considered in isolation or as a substitute for operating income or other statement of operations or cash flow data prepared in accordance with IFRS as a measure of our profitability or liquidity. Adjusted EBITDA does not take into account our debt service requirements and other commitments, including capital expenditures, and, accordingly, is not necessarily indicative of amounts that may be available for discretionary uses. In addition, adjusted EBITDA, as presented in this annual report, may not be comparable to similarly titled measures reported by other companies due to differences in the way these measures are calculated.

The following is a reconciliation of adjusted EBITDA with net income and operating income:

	Year Ended December 31, 2016 2017 2018 (In NIS millions)		
Net income(loss)	150	113	(64 )
Financing expenses, net	150	144	144
Taxes on income (tax benefit)	10	40	(6 )
Operating income	310	297	74
Other expenses (income), net (excluding gain from the sale of a subsidiary and expense related to employee retirement plans)	8	(1 )	-
Depreciation and amortization	534	555	584
Share based payments	6	2	2
Adjusted EBITDA	858	853	660

(6) Operating income margin is defined as operating income as a percentage of total revenues for each of the applicable periods.

(7) Adjusted EBITDA margin is defined as adjusted EBITDA as a percentage of total revenues for each of the applicable periods.

The following table sets forth our consolidated statements of income as a percentage of total revenues from operations for the periods indicated:

	Year Ended December 31, 2016 2017 2018		
Revenues	100.0%	100.0%	100.0%
Cost of revenues	67.1 %	69.2 %	72.2 %
Gross profit	32.9 %	30.8 %	27.8 %
Selling and marketing expenses	14.3 %	12.4 %	15.3 %
General and administrative expenses	10.4 %	11.0 %	9.8 %
Other (income) expenses, net	0.5 %	0.2 %	0.7 %
Operating income	7.7 %	7.6 %	2.0 %
Financing expenses, net	3.7 %	3.7 %	3.9 %
Income(loss) before income tax	4.0 %	3.9 %	1.9 %
Income tax	0.3 %	1.0 %	0.2 %
Net income(loss)	3.7 %	2.9 %	1.7 %

#### Revenues

	Year Ended December 31, 2016 2017 2018 (In NIS millions)			Change 2017 2018 vs. vs. 2016 2017	
Revenues	4,027	3,871	3,688	(3.9)%	(4.7 )%

The decrease in revenues in 2018 compared with 2017 is attributable to a 10.3% decrease in service revenues in the cellular segment, and a 5% decrease in equipment revenues. The decrease in service revenues was partially offset by an increase in revenues from the fixed-line segment in the Internet and TV fields.

The decrease in revenues in 2017 compared with 2016 is attributable to a 3.8% decrease in service revenues, driven by a decrease in the cellular segment's service revenues and a 4.2% decrease in equipment revenues. The decrease in service revenues was partially offset by an increase in revenues from the fixed-line segment in the Internet and TV fields.

The following table sets forth the breakdown of our revenues for the periods indicated based on the various sources thereof:

	2016		2017		2018	
	% of Total Revenues		% of Total Revenues		% of Total Revenues	
	Revenue (in NIS millions)		Revenue (in NIS millions)		Revenue (in NIS millions)	
Service revenues:						
Cellular services	2,025	50.3	% 1,777	45.9	% 1,581	42.9
Land-line communications services*	871	21.6	% 1,004	25.9	% 1,068	29.0
Other services**	137	3.4	% 138	3.6	% 135	3.7
Total service revenues	3,033	75.3	% 2,919	75.4	% 2,784	75.5
Equipment revenues	994	24.7	% 952	24.6	% 904	24.5
Total revenues	4,027	100.0	% 3,871	100.0	% 3,688	100.0

\* Consists of international calling services, landline telephony services, transmission services, hubbing services, internet services (ISP and internet infrastructure services) and TV services.

\*\* Consists of repair services fees.

During 2018, service revenues (comprising 75.8% of total revenues) decreased 4.6%, compared with 2017. This decrease in service revenues resulted mainly from a 10.3% decrease in cellular service revenues resulting mainly from the ongoing erosion in the prices of these services. and from the difference between the national roaming services revenues and the revenues for rights of use in cellular networks according to the network sharing agreements as of the beginning of the second quarter of 2017. The decrease was partially offset by a 6.4% increase in the fixed-line service revenues resulting mainly from an increase in revenues from TV and internet services, as well as from fixed-line communications services provided according to the network sharing agreement with Golan which came into force as of the beginning of the second quarter of 2017.

During 2017, service revenues (comprising 75.4% of total revenues) decreased 3.8%, compared with 2016. This decrease in service revenues resulted mainly from a 12.2% decrease in cellular service revenues resulting mainly from the ongoing erosion in the prices of these services and from the difference between the national roaming services revenues and the revenues for rights of use in cellular networks according to the network sharing agreement with Golan. The decrease was partially offset by a 15.3% increase in the fixed-line service revenues resulting mainly from an increase in revenues from TV and internet services, as well as from fixed-line communications services provided according to the network sharing agreement with Golan which came into force as of the beginning of the second quarter of 2017.

Fixed-line service revenues totaled NIS 1,068 million in 2018 compared to NIS 1,004 million in 2017. This increase resulted mainly from an increase in revenues from TV and internet services, as well as of fixed-line communications services provided according to the network sharing agreement with Golan as of the beginning of the second quarter of 2017.

Fixed-line service revenues totaled NIS 1,004 million in 2017 compared to NIS 871 million in 2016. This increase resulted mainly from an increase in revenues from TV and internet services, as well as of fixed-line communications services provided according to the network sharing agreement with Golan, which was partially offset as a result of the

deconsolidation of Internet Rimon Israel 2009 Ltd. (our indirect subsidiary), or Internet Rimon, following the sale of the Group's holdings in Internet Rimon in the second quarter of 2017.

During 2018, revenues from other services totaled NIS 135 million compared with a total of NIS 138 million in 2017.

During 2017, revenues from other services totaled NIS 138 million compared with a total of NIS 137 million in 2016.

During 2018, equipment revenues (comprising 24.5% of total revenues) decreased 5%, compared with 2017. This decrease resulted mainly from a decrease in the quantity of cellular segment end user equipment sold during 2018 as compared to 2017. This decrease was partially offset by an increase in end user equipment sales in the fixed-line segment.

During 2017, equipment revenues (comprising 24.6% of total revenues) decreased 4.2%, compared with 2016. This decrease resulted mainly from a decrease in the quantity of cellular segment end user equipment sold during 2017 as compared to 2016. This decrease was partially offset by an increase in end user equipment sales in the fixed-line segment.

The following table sets forth the breakdown of our revenues for the periods indicated based on the types of subscribers:

	2016			2017			2018		
	% of			% of			% of		
	Total			Total			Total		
	Revenue	Revenues		Revenue	Revenues		Revenue	Revenues	
	(in			(in			(in		
	NIS			NIS			NIS		
	millions)			millions)			millions)		
Individual	2,832	70.3	%	2,702	69.8	%	2,579	69.9	%
Business	971	24.1	%	992	25.6	%	946	25.6	%
Other*	224	5.6	%	177	4.6	%	163	4.5	%
Total	4,027	100.0	%	3,871	100.0	%	3,688	100.0	%

\* Mainly consists of revenues from inbound roaming services, hosting services and network sharing services.

A breakdown of revenues according to types of subscribers (individual and business) during 2018 compared with 2017, shows a 4.6% decrease in revenues attributable to individual subscribers and a 4.6% decrease in revenues attributable to business subscribers. The decrease in the revenues attributable to individual subscribers resulted mainly from the ongoing erosion in the price of cellular services, resulting from the intensified competition in the cellular market. The decrease in revenues attributable to the business subscribers resulted mainly from the decrease in recurring revenue resulted mainly from the intensified competition in the cellular market.

A breakdown of revenues according to types of subscribers (individual and business) during 2017 compared with 2016, shows a 4.6% decrease in revenues attributable to individual subscribers and a 2.2% increase in revenues attributable to business subscribers. The decrease in the revenues attributable to individual subscribers resulted mainly from the ongoing erosion in the price of cellular services, resulting from the intensified competition in the cellular market. The increase in revenues attributable to the business subscribers resulted mainly from an increase in equipment revenues from that subscriber base.



The following table sets forth the breakdown of our revenues for the periods indicated based on the types of subscription plans:

	2016			2017			2018		
	% of			% of			% of		
	Total			Total			Total		
	Revenue	Revenues		Revenue	Revenues		Revenue	Revenues	
	(in			(in			(in		
	NIS			NIS			NIS		
	millions)			millions)			millions)		
Pre-paid	207	5.1	%	195	5.0	%	180	4.9	%
Post-paid	3,596	89.3	%	3,499	90.4	%	3,344	90.7	%
Other*	224	5.6	%	177	4.6	%	163	4.4	%
Total	4,027	100.0	%	3,871	100.0	%	3,688	100.0	%

\* Mainly consists of revenues from inbound roaming services, hosting services and network sharing services.

A breakdown of revenues according to types of subscription plans (pre-paid and post-paid) during 2018 compared with 2017, shows a 4.4% decrease in revenues attributable to post-paid subscribers and a 7.7% decrease in revenues attributable to pre-paid subscribers. The decrease in revenues attributable to post-paid subscribers was primarily the result of the ongoing erosion in the price of cellular services, resulting from the intensified competition in the cellular market. The decrease in revenues attributable to pre-paid subscribers resulted mainly from increased churn of pre-paid cellular subscribers, as well as from the ongoing price erosion.

A breakdown of revenues according to types of subscription plans (pre-paid and post-paid) during 2017 compared with 2016, shows a 2.8% decrease in revenues attributable to post-paid subscribers and a 5.8% decrease in revenues attributable to pre-paid subscribers. The decrease in revenues attributable to post-paid subscribers was primarily the result of the ongoing erosion in the price of cellular services, resulting from the intensified competition in the cellular market. The decrease in revenues attributable to pre-paid subscribers resulted mainly from increased churn of pre-paid cellular subscribers, as well as from the ongoing price erosion.

### Segment Revenues Discussion

We operate in two operating segments:

Cellular Segment – this segment includes the cellular communications services, cellular equipment and supplemental services.

Fixed-line Segment – this segment includes landline telephony services, internet infrastructure and connectivity services (ISP), television services, transmission services landline equipment and supplemental services.

These segments are managed separately for the purposes of allocating resources and assessing performance.

We started presenting our operations in these two segments as of January 1, 2016.

We measure revenues on an operating segment basis. The following is a discussion of our revenues for our two operating segments:

	Year Ended December 31,			Change	
	2016	2017	2018	2017 vs. 2016	2018 vs. 2017
(In NIS millions)					
Cellular service revenues	2,162	1,929	1,730	(10.8)%	(10.3)%
Cellular equipment revenues	836	770	655	(7.9 )%	(14.9)%
Total cellular revenues	2,998	2,699	2,385	(10.0)%	(11.6)%
Fixed-line service revenues	1,071	1,166	1,215	8.9 %	4.2 %
Fixed-line equipment revenues	158	182	249	15.2 %	36.8 %
Total Fixed-line revenues	1,229	1,348	1,464	9.7 %	8.6 %
Consolidation adjustments	(200 )	(176 )	(161 )	(12 )%	(8.5 )%
Consolidated revenues	4,027	3,871	3,688	(3.9 )%	(4.7 )%

### Cellular Segment

Revenues from the cellular segment in 2018 totaled NIS 2,385 million (including inter-segment revenues), compared to NIS 2,699 million in 2017. The decrease was primarily due to a decline in service revenues of 10.3% resulting mainly from the ongoing erosion in the price of these services and from the difference between the national roaming services revenues until the end of the first quarter of 2017 and the revenues for rights of use in cellular networks according to the network sharing agreement with Golan which came into force as of the beginning of the second quarter of 2017 as well as a decrease in cellular equipment revenues of 14.9% compared to 2017.

Revenues from the cellular segment in 2017 totaled NIS 2,699 million (including inter-segment revenues), compared to NIS 2,998 million in 2016. The decrease was primarily due to a decline in service revenues of 10.8% resulting mainly from the ongoing erosion in the price of these services and from the difference between the national roaming services revenues in 2016 and the revenues for rights of use in cellular networks according to the network sharing agreement with Golan which came into force as of the beginning of the second quarter of 2017 and a decrease in cellular equipment revenues of 7.9% compared to 2016.

### Fixed-line Segment

Revenues for the fixed-line segment (including inter-segment revenues) in 2018 totaled NIS 1,464 million, compared to NIS 1,348 million in 2017. This increase resulted mainly from an increase in revenues from TV and internet services, as well as of fixed-line communications services provided according to the network sharing agreement with Golan as of the beginning of the second quarter of 2017 and an increase in fixed-line equipment revenues.

Revenues for the fixed-line segment (including inter-segment revenues) in 2017 totaled NIS 1,348 million, compared to NIS 1,229 million in 2016. This increase resulted mainly from an increase in revenues from TV and internet services, as well as of fixed-line communications services provided according to the network sharing agreement with Golan.

### Segment Adjusted EBITDA Discussion

We measure adjusted EBITDA on an operating segment basis. See note 6 to our financial statements included elsewhere in this report for details of this measure of segment profitability. We define segment adjusted EBITDA as income for a segment before financing income (expenses), net; other income (expenses), net (excluding gain from the

sale of a subsidiary and expenses related to employee retirement plans); income tax; depreciation and amortization; and share based payments.

## Cellular segment

In 2018, the cellular segment generated adjusted EBITDA of NIS 391 million compared to NIS 595 million in 2017, a 34.3% decrease. This decrease resulted mainly from the ongoing erosion in cellular service revenues.

In 2017, the cellular segment generated adjusted EBITDA of NIS 595 million compared to NIS 625 million in 2016, a 4.8% decrease. This decrease resulted mainly from the difference between national roaming services revenues in 2016 and the revenues for rights of use in cellular networks according to the network sharing agreement with Golan in 2017, and from the ongoing erosion in cellular service revenues. This decrease was partially offset by a decrease in selling and marketing expenses due to the capitalization of part of the customer acquisition costs as a result of the early adoption of a new International Financial Reporting Standard (IFRS15).

## Fixed-line segment

In 2018, the fixed-line segment generated adjusted EBITDA of NIS 269 million compared to NIS 258 million in 2017, a 4% increase. The increase arose mainly as a result of an increase in revenues from internet and TV services as well as fixed-line communications services provided according to the network sharing agreement with Golan since the second quarter of 2017 .

In 2017, the fixed-line segment generated adjusted EBITDA of NIS 258 million compared to NIS 233 million in 2016, a 10.7% increase. The increase arose mainly as a result of an increase in revenues from fixed-line communications services provided according to the network sharing agreement with Golan and from a decrease in operating expenses. This increase was partially offset as a result of an erosion in the internet field profitability, as well as from the deconsolidation of Internet Rimon following its sale.

## Cost of revenues and gross profit

	Year Ended December 31,			Change	
	2016	2017	2018	2017 vs. 2016	2018 vs. 2017
	(In NIS millions)				
Cost of service revenues	2,028	2,035	2,019	0.3 %	(0.8 )%
Cost of equipment revenues	674	645	642	(4.3 )%	(0.5 )%
Total cost of revenues	2,702	2,680	2,661	(0.8 )%	(0.7 )%
Gross profit	1,325	1,191	1,027	(10.1)%	(13.8)%

The decrease in cost of service revenues in 2018 compared with 2017 resulted mainly from decrease in interconnect costs, depreciation and repair services. This decrease was partially offset by an increase in costs of TV services content and in costs related to internet services in the fixed-line segment.

The decrease in cost of equipment revenues resulted mainly from a decrease in costs of end user equipment sold, primarily as a result of a decrease in the quantity of end user equipment sold in the cellular segment during 2018 as compared to 2017, which was partially offset by an increase in fixed-line equipment costs.

The increase in cost of service revenues in 2017 compared with 2016 resulted mainly from an increase in costs of TV services content and in costs related to internet services in the fixed-line segment. This increase was partially offset by a decrease in costs resulting from Golan's participation in operating costs according to the network sharing agreement with Golan.



The decrease in cost of equipment revenues resulted mainly from a decrease in costs of end user equipment sold, primarily as a result of a decrease in the quantity of end user equipment sold in the cellular segment during 2017 as compared to 2016.

The decrease in gross profit in 2018 compared with 2017 resulted mainly from the ongoing erosion in the price of cellular services.

The decrease in gross profit in 2017 compared with 2016 resulted mainly from the ongoing erosion in the price of cellular services.

#### Selling and marketing expenses and general and administrative expenses

	Year Ended December 31,			Change	
	2016	2017	2018	2017 vs. 2016	2018 vs. 2017
	(In NIS millions)				
Selling and marketing expenses	574	479	567	(16.6)%	18.4 %
General and administrative expenses	420	426	360	1.4 %	(15.5)%
Total	994	905	927	(8.9 )%	2.4 %

The increase in selling and marketing expenses in 2018 compared with 2017, is primarily the result of an increase in depreciation of acquisition costs that were capitalized as a result of the early adoption of a new International Financial Reporting Standard (IFRS 15) as of January 1, 2017.

The decrease in selling and marketing expenses in 2017 compared with 2016, is primarily the result of a decrease in salaries and commissions expenses due to the capitalization of part of the customer acquisition costs as a result of the early adoption of a new International Financial Reporting Standard (IFRS 15) as of January 1, 2017. The effect of the adoption of the standard on 2017 expenses was in a total amount of NIS 93 million (\$27 million).

The decrease in general and administrative expenses in 2018 compared with 2017 resulted mainly from a decrease in salaries and related expenses as well as a decrease in doubtful debts..

The increase in general and administrative expenses in 2017 compared with 2016 resulted mainly from an increase in doubtful debts in 2017 compared to 2016.

#### Other income (expenses), net

	Year Ended December 31,		
	2016	2017	2018
	(In NIS millions)		
Other income (expenses), net	(21)	11	(26 )

Other expenses in 2018 mainly includes expense of NIS 26 million following employee voluntary retirement plan executed in the second quarter of 2018. Other income in 2017 includes mainly a gain from the sale of a subsidiary (Internet Rimom) in the amount of approximately NIS 10 million.

Other income in 2017 mainly includes a gain from the sale of subsidiary Internet Rimon, in the amount of approximately NIS 10 million. Other expenses in 2016 primarily include an expense of NIS 13 million following an employee voluntary retirement plan executed in the second quarter of 2016.

#### Financing expenses, net

	Year Ended December 31,		
	2016	2017	2018
	(In NIS millions)		
Financing expenses	(196)	(196)	(190)
Financing income	46	52	46
Financing expenses, net	(150)	(144)	(144)

Financing expenses, net, for 2018 was similar to expenses, net, in 2017 and resulted mainly from losses in the Company's investment portfolio in 2018 due to capital market losses in the last quarter of 2018, which were offset by a decrease of the interest of debentures of the Company.

Financing expenses, net, for 2017 decreased 4.0% compared with 2016. The decrease resulted mainly from higher gains in the Company's investment portfolio in 2017 compared to 2016.

#### Income tax

	Year Ended December 31,			Change	
	2016	2017	2018	2017 vs. 2016	2018 vs. 2017
	(In NIS millions)				
Taxes on income(tax benefit)	10	40	(6 )	400%	na

Taxes on income for 2018 totaled NIS 6 million as a result of the loss before taxes on income that the Company recorded in 2018, which was partially offset by tax expenses due to non-deductible expenses.

In January 2019, after the end of the reporting period, the Israeli Tax Authority issued a best judgment assessment for 2014 to the Company, generally due to timing differences. According to the assessment, if the Company's claims are rejected, the Company will be required to pay additional income tax in relation to the year 2014, in an amount of approximately NIS 56 million (including interest and Israeli CPI differences). The Company filed an objection to the tax assessment.

Taxes on income for 2017 increased 400% compared with 2016. This increase resulted mainly from the positive effects in 2016 of a tax assessment agreement for the years 2012-2013 and from recording income deferred tax in 2016 following a decrease in the corporate tax rate for the years 2017 and thereafter.

## Net income (Loss)

	Year Ended December 31,			Change	
				2017	2018
				vs.	vs.
	2016	2017	2018	2016	2017
(In NIS millions)					
Net income (loss)	150	113	(64 )	(24.6)%	na

The loss in 2018 totaled 64 million, primarily due to a decrease in operating profit mainly from the ongoing erosion in the price of cellular services.

The decrease in net income in 2017 compared with 2016, was primarily due to a decrease in operating profit mainly from the ongoing erosion in the price of cellular services and from a tax income in 2016, as a result of a tax assessment agreement for the years 2012-2013 and a decrease in corporate tax rate for the years 2017 and thereafter.

## B. LIQUIDITY AND CAPITAL RESOURCES

### General

Our liquidity requirements relate primarily to working capital requirements, debt service, capital expenditures for the expansion and enhancement of our networks, end user equipment and payment of dividends, to the extent declared. We fund these requirements through cash flows from operations, raising new debt and issuances of equity securities, including ordinary shares.

Since institutional investors were required to follow certain procedures and requirements pursuant to Israeli regulation before investing in non-governmental debentures, our series F and H through L indentures include certain limitations and covenants. For additional details see "– Debt Service" below. These limitations are generally also included in our other credit facilities (see "– Other Credit Facilities" below) and are expected to apply to any additional debt incurred by us. These procedures, limitations and covenants limit our freedom to conduct our business, may impose additional costs on us and may limit our ability to borrow additional debt from Israeli institutional investors as well as adversely affect the terms and price of such debt raising.



In May 2012 and June 2013, the rating of our debentures was downgraded. Though the rating of our debentures remained stable since then, any downgrade in our ratings may adversely affect the terms and price of our debt or additional debt raised, particularly through the issuance of debentures to institutional investors, which, given the limitation on the ability of Israeli banks to lend money to us pursuant to the “Guidelines for Sound Bank Administration” issued by the Israeli Supervisor of Banks (as for that purpose we are deemed to be included in the same group as DIC), may limit our ability to obtain additional financing to operate, develop and expand our business or to refinance existing debt. We believe that our sources of liquidity and capital resources, are adequate for our current requirements and business operations and should be adequate to satisfy our anticipated cash needs for working capital, capital expenditures, other current corporate needs and debt service for at least the next 12 months. Our future capital requirements will depend on many factors, including the level of revenues, the timing and extent of spending to support marketing and subscriber retention efforts, the expansion of sales and marketing activities and the timing of introductions of new products and enhancements of existing products, the level and timing of investing in our networks and services, including our OTT TV, internet infrastructure the investment in IBC and the purchase of additional frequencies and IOT services and any decision to reinstate dividends. Our Board of Directors would not expect to reinstate dividends unless it believes that our cash flow and available reserves will be sufficient to fund our needs, including our dividends. In February 2006, our Board of Directors adopted a policy to distribute each year at least 75% of our annual net income, on a quarterly basis, as dividends, subject to compliance with applicable law, our license and contractual obligations and so long as the distribution would not be detrimental to our cash needs or to any plans approved by our Board of Directors. We undertook limitations on dividend distributions in our indentures of series F and H through L debentures and in other credit facilities. See “Item 8. Financial Information – A. Consolidated Statements and Other Financial Information – Dividend Policy”, “– Debt Service” and “–Other Credit Facilities” below. In respect of 2018, our Board of Directors chose not to declare dividends given the intensified competition and its adverse effect on our results of operations and in order to strengthen our balance sheet. It is possible that our Board of Directors’ estimate of our cash needs will be incorrect, or that events could occur that could increase our cash needs beyond anticipated. If that occurs, we may not have sufficient cash to cover these needs as a result of various expenditures previously made by the Company, including prior investments and expenses and prior dividend payments, and we would need to identify additional sources of financing, which could include equity or debt financing. We may not be able to obtain such financing on acceptable terms or at all.

#### Dividend payments

In 2016, 2017 and 2018 our Board of Directors chose not to declare dividends given the intensified competition and its adverse effect on our results of operations and in order to strengthen our balance sheet.

#### Shelf Prospectus

In August 2017, we filed a shelf prospectus with the Israeli Securities Authority, or ISA, and the Tel Aviv Stock Exchange, or TASE. The shelf prospectus allows us, from time to time, until August 2019 (or if approved by the ISA, subject to certain conditions, until August 2020), to offer and sell various securities including debt and equity, in Israel, in one or more offerings, subject to filing a supplemental shelf offering report that describes the terms of the securities offered and the specific details of the offering and the prior approval of the TASE of the supplemental shelf offering report.

At this stage, no decision has been made as to the execution of any offering, nor as to its scope, terms and timing, if executed, and there is no certainty that such offering will be executed.

The shelf prospectus includes our undertaking to comply with certain reporting obligations under the Israeli Securities Law in the event of certain warning signs of financial stress.

## Issuances of equity securities

In June 2018, the Company issued in an offering to the public in Israel only for a total net immediate consideration from the offering of approximately NIS 275 million:

- 12,121,200 ordinary shares of the Company (par value NIS 0.01 per share, or ordinary shares).

- 3,030,300 Series 1 Options. Each Series 1 Option entitled the holder thereof to purchase one ordinary share at an exercise price of NIS 19.50, until December 24, 2018. Series 1 Options were exercised for a total consideration of NIS 59 million.

- 3,030,300 Series 2 Options. Each Series 2 Option entitles the holder thereof to purchase one ordinary share at an exercise price of NIS 20, until June 24, 2019.

The offering was made in Israel only under the Company's Israeli 2017 shelf prospectus and the securities were registered for trading on the Tel Aviv Stock Exchange.

## Debt service

### Public debentures

Our Series F and G debentures were issued in March 2012 to the public in Israel under our 2011 shelf prospectus (as amended in March 2012) and were listed for trading on the Tel Aviv Stock Exchange. As of December 31, 2018, Series F debentures consisted of approximately NIS 429 million (\$114 million) aggregate principal amount debentures (and in January 2019, we repaid a principal payment in the amount of approximately NIS 214 million (\$57 million)) and Series G approximately NIS 86 million (\$23 million) aggregate principal amount debentures (and in January 2019, we repaid Series G debentures in full).

The Series F principal is payable in four annual installments: one payment of 10% of the principal on January 5, 2017, and three equal annual installments of 30% of the principal, on January 5 of each of the years 2018 through 2020 (inclusive). The interest on Series F debentures is payable in semi-annual installments on January 5 and on July 5, of each calendar years commencing July 5, 2012 through January 5, 2020 (inclusive). Series F debentures bear an interest rate of 4.35% per annum, linked to the Israeli CPI for February 2012. In June 2013, following the ratings decrease discussed above, the annual interest rate for our Series F debentures was increased by 0.25% to 4.60%, beginning July 5, 2013.

The Series F debentures are unsecured and contain, in addition to standard terms and obligations, the following obligations:

- a negative pledge, subject to certain exceptions;

- a covenant not to distribute more than 95% of the profits available for distribution according to the Companies Law ("Profits"); provided that if our net leverage (defined as the ratio of net debt to EBITDA during a period of 12 consecutive months, excluding one-time events) exceeds 3.5:1, we will not distribute more than 85% of our Profits and if our net leverage exceeds 4.0:1, we will not distribute more than 70% of our Profits. For this purpose, net debt is defined as credit and loans from banks and others and debentures, net of cash and cash equivalents and current investments in tradable securities; and EBITDA is defined as profit before depreciation and amortization, other expenses or income, net, financing expenses or income, net and taxes on income;

- a limitation on our ability to voluntarily redeem the debentures prior to their stated maturity date to a minimum amount of NIS 100 million of each series of debentures and an undertaking to pay the holders of such debentures an additional annual interest of 1% in the event of such early redemption;
- a covenant to have the debentures rated by a rating agency (in as much as under our control);
- an obligation to pay additional interest of 0.25% for a two-notch downgrade in the debentures' rating and additional interest of 0.25% for each additional one-notch downgrade and up to a maximum addition of 1%, in comparison to the rating given to the debentures prior to their issuance;
- a covenant not to issue additional debentures of the relevant series if the additional issuance by itself, will cause a certain rating downgrade.

We also agreed to the addition of the certain events to the list of events of default of the Series F debentures, including:

- cross default, excluding following an immediate repayment initiated in relation to a liability of NIS 150 million or less;
- failure of our main business to be cellular communications or loss of our cellular license for a period of over 60 days;
- suspension of trading of the debentures on the TASE over a period of 45 days;
- failure to comply with the above covenant regarding limitations on dividend distributions;
- failure to have the debentures rated over a period of 60 days;
- a petition or court order to withhold all legal proceedings against us or petition for creditors arrangement filed;
- the sale of a major part of our assets or merger (with certain exclusions);
- failure to publish financial reports when due;
- a net leverage in excess of 5.0:1, or in excess of 4.5:1 during four consecutive quarters;
- failure to comply with our negative pledge covenant; and
- any other event causing or expected to cause a material adverse effect (which shall not include any event that shall or is likely to cause our net leverage to increase to a ratio of under 5.0:1) on our business and posing real threat of a substantial damage to the debenture holders' rights.

Our Series H and I debentures were issued in July 2014 to the public in Israel under our 2014 shelf prospectus and were listed for trading on the Tel Aviv Stock Exchange. In February 2015, pursuant to an exchange offer under our 2014 shelf prospectus and in a private offering, we issued approximately NIS 844 million (\$225 million) principal amount of Series H debentures and approximately NIS 335 million (\$89 million) principal amount of series I debentures in exchange for approximately NIS 555 million (\$148 million) principal amount of Series D debentures and approximately NIS 272 million (\$73 million) principal amount of Series E debentures, respectively. Series D and Series E were fully repaid. In March 2016, we issued approximately NIS 246 million (\$66 million) aggregate principal amount of additional Series I debentures to certain institutional investors in a private offering. As of December 31, 2018, our Series H and I debentures consisted of approximately NIS 836 million (\$223 million) principal amount and NIS 724 million (\$193 million) principal amount, respectively.

The Series H debentures principal is payable in seven annual installments: three equal annual installments of 12% of the principal on July 5 of the years 2018 through 2020 (inclusive), and four equal annual installments of 16% of the principal on July 5 of the years 2021 through 2024 (inclusive). The interest on the Series H debentures is payable in semi-annual installments on January 5 and on July 5, of each calendar year commencing on January 5, 2015 through July 5, 2024 (inclusive). The Series H debentures bear an interest rate of 1.98% per annum, linked to the Israeli Consumer Price Index for May 2014.

The Series I debentures principal is payable in eight annual installments: three equal annual installments of 10% of the principal on July 5 of the years 2018 through 2020 (inclusive), and five equal annual installments of 14% of the principal on July 5 of the years 2021 through 2025 (inclusive). The interest on the Series I debentures is payable in semi-annual installments on January 5 and on July 5 of each calendar year commencing on January 5, 2015 through July 5, 2025 (inclusive). The Series I debentures bear an interest rate of 4.14% per annum, without any linkage.

The Series H and I debentures are unsecured and contain, in addition to standard terms and obligations and the above undertakings in our Series F indenture which generally apply to our Series H and I debentures as well, the following obligations:

· in addition to being an event of default, meeting the financial covenants would be a condition for dividend distribution; and

· meeting the financial covenants would also be a condition for the issuance of additional debentures of each of the two new series.

The Series H and I Indenture contains substantially similar events of default to those included in the Series F Indenture, with the addition of certain events of default that do not appear in the Series F Indenture as well as certain modifications to the events of default that are included in the Series F Indenture, including:

· breach of the above limitation on dividend distributions;

· the minimum amount required for triggering a cross default shall not apply to a cross default triggered by another series of debentures;

· the existence of a real concern that we shall not meet our material undertakings towards the debenture holders;

the inclusion in our financial statements during a period of two consecutive quarters of a note regarding the existence of significant doubt as to our ability to continue as a going concern; and

·breach of our undertakings regarding the issuance of additional debentures.

Our Series J and K debentures were issued in September 2016 to the public in Israel under our 2014 shelf prospectus and were listed for trading on the Tel Aviv Stock Exchange. In July 2018, we issued NIS 220 million (\$59 million) principal amount of additional series K debentures in a private offering to certain Israeli institutional investors according to our June 2017 agreement with such investors. In December 2018, we issued approximately NIS 187 million (\$50 million) principal amount of additional series K debentures to the public in Israel under our 2017 shelf prospectus. As of December 31, 2018, our Series J and K debentures consisted of approximately NIS 103 million (\$27 million) principal amount and NIS 711 million (\$190 million) principal amount, respectively.

The Series J debentures principal is payable in six installments, of which the first four installments of 15% of the principal each are payable on July 5 of the years 2021 through 2024, and the remaining two installments of 20% of the principal each are payable on July 5 of the years 2025 and 2026. The interest on the Series J debentures is payable on January 5 and on July 5 of each of the years 2017 through 2026. The Series J debentures bear interest at the rate of 2.45% per annum, linked to the Israeli Consumer Price Index for August 2016.

The Series K debentures principal is payable in six installments, of which the first four installments of 15% of the principal each are payable on July 5 of the years 2021 through 2024, and the remaining two installments of 20% of the principal each are payable on July 5 of the years 2025 and 2026. The interest on the Series K debentures is payable on January 5 and on July 5 of each of the years 2017 through 2026. The Series K debentures bear interest at the rate of 3.55% per annum, without linkage.

The Series J and Series K debentures are unsecured and contain standard terms and conditions in addition to certain additional undertakings by us generally similar to the terms of our Series H and Series I debentures.

Our Series L debentures were issued in January 2018 to the public in Israel under our 2017 shelf prospectus and were listed for trading on the Tel Aviv Stock Exchange. In December 2018, we issued approximately NIS 213 million (\$57 million) principal amount of additional series L debentures to the public in Israel under our 2017 shelf prospectus. As of December 31, 2018, our Series L debentures consisted of approximately NIS 614 million (\$164 million) principal amount.

The Series L debentures principal is payable in six installments, of which the first four installments of 15% of the principal are each payable on January 5 of the years 2023 through 2026, and the remaining two installments of 20% of the principal are each payable on January 5 of the years 2027 and 2028. The interest on the Series L debentures is payable on January 5 of each of the years 2019 through 2028. The Series L debentures bear interest at the rate of 2.5% per annum, without linkage.

The Series L debentures are unsecured and contain standard terms and conditions in addition to certain additional undertakings by us generally similar to the terms of our Series J and Series K debentures, with a change to the additional interest to be paid in case of a two-notch downgrade in the debentures' credit rating to 0.5% (with no change to the maximum additional interest).

As of December 31, 2018, we complied with the above covenants.

#### Other credit facilities

In May 2015, we entered into a loan agreement with two Israeli financial institutions, or Lenders, according to which the Lenders have agreed, subject to certain customary conditions, to provide us two deferred loans for the total principal amount of NIS 400 million (\$115 million), without any linkage, as follows:

A principal amount of NIS 200 million (\$53 million) was provided to us in June 2016, and bears an annual fixed interest of 4.6%. The loan's principal amount is payable in four equal annual payments on June 30 of each of the years 2018 through 2021 (inclusive). The interest will be paid in ten semi-annual installments on June 30 and December 31, of each calendar year commencing December 31, 2016 through and including June 30, 2021. As of December 31, 2018, the outstanding principal amount under this loan is NIS 150 million (\$40 million).

A principal amount of NIS 200 million (\$53 million) was provided to us in June 2017, and bears an annual fixed interest of 5.1%. The loan's principal amount is payable in four equal annual payments on June 30 of each of the years 2019 through 2022 (inclusive). The interest will be paid in ten semi-annual installments on June 30 and December 31, of each calendar year commencing December 31, 2017 through and including June 30, 2022.

Under the agreement, the interest rate may be subject to certain adjustments. We may cancel or prepay one or both loans, subject to a certain cancellation fee or prepayment fee, as applicable. The agreement includes standard terms and obligations and also generally includes the negative pledge, limitations on distributions, events of default and financial covenants applicable to our series F, H and I debentures.

In August 2015, we entered into a loan agreement with an Israeli bank, or Lender, according to which the Lender has agreed, subject to certain customary conditions, to provide us a deferred loan in a principal amount of NIS 140 million (\$37 million), without any linkage, which was provided to us in December 2016, and bears an annual fixed interest of 4.9%. The loan's principal amount is payable in five equal annual payments on June 30 of each of the years 2018 through 2022 (inclusive), and the interest will be payable in 11 semi-annual installments on June 30 and December 30 of each calendar year commencing June 30, 2017 through and including June 30, 2022. As of December 31, 2018, the outstanding principal amount under this loan is NIS 112 million (\$30 million).

Under the Agreement, the interest rate may be subject to certain adjustments. We may prepay the loan, subject to a prepayment fee. The agreement also includes certain events which if not approved by the Lender allow the Lender to notify us of an acceleration of the repayment of the loan.

The agreement includes standard terms and obligations and also generally includes the negative pledge, limitations on distributions, financial covenants and event of defaults applicable to our series F, H and I debentures, with certain modifications, including foreclosure, materialization of a pledge, execution actions, receivership and (subject to certain exclusions) sale of assets in a specified certain lower amount, a failure to operate in a field which is material to our operations, and mergers and changes of formation (with more limited exclusions) will trigger an event of default. In case we provide stricter financial covenants to another financial institution or debenture holder, those will apply to this agreement as well.

In June 2017, we entered into an additional loan agreement with the Lender according to which the Lender has agreed, subject to certain customary conditions, to provide us a deferred loan in a principal amount of NIS 150 million (\$40 million), unlinked, in March 2019, which will bear an annual fixed interest of 4%. The loan's principal amount will be payable in four equal annual payments on March 31 of each of the years 2021 through and including 2024 and the interest will be payable in ten semi-annual installments on March 31 and September 30 of each calendar year, commencing September 30, 2019 through and including March 31, 2024. Until the provision of the loan, we are required to pay the Lender a commitment fee. The agreement includes similar terms and obligations to those included in our August 2015 loan agreement and applies the right to demand immediate repayment of either or both loans due to certain events of default under either agreement.

As of December 31, 2018, we complied with the above covenants.

In the ordinary course of business, from time to time, we and our subsidiaries, enter into framework agreements with banks for various banking services, such as credit lines and hedging transactions. In 2015, we entered into an extended payment terms agreement with a bank in relation to a certain supplier, which includes terms similar to our loan agreements and we allow such arrangements requested by our suppliers from time to time.

#### Capital expenditure

Our accrual capital expenditure in 2016, 2017 and 2018 amounted to NIS 382 million, NIS 550 million and NIS 647 million, respectively. Accrual capital expenditure is defined as investment in fixed assets and intangible assets, such as investments in our communications networks, fiber-optic infrastructure, information systems, software and TV set-top boxes and as from 2017, capitalization of part of the customer acquisition costs as a result of the early adoption of a new International Financial Reporting Standard (IFRS15).

#### Cash flows from operating activities

Cash flows from operating activities totaled NIS 770 million in 2018, a decrease from NIS 774 million in 2017. The decrease in cash flow is primarily attributed to a decrease in proceeds from customers due to the decrease in service revenues.

Cash flows from operating activities totaled NIS 774 million in 2017, a decrease from NIS 781 million in 2016. The decrease in cash flow is primarily attributed to a decrease in proceeds from customers due to the decrease in service revenues.

#### Cash flows from investing activities

The net cash flows from operating activities is the main capital resource for our investment activities. In 2016, 2017 and 2018, our net cash used in investing activities amounted to NIS 364 million, NIS 644 million and NIS 631 million, respectively. The payments were used primarily for the improvement and expansion of our networks, fiber-optic infrastructure and information systems. The decrease in 2018 compared with 2017 resulted mainly from a decrease in our current investments in debt securities and shares. The increase in 2017 compared with 2016 resulted mainly from higher cash capital expenditures in fixed assets and intangible assets and others in 2017 mainly due to the capitalization of part of the customer acquisition costs as a result of the early adoption of a new International Financial Reporting Standard (IFRS15) as compared to 2016 and of our current investments in tradable debentures.

#### Cash flows from financing activities

In 2018, net cash received in financing activities amounted to NIS 537 million compared to NIS 843 million used in 2017. The net cash we received is primarily attributable to issuances of debentures and equity offering in 2018.

In 2017, net cash used in financing activities amounted to NIS 843 million compared to NIS 62 million received in 2016. The net cash we used is primarily attributable to payments of principal and interest for our debentures.

#### Working capital

Our working capital as of December 31, 2018 was NIS 1269 million, compared with NIS 692 million as of December 31, 2017. The decrease in working capital was primarily due to an increase in cash and cash equivalents as a result of issuances of debentures and equity offering in 2018.

Our working capital as of December 31, 2017 was NIS 692 million, compared with NIS 1,074 million as of December 31, 2016. The decrease in working capital was primarily due to a decrease in cash and cash equivalents.

#### Trade receivables

Trade receivables consist of outstanding amounts due from customers, mainly for cellular, internet infrastructure and connectivity and landline telephony services and handsets and accessories, net of the allowance for doubtful accounts. Most of our handset sales are made on an installment basis (generally, 36 monthly payments). Installments due in the twelve months following the balance sheet date are included in current trade receivables; the remaining installments are included in long-term receivables. As of December 31, 2018, net current trade receivables amounted to NIS 1,152 million compared with NIS 1,280 million as at December 31, 2017 and NIS 1,325 million as at December 31, 2016. Net long-term trade receivables as of December 31, 2018 amounted to NIS 370 million compared with NIS 412 million as at December 31, 2017 and NIS 461 million as at December 31, 2016. The decrease in trade receivables (current and long-term) in 2018 compared with 2017 was mainly due to a decrease in service and equipment revenues. The decrease in trade receivables (current and long-term) in 2017 compared with 2016 was mainly due to a decrease in service and equipment revenues. . The current maturity of long-term receivables as of December 31, 2018 was NIS 466 million, compared with NIS 523 million as of December 31, 2017 and NIS 566 million as of December 31, 2016.

#### C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.

Not applicable.



## D. TREND INFORMATION

Trend information is included throughout the other sections of this Item 5.

## E. OFF-BALANCE SHEET ARRANGEMENTS

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, except future commitments and agreements that are detailed in this report.

## F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

Set forth below is a description of our contractual cash obligations, in millions of NIS, as of December 31, 2018.

	Total	2019	2020-2021	2021-2022	2023 and Beyond
Long-term debt obligations (including interest)(1)	4,512	757	1,248	1,068	1,433
Operating lease obligations	741	283	316	119	23
Purchase obligations	452	275	138	39	-
Total	5,705	1,315	1,702	1,226	1,462

(1) Interest does not include any increase in interest that would be required based on increases in the Israeli CPI.

## Application of Critical Accounting Policies and Use of Estimates

The preparation of our financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the amounts reflected in the consolidated financial statements and accompanying notes, and related disclosure of contingent assets and liabilities. We base our estimates upon past experience, where applicable, various factors, external sources and on other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, and could have a material impact on our reported results.

In many cases, the accounting treatment of a particular transaction, event or activity is specifically dictated by accounting principles and does not require management's judgment in its application, while in other cases, management's judgment is required in the selection of the most appropriate alternative among the available accounting principles, that allow different accounting treatment for similar transactions.

We believe that the accounting policies discussed below are critical to our financial results and to the understanding of our past and future performance, as these policies relate to the more significant areas involving management's estimates and assumptions. We consider an accounting estimate to be critical if: (1) it requires us to make assumptions because information was not available at the time or it included matters that were highly uncertain at the time we were making our estimate and (2) changes in the estimate or different estimates that we could have selected may have had a material impact on our financial condition or results of operations.

## Long-lived assets – depreciation

### Nature of critical estimate items

The communications industry is capital intensive. The depreciation of operating assets constitutes a significant operating cost for us. We have substantial investments in tangible long-lived assets, primarily our communications networks.

### Assumptions / approach used

We depreciate our property, plant and equipment using the straight-line method. Separate individual significant components are depreciated over their individual estimated useful lives. We periodically review changes in our technology and industry conditions to determine adjustments to estimated remaining useful lives and depreciation rates.

### Effect if different assumptions used

Changes in technology or changes in our intended use of these assets can cause the estimated period of use or the value of these assets to change. Actual economic lives may differ from estimated useful lives. Periodic reviews could result in a change in our assets' depreciable lives, and therefore, in our depreciation expense in future periods.

## Impairment of long-lived assets

### Nature of critical estimate items

### Finite-lived long-lived assets

At each reporting date, we review finite-lived long-lived assets, principally consisting of property, plant and equipment, spectrum licenses and intangible assets for impairment based on the requirements of International Accounting Standard No. 36, whenever events or changes in circumstances indicate that their carrying values may not be recoverable through the present value of anticipated cash flows from the continued use of the asset, including those expected at the time of its future retirement and disposal. Where it is not possible to estimate the recoverable amount of an individual asset, we group together all of the assets that cannot be tested individually into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit"), and estimate the recoverable amount of the cash-generating unit to which the asset belongs. The recoverable amount is the higher of value in use and fair value less cost to sell. Value in use is determined by discounting the expected future cash flows, we expect to derive from the asset, using a pre-tax discount rate. An impairment loss is recognized if the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss.

### Indefinite-lived intangible assets

Once a year and for the same date, or more frequently if there are indications of impairment, we estimate the recoverable amount of each cash-generating unit that contains goodwill. Cash-generating units to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. We monitor goodwill at operating segments level. As regards cash-generating units that include goodwill, an impairment loss is recognized when the carrying amount of the cash-generating unit, after adjustment for goodwill, exceeds its recoverable amount.

#### Assumptions / approach used

In analyzing finite-lived long-lived assets and Indefinite-lived intangible assets for potential impairment, significant assumptions that are used in determining the discounted cash flows of the asset group include:

- cash flows attributed to the asset group;
  - future cash flows for the asset group, including estimates of residual values, which incorporate our views of growth rates for the related business and anticipated future economic conditions; and
  - period of time over which the assets will be held and used.
- Key assumptions used in the calculation of recoverable amounts are discount rate and terminal value growth rate.

#### Effect if different assumptions used

The use of different estimates and assumptions within our discounted cash flow models (e.g., terminal value growth rates, pre-tax discount rate, future economic conditions, estimates of residual values) could result in discounted cash flows that are lower than the current carrying value of an asset group, thereby requiring the need to reduce the carrying value to the discounted cash flow amount.

The use of different discount rates when determining the fair value of the asset group could result in different fair values, and impact any related impairment charges.

#### Change in estimates in finite-lived long-lived assets

During the year ended December 31, 2017 management has updated estimates as follows: Towards the end of the Company's 2G and 3G frequencies (the "Frequencies") original amortization period, the Company's annual depreciation committee examined the estimated useful life of the Frequencies. Based on Company's estimate, the Company will continue to use the Frequencies at least for the next 10 years.

The estimated useful life of the Frequencies was determined in the past according to the period of the Company's cellular license (until 2022).

According to applicable law, the Company's cellular license may be extended for additional 6-year periods, subject to the requirements set in the license. The Company estimates that based on its experience and acquaintance with the communications market in Israel, if current conditions continue, there is high probability that the license will be extended for an additional term of 6 years.

In light of the aforesaid, the estimated useful life of the Frequencies has been re-evaluated for the first time, for an additional period of ten years, starting from the beginning of the second quarter of 2017 and ending in 2028 (instead of 18-20 years ending in 2022, as originally estimated).

## Accounts receivable - bad debt and allowance for doubtful accounts

### Nature of critical estimate items

We maintain an allowance for doubtful accounts to reflect estimated losses resulting from impairment of accounts receivables.

### Assumptions / approach used

We regularly evaluate the adequacy of our allowance for doubtful accounts by taking into account variables such as past experience, age of the receivable balance and current economic conditions of the party owing the receivable balance. If the financial conditions of certain customers were to deteriorate, resulting in impairment in their ability to make payments, additional allowance for doubtful accounts may be required.

### Effect if different assumptions used

We believe that our allowance for doubtful accounts is adequate to cover estimated losses in customer accounts receivable balances under current conditions. However, changes to the allowance for doubtful accounts may be necessary in the event that the financial condition of our customers improves or deteriorates.

### Change in estimates

As from January 1, 2018 the Group applies IFRS 9, Financial Instruments The standard includes a new 'expected credit loss' model, which following its application, the amount of the provision for impairment of all the financial assets decreased by an amount of NIS 12 million as at January 1, 2018.

### Provisions for contingent liabilities

Provisions in general are highly judgmental, especially in cases of legal disputes. We assess the probability of an adverse event as a result of a past event and if the probability is evaluated to be more likely than not and the amount of the obligation can be estimated reliably, we fully provide for the total amount of the estimated contingent liability. We continually evaluate our pending provisions to determine if additional accruals are required. It is often difficult to accurately estimate the ultimate outcome of a contingent liability. Different variables can affect the timing and amount we provide for certain contingent liabilities. Our provisions are therefore subject to estimates made by us having taken into consideration the opinion of our legal counsel, which are subject to changes as the status of legal and commercial disputes changes over time. Adverse revision in our estimates of the potential liability could materially impact our financial condition, results of operations or liquidity.

### Uncertain tax positions

When assessing amounts of current and deferred taxes, we take into consideration the effect of the uncertainty that our tax positions will be accepted and the effect of incurring any additional tax and interest expenses. We are of the opinion that the cumulative tax liability is fair for all the years in respect of which final tax assessments have not yet been received, based on an analysis of a number of matters including interpretations of tax laws and our past experience. This assessment is based on estimates and assumptions that may also include assessments and exercising judgment regarding future events. It is possible that new information will become known in future periods that will require us to change our estimate regarding the tax liability that was recognized, and any such changes will be expensed immediately in that period.

## Recognition of deferred tax asset in respect of tax losses

The Company assesses the probability that in the future there will be taxable profits against which carried forward losses can be utilized and accordingly the Company recognizes (or not recognizes) a deferred tax asset in respect of losses carried forward. In the absence of certainty for the existence of taxable income, deferred taxes are not recognized as an asset. The possible effects of this estimate is the recognition of additional income tax expenses.

## New Accounting Standards Not Yet Adopted

For details regarding new accounting standards not yet adopted see note 3-R to our financial statements included elsewhere in this report.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

## A. DIRECTORS AND SENIOR MANAGEMENT

The following table sets forth information regarding our directors, executive officers and other key employees as of December 31, 2018:

Name	Age	Position
Ami Erel (2), (3), (4)	72	Chairman of the Board
Mauricio Wior (2)	62	Vice Chairman of the Board
Shlomo Waxe (1), (2), (4)	73	Independent Director
Sholem Lapidot*	39	Director
Ephraim Kunda (1), (2), (4), (5)	66	Independent Director
Joseph Barnea (1), (2), (3), (4), (5)	83	Independent / External Director
Ronit Baytel (1), (2), (5)	51	Independent / External Director
Nir Sztern	48	President and Chief Executive Officer
Shlomi Fruhling	46	Chief Financial Officer
Yoni Sabag	46	Vice President of Marketing
Ron Shvili	51	Chief Technology Officer
Nadav Amsalem	45	Vice President of Business Customers
Sharon Amit	52	Vice President of Human Resources
Amos Maor	55	Vice President of Sales and Service
Liat Menahemi Stadler	52	Vice President of Legal Affairs and Corporate Secretary
Teimuraz Romashvili	40	Vice President of Pre Paid Activity
Yaniv Gruenwald**	44	Vice President of Television and Content
Ronnen Shles	51	Controller

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(1) Member of our Audit Committee.

(2) Member of our Analysis Committee.

(3) Member of our Option Committee.

(4) Member of our Security Committee.

(5) Member of our compensation Committee.

\* Since March 2018

\*\*In March 2019, Mr. Yaniv Gruenwald resigned from office and will leave his position within the next few months.

Ami Erel has served as Chairman of our Board of Directors since 2005. From 2014 to 2017 Mr. Erel provided consulting services to Discount Investment Corporation Ltd. (where he served as President and Chief Executive Officer from 2001 to 2013). Until 2011, Mr. Erel served a period as Chief Executive Officer and a period as Chairman of the board of directors. From 1997 to 1999, he served as President and Chief Executive Officer of Bezeq. From 2011 to 2016, Mr. Erel also served as Deputy Chairman of the Board of Directors of ADAMA Agricultural Solutions Ltd. (where he served from 2006 as a director and later as Chairman of the Board of Directors). Mr. Erel also serves as a director of Elron Electronic Industries Ltd. (where he served from 1999 to 2001 as President and until January 2007 as Chairman of the Board of Directors), Knafaim Holdings Ltd. and Dan hotels Ltd. Mr. Erel served as the chairman of the executive committee of the Manufacturers Association of Israel from 2005 to 2009 and from 2009 to 2011 he served as the chairman of the Israel Export & International Cooperation Institute. Mr. Erel holds a B.Sc. in electrical engineering from the Technion, Israel Institute of Technology.

Mauricio Wior has served as our Vice Chairman of our Board of Directors since January 2017. In January 2018, 2.5% of our outstanding share capital held by Koor was transferred (through a lending transaction) to a company controlled by Mr. Wior, following which Mr. Wior is considered joint controlling shareholder with Koor. Mr. Wior has served as Deputy Chairman of the Board of Directors of Shufersal Ltd. and of Israil Aviation and Tourism Ltd. since 2016, a member of the board of directors of IRSA Inversiones y Representaciones Sociedad Anónima, DIC's controlling shareholder, since 2006, a member of the board of directors of Banco Hipotecario in Argentina, a substitute director in DIC, the Company's indirect controlling shareholder, since 2014 and a member of the board of directors of additional private companies in Argentina. From 1990 to 2005, Mr. Wior served as the Chairman and CEO of cellular operators in Argentina, Uruguay, Chile, Ecuador, Peru and Venezuela, and as a senior executive of BellSouth Telecommunications, LLC. Mr. Wior holds a B.A in finance and accounting and an M.B.A. in Business Management, both from Tel Aviv University.

Sholem Lapidot has served as a member of our Board of Directors since March 2018. Mr. Lapidot serves as CEO of DIC, our indirect controlling shareholder, and of IDB. He also serves as a member of the board of directors of IDB, DIC and Shufersal Ltd., chairman of the board of directors of Modi'in - Energy Management (1992) Ltd., substitute director at Elron Electronic Industries Ltd., committee member at the IDB Fund and a member of the board of directors of additional private companies owned by DIC and IDB. Mr. Lapidot served as a member of the board of directors of ADAMA Agricultural Solutions Ltd. from 2015 to 2016, from 2009 to 2013 he served as the CEO and member of the board of directors of CLADD S.A. and from 2008 to 2012 as a member of the board of directors of Australtex S.A. Mr. Lapidot has studied Rabbinical Studies.

Shlomo Waxe has served as a member of our Board of Directors since 2006. Mr. Waxe has served as Director General of the Israel Association of Electronics and Software Industries from 2006 to 2016. Until 2016 he served as a member of the board of the Israeli Standards Institute. From 2002 to 2005, he worked in the field of communications management and consultancy. From 1999 to 2001, he served as Chief Executive Officer of Zeevi Communications Ltd. From 1997 to 1999, he served as a consultant to cellular communications projects in Sao Paulo, Brazil and in Northeast Brazil. From 1993 to 1997, he served as the Director General of Israel's Ministry of Communications. From 1990 to 1993, he served as commanding officer of the signal, electronics and computer corps of the Israel Defense Forces and he is a retired brigadier general. Mr. Waxe also serves as a member of the boards of directors of C. Mer Industries Ltd. and until 2009, served as a board member of Shrem, Fudim – Technologies Ltd. and until May 2012, served as a board member of Tambour Ltd. Mr. Waxe holds a B.A. in political science from the University of Haifa.

Ephraim Kunda has served as a member of our Board of Directors since 2010. Mr. Kunda is an Israeli businessman and is the owner and managing director of a private consulting company that provides economic consultancy and business mediation services. From 2007 to 2010, Mr. Kunda has served as the Chairman of the board of directors and since 2010 as a member of the board of directors of Ravad Ltd., a public real estate investment company. From 2003 to 2007, Mr. Kunda served as an external director of Property and Building Corporation Ltd., a public real estate company controlled by DIC. Mr. Kunda holds a B.A. in Economics from Tel Aviv University.

Joseph Barnea has served as a member of our Board of Directors since 2007. Mr. Barnea is a retired businessman. From 2012 to 2015, Mr. Barnea served as an external director of Imagesat International Ltd. He served as the Chief Executive Officer of Oxygen & Argon Works Ltd. from 1987 to 2005 and continued to serve as a member of its management until 2006. From 1985 to 1987, he served as the Chief Executive Officer of Telkoor Ltd. From 1980 to 1985, he served as a Vice President of Elscint Medical Imaging Ltd. Mr. Barnea is a member of the executive committee of the Israeli Industrialists Association and until 2007 he served as the Chairman of its Chemistry and Environment Association. From 2004 to 2009 Mr. Barnea served as a member of the board of the Israeli Export & International Cooperation Institute, from 2005 to 2014 he served as a member of the standard committee of the Israeli Standards Institute and prior to that, as a member of its board. From 2002 to 2004 he served first as President and then as Chairman of the International Oxygen Manufacturers Association (IOMA) USA. He served as Deputy Commander of the signal, electronics and computer corps of the Israeli Defense Forces. Mr. Barnea holds a B.Sc. in electrical engineering from the Technion, Israel Institute of Technology and an M.Sc. in electrical engineering from Columbia University, New York, USA.

Ronit Baytel has served as a member of our Board of Directors since 2007. As of February 2019, Ms. Baytel serves as CFO and team manager at ERB financial Group Ltd. From 2017 until 2018, Ms. Baytel served as a financial consultant at an Israeli financial consulting firm. From 2005 to 2016, Ms. Baytel served as a director in the finance department of Ormat Technologies, Inc., a company listed on the NYSE, in charge of SOX internal controls, the preparation of financial statements and tax and special projects. From 1998 to 2005 she served as senior manager at Kesselman & Kesselman, a certified public accountants firm in Israel, which is a member of the international PriceWaterhouseCoopers Accountants firm. Ms. Baytel is a certified public accountant and holds a B.A. in economics and accountancy from Tel Aviv University and an M.B.A. from the Hebrew University.

Nir Sztern has served as our Chief Executive Officer since 2012. Mr. Sztern served as the chief executive officer of Netvision, from 2010 to 2011. From 2008 to 2010 he served as deputy CEO of Pelephone, and from 2002 to 2008 as Pelephone's vice president of marketing. From 2001 to 2002 he served as vice president of marketing and sales of Barak 013 Ltd. or Barak, a long distance operator (which was later merged into Netvision) and from 1999-2001 as head of Barak's marketing department. From 1994 to 1999 Mr. Sztern served as head of our private sector marketing department. Mr. Sztern holds a B.A. in economics and management from the Tel Aviv University and an M.B.A. in business administration, from the Israeli branch of Manchester University.

Shlomi Fruhling has served as our Chief Financial Officer since September 2013. Mr. Fruhling has served as a vice president of DIC from 2012. From 2008 to 2011 he served as VP Strategy and Finance of 013 Netvision Ltd. From 2005 to 2008 Mr. Fruhling has served as head economist of DIC. Mr. Fruhling holds a B.A. in economics and business administration from the Tel-Aviv Management College.

Yoni Sabag has served as our Vice President of Marketing since 2011. Mr. Sabag has served as head of our private sector marketing department, in charge of the private and small business sectors from 2006 to March 2011. From 2003 to 2006, he served as a director of marketing for the private sector. Mr. Sabag has been a member of our marketing department since 2000.

Ron Shvili has served as our Chief Technologies Officer since November 2013. Mr. Shvili has been an Entrepreneur in the field of cyber security since the beginning of 2013, when he retired from the Israeli Defense Forces, or IDF. From 1990 to 2012 Mr. Shvili held various key managerial and technological positions in the IDF and the Israeli Ministry of Defense. Mr. Shvili holds B.Sc and M.Sc in Electrical engineering from Tel-Aviv University.

Nadav Amsalem has served as our Vice President of Business Customers since July 2017. Mr. Amsalem served as head of the strategic customers department in our business customers division, in charge of the major corporate business customers from 2014. From 2011 to 2014, he served as the director of strategic landline customers and major business customers sector. Mr. Amsalem has been a member of our business customer's division since 2006.

Sharon Amit has served as our Vice President of Human Resources since 2011. Ms. Amit has served as Netvision's VP of Human Resources from 2009 to November 2011. She served as VP of Human Resources of Tikshoov Call Center from 2006 to 2009, of Bynat Computer Communications from 2002 to 2006 and of ADC Israel from 1996 to 2002. Ms. Amit holds a B.A. in English literature and East Asia science, from the Hebrew University in Jerusalem and an M.A. in labor studies from the Tel Aviv University.

Amos Maor has served as our Vice President of Sales and Service as of 2012. Mr. Maor has served as our Vice President of Operations and Supply Chain from 2004 to January 2011. From 2002 to 2004, Mr. Maor served as manager of Supply Chain of Elite Industries Ltd., and from 2000 to 2002, he served as manager of Elite's sales division headquarters. Mr. Maor holds a B.Sc. in industry and management engineering from the Technion, Israel Institute of Technology.

Liat Menahemi Stadler has served as our Vice President of Legal Affairs and Corporate Secretary since 2006. From 2000 to 2006, Ms. Menahemi Stadler served as head of the technology and general purchasing division of our legal department. She has been a member of our legal department since 1998. Ms. Menahemi Stadler holds an LL.B. and a B.A. in English and French language and literature, both from the University of Haifa and is a member of both the Israeli and the New York bar associations.

Teimuraz Romashvili has served as our Vice President of Pre Paid Activity since 2011. Mr. Romashvili reports to the Company's VP Sales and Service. Mr. Romashvili has served as Netvision's head of pre-paid and international activity from 2007 to October 2011. From 2005 to 2007 he served as head of pre-paid activity in Barak and prior to that served in a variety of positions in Barak. Mr. Romashvili holds a B.A. in economics and management from the Economics Academy in Kiev, Ukraine.



Yaniv Gruenwald has served as our Vice President of television and content since August 2014. Mr. Gruenwald has served as Vice President of television and content of Netvision since 2012 and as Chief Technology Officer of Netvision from 2010 to 2011. From 2008 to 2010, he served as a Chief Technology Officer of wire-line & broadband division of Partner Communications Ltd., and from 2005 to 2008 he served as Partner's director of product development. Mr. Gruenwald Holds a B.A. in business administration from the Peres Academic Center and an Executive MBA from Tel-Aviv University.

Ronnen Shles has served as our Controller from January 2015. From 2007 to 2014, Mr. Shles served as head of the accounting unit in our financial control division. Mr. Shles is a certified public accountant and holds a B.A. in accounting and business administration from the College of Management.

## B. COMPENSATION

### Compensation Policy

Our compensation policy, described below, was approved by our compensation committee and board of directors and subsequently approved by our shareholders in January 2017 and shall be in effect for a period of three years therefrom.

#### Preamble

The Company's compensation policy is designed to align executive officer compensation with the Company's performance and to reflect best practices in executive officer compensation. The Company has created a pay-for-performance policy that is designed to align executive officer and shareholder interests by reinforcing the long-term growth, value creation and sustainability of the Company. The structure is designed to encourage a high degree of execution and rewards individuals for the achievement of objectives that ultimately create shareholder value. The structure is further designed to prevent executive officers from taking unnecessary risks in order to enlarge their compensation. The objective of the compensation policy is to attract, motivate and retain a talented management team that will continue providing unique solutions in a highly competitive and rapidly changing marketplace and deliver long-term value for all shareholders.

The Company's executive officer compensation policy refers to three main elements of compensation that include base salary, cash bonus compensation and equity-based compensation. The compensation package for each of our executive officers will include these three components.

The Compensation Committee and Board of Directors approve, periodically review and oversee the application of the Company's executive officer compensation programs.

Our Board of Directors monitors our executive officers' compensation structure annually in order to ensure that target total compensation for our executive officers is appropriate, considering our peer companies, overall company performance, individual executive officer's scope and size of responsibilities and performance during the previous year.

The compensation policy does not grant any rights to the Company's directors and executive officers, and the adoption of the compensation policy does not grant any of the Company's Directors and executive officers a right to receive any elements of compensation set forth in the compensation policy. The elements of compensation to which a director or executive officer will be entitled, will be exclusively those that are determined specifically in relation to him or her in accordance with the requirements of the Companies Law, and the regulations promulgated thereunder.

#### Executive Officer Pay for Performance

The Company's compensation philosophy is to encourage our executive officers to make sound decisions and drive long-term value creation for our shareholders. For our executive officers, we believe that in order to increase shareholder value, our compensation structure must:

- Have a substantial portion of pay "at risk" (i.e., pay that is not guaranteed); and

- Link "at risk" pay to performance objectives that are directly aligned to the Company's short and long-term performance objectives as well as strategic initiatives.

Effectively aligning the objectives of executive officer compensation with the interests of shareholders requires adopting compensation programs that motivate leadership to drive company performance to achieve sustainable top performance. To that end, our Board of Directors, at the recommendation of our Compensation committee, will establish cash and equity-based compensation plans with targets focused on rewarding individuals for strong company performance. In addition, because we believe that individuals should be rewarded based on the results of their contributions, we also consider individual performance in awarding incentive compensation.

#### Compensation Philosophy and Strategy

Our Board, at the recommendation of our Compensation Committee, has defined the following key objectives of our compensation programs for executive officers:

- Drive the Company's overall business strategy and results as they relate to long-term value creation;

- Pay for performance by linking total compensation to defined performance objectives, both at the Company level and for each executive officer individually;

- Attract and retain key executive officers by providing competitive total compensation opportunities, considering the Company's size, nature of operations and marketplace, while avoiding unnecessary risk taking by executive officers; and

- Align executive officer and investor interests by focusing executive officer behavior on driving long-term value creation.

## Compensation Risk Assessment

In designing our compensation policy, we reviewed our compensation policies and practices in order to determine whether they create risks that are likely to have a material adverse effect on the Company. We concluded that our compensation programs do not create risks that are reasonably likely to have a material adverse effect on the Company. Among the elements evaluated were the following:

- The multiple elements of our compensation packages for executive officers, including base salary, annual cash incentive and equity-based compensation program which vest over a number of years and provide a balance of short-term and long-term compensations with fixed and variable components that promote the long-term sustainability of our business;
- Equity-based compensation for our executive officers aligns the interests of the executive officers with those of our shareholders;
- Independent oversight by the Compensation Committee;
- Inclusion of claw-back provisions in the event of a material restatement of our financial statements for our financial performance based compensations;
- Effective management processes for developing strategic and annual work plans, and strong internal controls over financial reporting;
- The structure of our Annual Cash Bonus (as defined hereinafter) and equity-based compensation, which is based on a number of different performance measures to avoid employees placing undue emphasis on any particular performance measure at the expense of other aspects of the business; and
- The cap on our executive officers' Annual Cash Bonus and equity-based compensation, commensurable to objectives which do not motivate increased risk taking.

## Compensation Principles

**Peer Group Analysis.** We use benchmarking as one of the tools for setting and reviewing our compensation system. To attract and retain our key executive officers, our goal is to provide compensation opportunities at competitive market terms. The Company's peer group is made up of a minimum of 10 companies, including telecommunications companies and companies operating in other markets whose turnover are similar to the Company's, as recommended by the Company's independent compensation consultant. When using the benchmarking, our intent is to create a compensation structure that generally targets the median of our selected peer companies, but also allows total compensation to exceed the median when warranted due to company performance and/or individual experience, responsibilities and exceptional performance.

**Additional Considerations.** When deciding on or periodically reviewing each executive officer's total compensation, our Compensation Committee and Board of Directors consider the following: (1) each executive officer's individual attributes, including his/her education, skills, expertise, professional experience and achievements, the executive's role, his/her areas of responsibility and previous compensation arrangements (when applicable); (2) the ratio between our executive officer total target compensation and the total compensation of the rest of the company's employees and the Subcontractors' Employees engaged by the Company (as such term is defined under the Companies Law), and specifically the ratio to the average total compensation and the median total compensation of such employees, and the influence of those gaps on the working relations in the Company, taking into consideration the Company's size, nature of operations, employees composition, marketplace and comparative data. Our Compensation Committee and Board of Directors considered these ratios in the Company and determined that they do not adversely influence the working relations in the Company.

**Caps and limitations.** Our compensation policy sets the target total compensation comprising of the base salary, a 100% performance score for the Annual Cash Bonus award and maximum equity-based compensation for our executive officers, as well as a cap for the Special Cash Bonus, as detailed hereunder. Our Compensation Committee and Board decide on each executive officer's total actual compensation which is limited by the target compensation, based on performance metrics as detailed hereunder. Our Board will not reduce the compensation package approved or any of its components, and will not place additional limitations, not detailed in this compensation policy, other than in unusual circumstances according to our Compensation Committee's and Board of Directors' discretion.

**Compensation Recovery ("Claw back").** If our financial statements are materially restated within 4 years from publication thereof (other than restatement required due to changes in financial reporting standards), then the executive officers will repay prior payouts, in an amount of the excess over what the executive officer would have received according to the restated financial statements.

**Change in Compensation at CEO Discretion.** A change in the compensation package of an executive officer who reports to the CEO, which results in an increase of such executive officer's total compensation package by no more than 2.5%, may be approved solely by the CEO, provided all elements of compensation of such executive officer will continue to meet the requirements of the compensation policy.

#### Overview of Executive officer Compensation –the Elements of Pay

**Elements of Executive officer Compensation.** In line with the philosophy described above, the following elements compose the compensation of our executive officers:

- Base salary;
- An Annual Cash Bonus award and possible Special Cash Bonuses;
- Equity-based compensation awards; and
- Termination arrangements.

**Compensation Mix.** Base salary, Annual Cash Bonus and equity-based compensation awards make up the main elements of our executive officers' total compensation package. The Company strives to ensure that a substantial portion of each executive officer's total compensation is comprised of "at-risk" pay, with the targeted weight of each element out of the total compensation package of an executive officer being as follows:

- base salary – 30%-50% for our CEO and 40%-60% for other executive officers;
- Annual Cash Bonus - 25%-45% for our CEO and 20%-40% for other executive officers; and
- equity-based compensation\* - 15%-45% for our CEO and 10%-40% for other executive officers.

\*calculated per year, based on fair value at date of grant, with the value of the options amortized as compensation over the vesting period.

The ranges stated above represent the targeted compensation mix desired by the Company; however, the actual ratio between fixed and variable elements may vary based on performance. For example, in a year with no or limited Annual Cash Bonus, the percentage of base salary out of total compensation may be higher than stated above. The ranges above do not consider any Special Cash Bonus that our Compensation Committee and Board of Directors (and shareholders – in relation to our CEO) may decide to grant to an executive officer, as detailed under Special Cash Bonus below.

Our cash bonus and equity-based compensation awards are considered “at-risk” pay because they are not guaranteed and the recipients of the Annual Cash Bonus awards must achieve specific performance objectives at corporate and individual levels to receive any payment.

Total compensation cap. The Company's CEO's total annual compensation shall not exceed NIS 6 million, out of which the fixed element shall not exceed NIS 3 million. Each of the Company's other executive officers' total annual compensation shall not exceed NIS 3.6 million, out of which the fixed element shall not exceed NIS 1.8 million.\*

\* The value of equity-based awards refers to their value at the date of grant (in accordance with acceptable accounting principles) per each vesting annum (calculated on a linear basis).

Base Salary. The base salary varies between executive officers, and is individually determined according to past performance, educational background, prior business experience, qualifications, role and the business responsibilities of the executive officer. Since a competitive base salary is essential to our ability to attract and retain highly skilled professionals, we will seek to establish a base salary that is competitive with the base salaries paid to executive officers of a peer group of companies.

Accordingly, base salary shall generally target the 25%-75% percentiles of each executive officer's peer group salary, taking into consideration the aforementioned individual characteristics, as shall be reflected in a peer group analysis conducted by an independent consultant and reviewed by our Compensation Committee and Board of Directors, when such salary is set and/or updated.

The base salary may be linked to the Israeli Consumer Price Index, or CPI.

Benefits and Perquisites. The following benefits and perquisites may be granted to the executive officers in order, among other things, to comply with legal requirements:

- Vacation of up to 30 days per annum;
- Sick days of up to 30 days per annum;
- Convalescence pay equivalent to up to 10 days per annum;
- Monthly remuneration for an education fund, as allowed by applicable law;
- Contribution on behalf of the executive officer to a manager's insurance policy or a pension fund, as allowed by applicable law; and
- Contribution on behalf of the executive officer towards work disability insurance, as allowed by applicable law.

We may offer additional benefits and perquisites to the executive officers, which will be comparable to customary market practices, such as: company cellular phone and the costs of the use thereof; company car benefits; gifts for holidays and personal occasions (such as nuptials or birth of a child or grandchild), or for special projects; medical insurance, annual medical examination, professional associations membership fees etc., including tax gross-ups; provided however, that such additional benefits and perquisites shall be determined in accordance with our policies and procedures and with reference to the practice in peer group companies. The value of such additional benefits shall not exceed 30% of the executive officer's base salary.

**Annual Cash Bonus.** The Compensation Committee sets the annual cash bonus performance objectives and target annual bonus for each executive officer, at the start of each year, which are then reviewed and approved by the Board ("Annual Cash Bonus"). For our CEO, these objectives are based on the Company's annual work plan and objectives. For our other executive officers, these objectives are based on the Company's annual work plan and objectives at the corporate level and key strategic objectives each executive officer is expected to achieve during that year at the individual level, based on each executive officer's position and scope of responsibilities.

The Annual Cash Bonus payout is determined based on actual performance of the Company and the executive officer in question (after elimination of material one time and reevaluation influences), in each of the performance objectives set for each executive officer, measured on a performance matrix. The results for each group of objectives (as detailed hereunder) are then combined into one performance score, based on the weight each performance objective was given.

Corporate performance objectives may include adjusted EBITDA,\* net income, free cash flow\*and other Company performance objectives which the Company decides to focus on in a specific year. Our CEO's corporate performance objectives were determined by our shareholders general meeting to be the Company's adjusted EBITDA target for the relevant year.\*\* Corporate performance objectives weigh between 30% to 50% of the overall performance score of each executive officer and 80% for our CEO. In extreme cases, such as major changes in our market leading to annual work plan or budget adjustments, our Compensation Committee and Board of Directors may update the objectives to match such changes, during the first half of the relevant year.

Quantitative individual performance objectives may include the budget for the unit relevant to the executive officer, revenues from sales by the unit, recruiting subscribers by the unit and quality of network. These objectives weigh between 30% and 50% of the overall performance score of each executive officer.

Qualitative individual performance objectives may include corporate governance, risk management, leadership, response to major business changes, executing special projects, as per the CEO's evaluation of each executive officer and as per the evaluation of the CEO by the Compensation Committee and the Board of Directors. This component will weigh up to 20% of the overall performance score of each executive officer (including the CEO).

\*Adjusted EBITDA and Free Cash Flow are non-IFRS measures. For a definition of adjusted EBITDA, see footnote (5) under "Item 5. Operating and financial review and prospects – Results of operations – Comparison of 2016, 2017 and 2018". For a definition of Free Cash Flow see under "Item 5. Operating and financial review and prospects – A. Operating results – Overview – General".

\*\* Our CEO's performance score of his performance objectives in 2018 is 84%.

Any payout of Annual Cash Bonuses for any year will be subject to an additional minimum requirement of achieving an annual adjusted EBITDA of not less than 75% of the Company's adjusted EBITDA for the previous year. We have met this threshold. Such minimum requirements are in no way indicative of the Company's expectations or estimations for any fiscal year, and are provided in order to assure shareholders that no Annual Cash Bonuses will be paid to office holders according to the Compensation Policy in years when the Company's performance has deteriorated materially compared to the prior year.

Our Compensation policy sets a minimal threshold score of 75% of the combined target performance and a target Annual Cash Bonus of 10 monthly salaries for our CEO and 5-7 monthly salaries for our other executive officers ("Target Bonus") for the target performance objectives, in line with each executive officer's capability to influence the Company's results of operations. Performance below the minimum threshold results in no payout. Performance score under the combined performance target and above the threshold results in a linear reduction in which a 5% reduction of the combined performance score represents a reduction of 10% of the Target Bonus (i.e. down to 50% of the Target Bonus for a performance score of 75% of the combined performance target). Performance score above the combined target performance rewards the executive officer with a linear addition to the Target Bonus in which a 5% addition of the combined performance score represents an addition of 10% to the Target Bonus and up to a maximum of 150% of the Target Bonus.

Following is a graphic representation of the Annual Cash Bonus our executive officers may be entitled to:

Notwithstanding the aforesaid, for our executive officers, except the CEO, the Compensation Committee and the Board of Directors will have full discretion to determine the final Annual Cash Bonus payout based, among other things, on the Annual Cash Bonus performance score and/or additional considerations relevant to the performance and objectives of the Company and the relevant executive officer, including qualitative criteria.

Subject to the conditions and limitations set above, an executive officer who ceases to perform his/her role as an executive officer but has provided services to the company for at least 6 months of the relevant year, will be entitled to receive an Annual Cash Bonus for that year, relative to the period in which he/she performed their duties during the relevant year. An executive officer who provides services to the Company for less than 6 months during the relevant year of cessation, will not be entitled to an Annual Cash Bonus for that year. An executive officer who joins the Company during the relevant year, will be entitled to a portion of the Annual Cash Bonus, relative to the period in which he/she performed their duties during the relevant year and provided such period is at least 6 month long.

The aggregate maximum payout of all of the executive officers' Annual Cash Bonuses per annum shall not exceed 2% of the adjusted EBITDA for that calendar year (after elimination of material one time and reevaluation influences). In case of a positive adjusted EBITDA but negative net profit in a particular year, the Compensation Committee and the Board of Directors of the Company shall examine the circumstances leading to a negative net profit and shall consider reducing or cancelling the Annual Cash Bonus for that year. For 2018, our Compensation Committee and the Board of Directors resolved not to award an Annual Cash Bonus, given the Company's results of operations.

**Special Cash Bonus.** The Company may grant, subject to approvals required by law, a special bonus to one or more executive officers that have shown a special contribution, considerable efforts or special achievements, in relation to a unique or extraordinary business activity or other special circumstances, in advancement of the Company's goals (the "Special Cash Bonus"). The Special Cash Bonus is a separate bonus from the Annual Cash Bonus mentioned above. The Special Cash Bonus will be determined by quantitative and/or qualitative parameters, and while considering the personal contribution of the executive officer. The maximum payout for the Special Cash Bonus during the term of the Compensation Policy with respect to any executive officer will be the greater of: (a) 9 base salaries for our CEO and 7 base salaries for our other executive officers, or (b) 150% of the Target Bonus minus any Annual Cash Bonus payout for the relevant year. Any Special Cash Bonus with respect to the CEO will require approval by our shareholders' meeting in addition to the Compensation Committee and board of directors' approval. The aggregate maximum payout cap for Annual Cash Bonuses of all of the executive officers, as described in the previous section of this policy, shall apply also to the aggregate payout of the Special Cash Bonus of all of the executive officers, so that the aforesaid cap shall apply to the aggregate payout of all cash bonuses under this policy.

**Equity-based compensation Plan.** Under the Company's 2015 Share Incentive Plan or under any equity-based compensation plan adopted by the Company in the future, the Compensation Committee and Board may resolve to grant, from time to time, options or restricted share units ("RSUs"), or other instruments of equity-based compensation, to our executive officers.

The decision on equity-based compensation grant shall take into consideration each executive officer's position, scope of responsibilities, as well as its past performance and contribution to the Company.

In order to align executive officer and investor interests for creation of long term value, equity-based awards will include the following terms:

Awards will vest linearly over a minimum period of three years beginning on the first anniversary of the grant date. The terms of such equity-based awards may include provision for acceleration of vesting in certain events, such as in the event of a merger, a consolidation, a sale of all or substantially all of our consolidated assets, change of controlling shareholder, or the sale or other disposition of all or substantially all of our outstanding shares.

The exercise price of equity-based awards will be set so as to induce an incentive for long term value creation, but in any case, not lower than the higher of 5% above the average market price of the Company's share during the 30 day period preceding the date of grant, and the market price of the Company's share at the end of the trading day preceding the date of grant, and will be subject to customary adjustments including for dividend distributions.



The value of equity-based awards at the date of grant (in accordance with acceptable accounting principles) per each vesting annum (calculated on a linear basis), in addition to the Target Bonus (whether or not actually paid), will not exceed 70% of our CEO's and 60% of our other executive officers' total cost of employment in that calendar year. We believe a grant date cap is more appropriate than an exercise date cap as it better aligns long term value creation objectives.

The annual exercise of shares reserved for issuance upon the exercise of options of all the Company's executive officers will not dilute the Company's shareholders by more than 2% (in regards to option plans which contain a 'net exercise mechanism') of the Company's outstanding share capital for the year in which such options may be exercised. In addition, our board of directors committed to DIC that the Company will not issue options or shares pursuant to executive officers or employees' compensation, which may lead to a dilution of the Company's shareholders by more than 0.5% of the Company's outstanding share capital for the year in which such options may be exercised.

**Termination and Retirement.** Our executive officers may be entitled to up to a 3 months advance notice period upon termination of their employment with the Company if worked in the Company for up to 3 years, or up to 6 month advance notice period if worked in the Company for over three years and will be required to provide the Company with the same notice when they initiate retirement from their position. The executive officer is obligated to work during such period and Company may decide, at its sole discretion, to waive actual work during that period, in whole or in part. Under special circumstances, the Company may, as approved by our Compensation Committee and Board of directors, grant an executive officer who worked in the Company for a minimum of two years and was not terminated for cause, a termination bonus equal to up to 3 monthly salaries of the executive officer, including benefits or an adjustment period of up to 3 month during which the executive officer will be entitled to continue to enjoy all compensation and benefits. In case the executive officer worked in the Company for a minimum period of five years, such termination bonus or adjustment period, may be up to 6 monthly salaries or 6 months, respectively. In deciding on the grant of a termination bonus or the like, our Compensation Committee and Board of Directors shall take into consideration the executive officer's term of employment, his/her compensation during his/her employment with the Company, the Company's performance during that period, the contribution of the executive officer to achieving the Company's objectives and increasing its profits and the circumstances of termination.

The Company may approve, upon termination of an executive officer's employment, amendment of the terms in connection with the executive officer's equity-based compensation grants, such as extending the period for exercise of equity-based compensation upon termination, for longer periods than as set forth in the applicable plan, enabling acceleration of vesting of unvested equity-based compensation, while considering the same considerations stated above for a termination bonus.

The Company will not pay its executive officers any non-competition fees for post termination periods, although executive officers may be bound by post termination non-competition obligations.

#### Compensation for our directors

All directors (other than Executive Directors, as defined hereinafter), including external directors, independent directors, directors who are affiliated with our controlling shareholder or nominated or appointed by our controlling shareholders ("Controlling Shareholder Directors") and other directors, will be entitled to a directors fees in accordance with the amounts of statutory compensation to an external director of a dual-listed company allowed by the applicable Israeli law and regulations (as shall be updated from time to time and up to the maximum amounts allowed) and will not receive cash bonuses or equity-based compensation. Such directors' fees in relation to Controlling Shareholder Directors may be paid either directly to the director or to the controlling shareholder through a management agreement (if such agreement is in effect).



Our Controlling Shareholder Directors who hold an active role in the Company ("Executive Directors"), which may include the chairman of the Board of Directors, may be entitled to compensation from the Company (instead of the above directors fees) which may include an annual fixed payment and equity-based compensation. The provisions regarding our CEO's base salary and equity-based compensation detailed above in this policy, shall apply mutatis mutandis to the annual fixed payment and equity-based compensation such Executive Directors shall receive for their services, assuming a full time position as our Executive Directors. A part-time position may entitle our Executive Directors to a corresponding portion of annual fixed payment and equity-based compensation. Our Executive Directors are not entitled to receive a cash bonus.

#### Indemnification

Exemption from liability and liability insurance policy. Our articles of association allow us to exempt in advance a director and executive officer, or office holders, from liability to the company, in whole or in part, for a breach of his or her duty of care (except in connection with distributions) and we may enter into a contract for insurance against liability of any of our office holders with respect to certain breaches of his/her duties and certain financial liabilities and litigation expenses.

We maintain a liability insurance policy for the benefit of our office holders. Our directors and executive officers' coverage will not exceed US\$100 million per claim in the aggregate, and additional reasonable expenses in connection with defending lawsuits, and the premium will not exceed US\$ 1 million per annum in any renewal or extension or substitution of the policy and the deductible will not exceed US\$ 0.5 million per claim. Any such renewal or extension or substitution of the liability insurance policy for the benefit of our office holders (including those who are or are related to controlling shareholders or in respect of whom our controlling shareholders have a personal interest, who shall be insured under identical terms) does not require a separate approval of the Company's shareholders, in addition to the approval of this compensation policy (which in itself requires approval once every three years) if our compensation committee resolves that such renewal or extension or substitution upholds the limitations set above.

Indemnification. Our articles of association provide that we may indemnify our office holders against certain financial liability and litigation expenses. We have undertaken to indemnify our office holders for certain events listed in the indemnification letters given to them. Excluding reasonable litigation expenses, as noted above, the aggregate amount payable to all directors and officers and other employees who may have been or will be given such indemnification letters is limited to the amounts we receive from our insurance policy plus 30% of our shareholders' equity as of December 31, 2001, or NIS 486 million, and to be adjusted by the Israeli CPI. The approval of the compensation policy by our shareholders shall not be considered as approval of the indemnification amount to the Company's office holders (over the amounts received from the Company's insurance policy).

The above exemption, indemnification and insurance coverage, are subject to the limitations set in the Companies Law.

### Executive Officer and Director Compensation

The aggregate direct compensation we paid to all our executive officers and directors as a group (17 persons) for 2018 was approximately NIS 14.8 million, of which approximately NIS 2.1 million was set aside or accrued to provide for pension, retirement, severance or similar benefits. These amounts do not include expenses we incurred for other payments, including dues for professional and business associations, business travel and other expenses and benefits commonly reimbursed or paid by companies in Israel. In addition, in 2018 we recorded the sum of approximately NIS 2 million, as a compensation cost related to the options granted to all our executive officers under our share incentive plans. See “6. Directors, Senior Management and Employees – E. Share Ownership – Share Incentive Plans”. We pay our executive officers an annual bonus based on our overall performance and individual performance, in accordance and subject to the provisions of our compensation policy (described above). For 2018, our compensation committee and board of directors resolved not to pay our executive officers an Annual Cash Bonus.

The table below reflects the compensation granted to our five most highly compensated office holders during or with respect to the year ended December 31, 2018. We refer to the five individuals for whom disclosure is provided herein as our “Covered Executives.” All amounts reported in the table are in terms of cost to the Company, as recognized in our financial statements for the year ended December 31, 2018, which includes compensation paid or to be paid to such Covered Executive following the end of the year in respect of services provided during the year. Each of the Covered Employees was covered by our D&O liability insurance policy and was entitled to indemnification and exculpation in accordance with applicable law and our articles of association. The amounts set forth in the table below are given in thousands of New Israeli Shekels (NIS).

Name and Principal Position <sup>(1)</sup>	Salary Cost (2)	Bonus <sup>(3)</sup>	Equity-Based Compensation <sup>(4)</sup>	Total
Nir Sztern, President and Chief Executive Officer	2,044	-	203	2,246
Shlomi Fruhling, Chief Financial Officer	1,318	-	205	1,523
Ron Shvili, Chief Technology Officer	1,197	-	205	1,402
Sharon Amit Vice President HR	1,140	-	205	1,345
Liat Menahemi Stadler Vice President of Legal Affairs and Corporate Secretary	1,122	-	205	1,328

(1) Unless otherwise indicated herein, all Covered Executives are or were employed on a full-time (100%) basis.

Salary cost includes the Covered Executive's gross salary plus payment of social benefits made by the Company on behalf of such Covered Executive. Such benefits may include, to the extent applicable to the Covered Executive, payments, contributions and/or allocations for savings funds (e.g., Managers' Life Insurance Policy), education funds (referred to in Hebrew as “keren hishtalmut”), pension, severance, risk insurances (e.g., life, or work disability insurance), payments for social security and tax gross-up payments, vacation, car, medical insurance and benefits, phone, convalescence or recreation pay and other benefits and perquisites consistent with our policies.

- (3) Represents Annual Cash Bonuses approved by our compensation committee and board of directors to the Covered Executives with respect to the year ended December 31, 2018, based on our compensation policy.

- (4) Represents the equity-based compensation expenses recorded in our consolidated financial statements for the year ended December 31, 2018, based on the fair value of the applicable options on the date of grant thereof, in accordance with accounting guidance for equity-based compensation. For a discussion of the assumptions used in reaching this valuation, see Note 20 to our consolidated financial statements included elsewhere in this report.

We pay each of our external directors the maximum amount of statutory compensation to an external director of a dual-listed company allowed by the applicable law and regulations, which is in the amount of NIS 134,180 (approximately \$35,800) per year and NIS 4,035 (approximately \$1,077) per meeting which such external director attends (including meetings of committees of the Board of Directors), adjusted for changes in the Israeli CPI for October 2015, or a Director's Fee. As resolved in our annual shareholders meeting held in July 2011, our independent directors (Shlomo Waxe and Ephraim Kunda) are compensated at the same level as a statutory external director of a dual listed company, as described above.

We pay our Controlling Shareholder Directors as follows: Regarding Mr. Ami Erel, our Chairman of the board of directors, we paid the monthly remuneration approved by our compensation committee, board of directors and shareholders for his services as an executive director - the amount of NIS 87,500 plus VAT, linked to the Israeli CPI. Regarding Mr. Mauricio Wior, our Vice Chairman of the board of directors, we paid a Director's Fee. Regarding Mr. Sholem Lapidot, until October 2018 we paid DIC under our management services agreement with DIC, a sum equal to a Director's Fee for Mr. Lapidot's services and thereafter, we paid Mr. Lapidot a Director's Fee (paid to DIC according to Mr. Lapidot's instructions). See "Item 8. Major Shareholders and Related Party Transactions – Related Party Transactions – Relationship With Affiliates".

#### Employment Agreement of Nir Sztern

Mr. Nir Sztern, our Chief Executive Officer as of January 1, 2012, is entitled to a gross monthly salary of NIS 120,000 linked to Israeli CPI. He is also entitled to a company car and the use of a cellular phone. Mr. Sztern may receive an Annual Cash Bonus and Special Cash Bonus as per our Compensation Policy detailed above, in respect of which no social benefits are accrued. Mr. Sztern was not awarded an Annual Cash Bonus for 2018. Mr. Sztern is also entitled to participate in our share option plan. Mr. Sztern's agreement contains provisions for vacation days, sick leave, managers' insurance and an education fund. The aggregate monthly cost to us of Mr. Sztern's employment in 2018 amounted to approximately NIS 170,300 (approximately \$45,438). The agreement is for an unspecified period of time and can be terminated by either party with advance notice of three months. Mr. Sztern will continue to receive his salary and benefits for an additional period after termination by either party, unless we terminate the agreement for cause, as per our Compensation Policy.

## C. BOARD PRACTICES

## Corporate Governance Practices

We are incorporated in Israel and therefore are subject to various corporate governance practices prescribed by the Companies Law and the regulations promulgated thereunder, relating to such matters as external directors, the audit committee, the compensation committee and the internal auditor. These matters are in addition to the applicable requirements of the New York Stock Exchange and U.S. securities laws. Under the New York Stock Exchange rules, a foreign private issuer may generally follow its home country rules of corporate governance in lieu of the comparable New York Stock Exchange requirements, except for certain matters such as composition and responsibilities of the audit committee and the independence of its members. We follow the Companies Law, the relevant provisions of which are summarized in this annual report, and comply with the New York Stock Exchange requirement to solicit proxies from our shareholders in respect of each meeting of shareholders.

For a summary of the significant differences between our corporate governance practices as a foreign private issuer and those required of U.S. domestic companies under NYSE Listing Standards, see “Item 16G – Corporate Governance”.

Under the Companies Law, our Board of Directors must determine the minimum number of members of our Board of directors required to have financial and accounting expertise, as defined in the regulations of the Companies Law. In determining the number of directors required to have such expertise, the Board of Directors must consider, among other things, the type and size of the company and the scope and complexity of its operations. Our Board of Directors has determined that we require at least two directors with the requisite financial and accounting expertise and that Messrs. Erel and Wior have such financial and accounting expertise. The Companies Law and the regulations promulgated thereunder also require that at least one of our External Directors has financial and accounting expertise, and consider a person who is an audit committee independent financial expert according to U.S. law, and meets a lower standard of "professional qualification" under the Companies Law, to comply with that requirement. Our Board of Directors has determined that Ms. Ronit Baytel qualifies as an "audit committee financial expert" as defined in Item 16.A of Form 20-F. Ms. Ronit Baytel's service as an external director of our Company shall end on the date of our 2019 Annual Shareholders meeting, scheduled for March 28, 2019. Therefore, our Board of Directors has determined that Mr. Shmuel Hauzer, who will be nominated to serve as an external director at our 2019 Annual Shareholders Meeting, also qualifies as an "audit committee financial expert" as defined by the SEC in Item 16.A of Form 20-F.

## Board of Directors and Officers

Our articles of association provide that we must have at least five directors. Each director (other than external directors and directors required to be appointed by Israeli citizens and residents from among our founding shareholders) will hold office until the next annual general meeting of our shareholders following his or her election. The approval of at least a majority of the voting rights represented at a general meeting and voting on the matter is generally required to remove any of our directors from office (other than external directors and directors required to be appointed by Israeli citizens and residents from among our founding shareholders), provided that directors appointed by the Board of Directors may also be removed by the Board of Directors. A majority of our shareholders at a general meeting may elect directors or fill any vacancy, however created, in our Board of Directors (other than external directors and directors required to be appointed by Israeli citizens and residents from among our founding shareholders). In addition, directors, other than an external director or a director required to be appointed by Israeli citizens and residents from among our founding shareholders, may be appointed by a vote of a majority of the directors then in office. We do not enter into service contracts with our directors.

Our Board of Directors currently consists of seven directors, including four independent directors under the rules of the NYSE, of whom two also qualify as external directors under the Companies Law. Mr. Waxe, one of our independent directors, was elected at our annual shareholders meeting held in December 2018 until the earlier of (1) our 2019 annual general meeting and (2) March 31, 2019, and Mr. Kunda, who is also an independent director, was elected at our annual shareholders meeting held in December 2018 until our next annual meeting. Mr. Wior who was also elected by our 2017 general meeting, was later on (February 2018) appointed by the Israeli shareholders, in accordance with our license and articles of association's requirement that at least 10% of our directors be appointed by Israeli citizens and residents from among our founding shareholders, or Israeli Shareholders. Mr. Erel (who had been previously appointed by DIC in its capacity as our previous Israeli Shareholder) was appointed by our board of directors in February 2018, and re-elected in our annual shareholders meeting held in December 2018 until our next annual meeting and Mr. Lapidot was appointed by our board of directors in March 2018, and re-elected in our annual shareholders meeting held in December 2018 until our next annual meeting. Our external directors, Mr. Barnea and Ms. Baytel, who were first appointed in 2007, were re-elected in our shareholders meetings for additional terms until the earlier of (1) our 2019 annual general meeting and (2) March 31, 2019.

At our 2019 Annual Shareholders Meeting scheduled for March 28, 2019, our shareholders will be asked to approve the re-election of Messrs. Erel and Lapidot as directors and Mr. Kunda as an independent director, and the election of Mr. Gustavo Traiber as an independent director and Ms. Varda Liberman and Mr. Shmuel Hauzer as external directors. If the Annual Shareholders Meeting approves such proposals, our board of director would consist of Mr. Ami Erel (Chairman), Mr. Mauricio Wior (Vice Chairman), Mr. Sholem Lapidot, Mr. Efraim Kunda (independent director), Mr. Gustavo Traiber (independent director), Ms. Varda Liberman (external director) and Mr. Shmuel Hauzer (external director). A brief biography of each of Ms. Liberman and Messrs. Traiber and Hauzer, is set forth below:

Gustavo Traiber is the owner and CEO of private real-estate investment company since 2015. From 2010 to 2014 Mr. Traiber served as CEO and Partner at Sun Team Group Ltd. Prior to that, Mr. Traiber served as a CEO of a private company and until 2006 served in several senior management positions in the cable companies. Since 2015, Mr. Traiber also serves as an external director of Adama Agricultural Solution Ltd.. Mr. Traiber holds a B.A. in Political Science and International Relations from the Hebrew University in Jerusalem and an M.B.A. from the Interdisciplinary Center in Herzliya.

Varda Liberman serves as a Prof. in the Interdisciplinary Center Herzliya since 1995, founded and heading the MBA program in Healthcare Innovation and entrepreneurship (since 2016), heading the business school's Behavioral Decision Making Area (since 2012) and heading the Mathematical and Statistical Studies (since 1995). Prof. Liberman further provides decision making lectures, counseling and coaching to various organizations including the Israeli judicial system, the Israeli healthcare system, hi-tec companies, investment banks and office holders. From 2007 to 2010 Prof. Liberman served as an external director in Clal Insurance, from 2000 to 2006 in Tamir Fishman Mutual Funds and from 2001 until its privatization in 2004 in Sivan Training and Systems Ltd. Prof. Liberman holds a B.Sc. in Statistics and Mathematics, M.Sc. in Mathematics and Ph.D. in Mathematics, all from Tel Aviv University.

Shmuel Hauser is a Senior Vice President at Ono Academic College, a former Dean at Ono Academic faculty of Business and a Professor of Finance at Ben-Gurion University. From 2011 to 2018, Prof. Hauser served as the Chairman of the Israel Securities Authority (ISA), co-chairman of Israel Accounting Standards Board (IASB), member of an advisory committee to the Banks' Supervisor at the Bank of Israel, and (in 2017) member of the advisory committee to the Israel Capital Market, Insurance and Savings Authority. Prior to that, from 2008 to 2011 Prof. Hauser served as the chairman of a private company, a director in two financial investment houses, and a director in the Israeli S&P ranking company (Maalot). Prof. Hauser also serves as an external director in Gazit Globe Ltd. and as an independent director in Alrov Group. Concurrent with his work, Prof. Hauser pursued an academic career in the fields of: Corporate Finance, Capital Market Regulation, and Microstructure. Prof. Hauser holds a B.A. in Statistics and Economics and an M.B.A., both from the Hebrew University in Jerusalem, and a Ph.D. from Temple University, Philadelphia, USA.

Our articles of association provide, as allowed by Israeli law, that any director may, by written notice to us, appoint another person who is not a director to serve as an alternate director (subject to the approval of the chairman of the Board of Directors; and in the case of an appointment made by the chairman, such appointment shall be valid unless objected to by the majority of other directors) and may cancel such appointment. The term of appointment of an alternate director is unlimited in time and scope unless otherwise specified in the appointment notice, or until notice is given of the termination of the appointment. No director currently has appointed any other person as an alternate director. The Companies Law stipulates that a person who serves as a director may not serve as an alternate director except under very limited circumstances. In addition, the Companies Law provides that an external director cannot appoint an alternate director to serve on the Board of Directors, and an external director cannot appoint another external director to serve as his or her alternate on a committee of the Board of Directors unless the alternate has the same qualifications as the appointing director. Similarly, an independent director cannot appoint an alternate director, unless the alternate director has the qualifications to serve as an independent director. An alternate director has the same responsibility as a director. Appointment of an alternate director does not negate the responsibility of the appointing director.

Each of our executive officers serves at the discretion of our Board of Directors and holds office until his or her successor is elected or until his or her earlier resignation or removal. There are no family relationships among any of our directors or executive officers.

#### External Directors

##### Qualifications of external directors

Companies incorporated under the laws of the State of Israel whose securities are listed on a stock exchange are required by the Companies Law to appoint at least two external directors. External directors are required to possess professional and other qualifications as set out in the Companies Law and the regulations promulgated thereunder. Our external directors were appointed by our shareholders in May 2007 for an initial term of three years, and were thereafter reelected to additional terms until the earlier of (1) our 2019 annual general meeting, and (2) March 31, 2019. The Companies Law provides that a person may not be appointed as an external director of a company that has a controlling shareholder if the person is a relative of the controlling shareholder, or if the person, or the person's relative, partner, employer, direct or indirect supervisor or any entity under the person's control has or during the two years preceding the date of appointment had, an affiliation with the company or any entity controlling, controlled by or under common control with the company.



The term “office holder” is defined in the Companies Law as a general manager, chief business manager, deputy general manager, vice general manager, any manager directly subordinate to the general manager or any other person assuming the responsibilities of any of the foregoing positions, without regard to such person’s title, and a director. Each person listed above under “Item 6.A - Directors and Senior Management,” except our controller, is an office holder for this purpose.

No person may serve as an external director if the person’s position or other business interests creates, or may create, a conflict of interest with the person’s responsibilities as a director or may otherwise interfere with the person’s ability to serve as a director. If at the time an external director is appointed all current members of the board of directors are of the same gender, then that external director must be of the other gender.

For two years following the termination of an external director’s service, the company and its controlling shareholder may not appoint the external director, or his or her spouse or child, as an office holder in that company or another company under common control, and cannot employ or receive services from that person for pay or grant any benefit, either directly or indirectly, including through a corporation controlled by that person. The same restrictions apply in regards to a relative who is not the external director’s spouse or child for a period of one year.

#### Election of external directors

External directors are typically elected by a 'Special Majority', meaning a majority vote at a shareholders’ meeting, provided that either:

a majority of the aggregate number of shares voted at the meeting by non-controlling shareholders and shareholders who do not have a personal interest in the matter (other than a personal interest that is not the result of the shareholder's connections with a controlling shareholder) are voted in favor of the election of the external director (disregarding abstentions); or

the total number of shares of non-controlling shareholders and shareholders who do not have an applicable personal interest in the matter voted against the election of the external director does not exceed 2% of the aggregate voting rights in the company.

The initial term of an external director is three years and he or she may be reelected to up to two additional terms of three years each by means of one of the following mechanisms: (i) the board of directors proposed the nominee and the nominee's appointment was approved by the shareholders by a Special Majority, or (ii) a shareholder holding 1% or more of the voting rights or the external director proposed the nominee, and the nominee is approved by the shareholders by a Special Majority, and that the nominee is not the proposing shareholder or a 5% shareholder who is an affiliate or competitor of the company or a relative or affiliate of such a shareholder. Thereafter, in dual listed companies like us, an external director may be reelected by our shareholders for additional periods of up to three years each under certain conditions. An external director may only be removed by the same percentage of shareholders votes as is required for the election of an external director, or by a court, and then only if the external director ceases to meet the statutory qualifications or violates his or her duty of loyalty to the company. If an external directorship becomes vacant, a company’s board of directors is required under the Companies Law to call a shareholders’ meeting promptly to appoint a new external director.

Each committee of a company's board of directors that has the right to exercise a power delegated by the board of directors is required to include at least one external director, and the audit and compensation committees are required to include all of the external directors. An external director is entitled to compensation as provided in regulations adopted under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with services provided as an external director.

#### Israeli-appointed directors

Our license requires that at least 10% of our directors will be appointed and removed by shareholders who are Israeli Shareholders. If our Board of Directors is comprised of 14 directors or less, the Israeli Shareholders will be entitled to appoint one director, and if our Board of Directors is comprised of between 15 and 24 directors, the Israeli shareholders will be entitled to appoint two directors. Our articles of association so provide. Mr. Mauricio Wior is the director appointed by the Israeli Shareholders.

#### Board Committees

Our Board of Directors has established an audit committee, analysis committee, option committee, compensation committee and a security committee.

#### Audit committee

Under the Companies Law, the board of directors of a public company must establish an audit committee. The audit committee must consist of at least three directors and must include all of the company's external directors, and the majority of its members is required to be independent (as such term is defined under the Companies Law). The chairman of the audit committee is required to be an external director. The members of the audit committee are also required to meet the independence requirements established by the SEC in accordance with the requirements of the Sarbanes-Oxley Act.

Our audit committee provides assistance to our Board of Directors in fulfilling its legal and fiduciary obligations in matters involving our accounting, auditing, financial reporting and internal control functions by pre-approving the services performed by our independent accountants and reviewing their reports regarding our accounting practices and systems of internal control over financial reporting. The audit committee also oversees the audit efforts of our independent accountants and takes those actions as it deems necessary to satisfy itself that the accountants are independent of management and is responsible for reviewing and approving certain related party transactions, as described below

Our audit committee is composed entirely of independent members (both under the Companies Law and the Sarbanes-Oxley Act) and includes all the external directors. The members of our audit committee are Messrs. Barnea (chairman), Waxe, and Kunda and Ms. Baytel. Our board of directors determined Ms. Baytel to be qualified to serve as an "audit committee financial expert" as defined by the SEC's rules. Following our 2019 Annual Shareholders Meeting and subject to their appointment by the shareholders, the Audit Committee shall be comprised of Ms. Liberman and Messrs. Hauzer, Traiber and Kunda.

#### Financial exposure management subcommittee

Our financial exposure management subcommittee, which is a subcommittee of our audit committee, was nominated by our Board of Directors and reviews our financial exposures, investment and hedging policies and recommends to our Board of Directors how we might enhance our investment and hedging performance. Our financial exposure management subcommittee consists of our external directors, Mr. Barnea and Ms. Baytel.

#### Analysis committee

Our analysis committee reviews our costs and annual budget and recommends ways to achieve cost efficiency in our activities to our Board of Directors. Our analysis committee also reviews our operations and future plans and recommends how we might enhance our present and future performance to our Board of Directors. Our analysis committee consists of Messrs. Erel, Wior, Barnea (chairman), Waxe, and Kunda and Ms. Baytel.

#### Option committee

Our option committee administers the issuance of options under our 2015 Share Incentive Plan to our employees who are not office holders, as well as any actions and decisions necessary for the ongoing management of the plan. Our option committee consists of Messrs. Erel (chairman) and Barnea.

#### Security committee and observer

Our security committee, which we were required to appoint once we became a public company pursuant to our license, deals with matters concerning state security. Only directors who have the requisite security clearance by Israel's General Security Services may be members of this committee. The committee is required to be comprised of at least four members, including at least one external director. In addition, the Minister of Communications is entitled under our license to appoint a state employee with security clearance to act as an observer in all meetings of our Board of Directors and its committees. Such an observer was appointed in February 2008. Our security committee consists of Messrs. Erel, Waxe, Kunda and Barnea.

#### Compensation committee

Under the Companies Law, the board of directors of a public company must establish a compensation committee. The compensation committee must consist of at least three directors and must include all of the company's external directors and the external directors must constitute the majority of its members. The chairman of the compensation committee must be one of the external directors. Other members of the committee should be directors whose terms of compensation are the same as external directors. Under the Companies Law, the compensation committee functions are to recommend to the board of directors, for ultimate shareholder approval by a special majority, a policy governing the compensation of office holders, based on specified criteria, to review modifications to the compensation policy from time to time, to review its implementation and to approve the actual compensation terms of office holders. The composition of our compensation committee complies with the requirements described above. Our compensation committee consists of Ms. Baytel (chairperson), Mr. Kunda and Mr. Barnea.



## Internal Auditor

Under the Companies Law, the board of directors of a public company must appoint an internal auditor nominated by the audit committee. The role of the internal auditor is to examine whether a company's actions comply with applicable law and orderly business procedure. Under the Companies Law, the internal auditor may not be an interested party or an office holder, or a relative of any of the foregoing, nor may the internal auditor be the company's independent accountant or its representative. An interested party is generally defined in the Companies Law as a 5% or greater shareholder, any person or entity who has the right to designate one director or more or the chief executive officer of the company or any person who serves as a director or as the chief executive officer. Our internal auditor is Mr. Itzik Ravid of Rave Ravid and Associates, a leading Israeli internal auditing firm.

## Approval of Specified Related Party Transactions under Israeli Law

### Fiduciary duties of office holders

The Companies Law imposes a duty of care and a duty of loyalty on all office holders of a company. The duty of care requires an office holder to act with the degree of care with which a reasonable office holder in the same position would have acted under the same circumstances. The duty of care includes a duty to use reasonable means, in light of the circumstances, to obtain:

- information on the appropriateness of a given action brought for his or her approval or performed by virtue of his or her position; and
- all other important information pertaining to these actions.

The duty of loyalty of an office holder includes a duty to act in good faith and for the best interests of the company, including to:

- refrain from any conflict of interest between the performance of his or her duties in the company and his or her other duties or personal affairs;
- refrain from any activity that is competitive with the company;
- refrain from exploiting any business opportunity of the company to receive a personal gain for himself or herself or others; and
- disclose to the company any information or documents relating to the company's affairs which the office holder received as a result of his or her position as an office holder.

#### Personal interests of an office holder

The Companies Law requires that an office holder disclose any personal interest that he or she may have and all related material information known to him or her relating to any existing or proposed transaction by the company promptly and in any event no later than the first meeting of the board of directors at which such transaction is considered. If the transaction is an extraordinary transaction, the office holder must also disclose any personal interest held by the office holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of these people.

Under the Companies Law, an extraordinary transaction is a transaction:

- other than in the ordinary course of business;
- that is not on market terms; or
- that is likely to have a material impact on the company's profitability, assets or liabilities.

Under the Companies Law, once an office holder complies with the above disclosure requirement, the transaction can be approved, provided that it is in the best interest of the company. A director who has a personal interest in a matter which is considered at a meeting of the board of directors or the audit committee, will generally not be present at this meeting or vote on this matter unless a majority of the directors or members of the audit committee have a personal interest in the matter. If a majority of the directors have a personal interest in the matter, the matter also generally requires approval of the shareholders of the company. Under the Companies Law, unless the articles of association provide otherwise, a transaction with an office holder, or a transaction with a third party in which the office holder has a personal interest, requires approval by the board of directors. If it is an extraordinary transaction, audit committee approval is required, as well. For the approval of the compensation, indemnification or insurance of an officer holder, see "Compensation arrangements" below. Our articles of association provide that a non-extraordinary transaction with an office holder, or with a third party in which an office holder has a personal interest, may be approved by our Board of Directors, by our Audit Committee or, if the transaction involves the provision of our communications services and equipment or involves annual payments not exceeding NIS 250,000 per transaction, by our authorized signatories.

#### Personal interests of a controlling shareholder

Under the Companies Law, the disclosure requirements that apply to an office holder also apply to a controlling shareholder of a public company. A controlling shareholder for this purpose is a shareholder who has the ability to direct the activities of a company, including a shareholder that owns 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights, but excluding a shareholder whose power derives solely from his or her position on the board of directors or any other position with the company. Accordingly, Koor, DIC, our Israeli Shareholders, and entities and persons that directly or indirectly control DIC, are considered to be our controlling shareholders. Extraordinary transactions with a controlling shareholder or with relatives of a controlling shareholder or in which a controlling shareholder has a personal interest, directly and indirectly, including through a company controlled by him or her, and any transaction for him or her to provide services to the company (for arrangements regarding the compensation, indemnification or insurance of a controlling shareholder, see "Compensation arrangements" below), require the approval of the audit committee, the board of directors and a majority of the shareholders of the company, in that order. In addition, the shareholders' approval must be by a Special Majority.

In addition, any such extraordinary transaction whose term is more than three years generally requires approval as described above every three years.

#### Compensation arrangements

Every Israeli public company must adopt a compensation policy, recommended by the compensation committee and approved by the board of directors and the shareholders, in that order. The shareholder approval requires a Special Majority. In general, all office holders' terms of compensation – including fixed remuneration, bonuses, equity compensation, retirement or termination payments, indemnification, liability insurance and the grant of an exemption from liability – must comply with the company's compensation policy.

In addition, the compensation terms of directors, the chief executive officer, and any employee or service provider who is considered a controlling shareholder generally must be approved separately by the compensation committee, the board of directors and the shareholders of the company by a Special Majority, in that order. The compensation terms of other officers require the approval of the compensation committee and the board of directors.

#### Duties of shareholders

Under the Companies Law, a shareholder has a duty to refrain from abusing his or her power in the company and to act in good faith in exercising its rights in, and performing its obligations to the company and other shareholders, including, among other things, voting at general meetings of shareholders on the following matters:

- an amendment to the articles of association;
- an increase in the company's authorized share capital;
- a merger; and
- approval of related party transactions that require shareholders' approval.

In addition, any controlling shareholder, any shareholder who knows that its vote can determine the outcome of a shareholders' vote and any shareholder who, under the company's articles of association, can appoint or prevent the appointment of an office holder or holds any other right in respect of the company, is required to act with fairness towards the company. The Companies Law does not describe the substance of this duty except to state that the remedies generally available upon a breach of contract will also apply in the event of a breach of the duty to act with fairness, and this duty is the subject of ongoing judicial interpretation.

## Approval of Private Placements

Under the Companies Law, a private placement of securities requires approval by the board of directors and the shareholders of the company if it will cause a person to become a controlling shareholder or if:

- the securities issued amount to 20% or more of the company's outstanding voting rights before the issuance;
- some or all of the consideration is other than cash or listed securities or the transaction is not on market terms; and
- the transaction will increase the relative holdings of a shareholder that holds 5% or more of the company's outstanding share capital or voting rights, or will cause any person to become, as a result of the issuance, a holder of more than 5% of the company's outstanding share capital or voting rights.

## D. EMPLOYEES

Our ability to achieve our strategic goals largely depends on our employees. Consequently, we strive to recruit the most suitable candidates for each position, to give our employees the best training needed to qualify them for their tasks within our organization and aim to keep them satisfied while being productive and efficient. We implement a comprehensive review system that periodically analyzes our employees' performance in order to improve their performance and in order to enable us to properly compensate, retain and promote our best employees. Since we are committed to providing the best service to our subscribers, approximately 74% of our work force is engaged in customer-facing positions.

The numbers and breakdowns of our full-time equivalent employees as of the end of the past three years are set forth in the following table:

Unit	Number of Full-Time Equivalent Positions		
	December 2016	December 2017	December 2018***
Management and headquarters	40	42	44
Human resources	98	99	100
Marketing	59	58	53
Customers*	2,514	2,443	2,482
Finance	130	128	154
Technologies	540	537	500
Our subsidiaries**, excluding our wholly owned dealer	181	51	60
Total	3,563	3,358	3,392

\*Includes the customer-facing units: business customers, sales and services and supply chain.

\*\*Includes companies in which we hold 50% or more of the issued share capital. Includes 133 employees in 2016 of one of our subsidiaries which was sold in 2017.

\*\*\*In 2018, following the transfer of a wholly owned subsidiary's operations into Cellcom Fixed Line Communications Limited Partnership (also wholly owned), all the former employees of such subsidiary became employees of Cellcom Israel Ltd.



In 2015, we entered into a collective employment agreement with the Company's employees' representatives and the Histadrut, an Israeli labor union, for a term of three years (2015-2017) and Dynamica, our wholly owned dealer, entered into a similar collective employment agreement with Dynamica's employees' representatives and the Histadrut in July 2016. In July 2018 we and Dynamica entered a new collective employment agreement for a term of three years (2018-2020). The agreement applies to the Company's employees, excluding certain managerial and specific positions. The agreement defines employment policy and terms in various aspects, which are more favorable to our employees than the requirements of Israeli law, including minimum wage, annual salary increase, incentives, benefits, participation in our operational income over a certain threshold and other one time or annual payments to the employees, as well as a welfare budget and procedures relating to manning a position, change of place of employment and dismissal. In January 2019, the Histadrut announced a labor dispute at the Company and Dynamica regarding our intention to dismiss approximately 250 employees and failure to agree on other streamlining measures with the employees' union which do not include involuntary termination of employment. Under the announcement, our employees would be entitled to take organizational steps (including a strike). We are negotiating a new collective employment agreement with our employees' representatives and the Histadrut but cannot guarantee the outcome of such negotiations. See also "Item 3. Key Information – D. Risk Factors – Risks Related to our Business – The unionizing of our employees may impede necessary organizational and personnel changes, result in increased costs or disruption to our operation".

Israeli labor laws govern many aspects of the terms and conditions of employment and dismissal of employees, including minimum wages for employees, severance pay (Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment) and the employer's obligation to contribute certain percentages of the wages to a pension plan. As of January 2017, contribution to a pension plan by the employee is 6% of the employee's wages, with an additional 6.5% contribution by the employer. According to our collective employment agreement, such payments shall be increased as of 2020 to 7% and 7.5%, respectively. We contribute to part of our employees' pension arrangements a percentage higher than that required by applicable regulation, which contributions are also intended to cover future severance payments. Under the collective employment agreement, the contributions to severance payment of the employees shall amount to 8.3% of the employee wages, after completing 3 years of employment with us. A provision in our consolidated financial statements covers severance pay in other cases, such as to those employees who were not entitled to managers' insurance or other pension arrangements. Furthermore, we and our employees are required to make payments to the National Insurance Institute, which is similar to the U.S. Social Security Administration. Such amounts also include payments by the employee for health insurance. As of January 1, 2019, the total payments to the National Insurance Institute are up to 19.6% of an employee's wages (up to a specified amount), of which the employee contributes approximately 12% and the employer contributes approximately 7.6%.

The Israeli labor law subjects employers to increased liability, including monetary sanctions and criminal liability, in cases of violations of certain labor laws and certain violations by contractors providing maintenance, security and cleaning services.

In 2015, the Minimum Wage Law was amended to increase the minimum wage paid to employees in Israel in four installments, from April 2015 to December 2017. The increase has adversely affected our results of operations. In April 2018, the hourly minimum wages increased again as a result of shortening of the work week in Israel.

We enter into personal employment agreements with our employees on either a monthly (in most cases, full-time positions) or hourly basis. Employment agreements of our employees who are included in the collective agreement are subject to the provisions of the collective employment agreement. Substantially all of our employees have signed non-disclosure and non-competition agreements, although the enforceability of non-competition agreements is limited under Israeli law

Our employee compensation structure is aimed at encouraging and supporting employee performance towards enabling us to meet our strategic goals. Approximately 87% of our customer-facing employees are entitled to performance-based incentives, which are granted mainly to customer-facing personnel. In addition, some of our employees are entitled to an annual bonus based on our overall performance and individual performance, subject to the discretion of our Board of Directors. Under the collective employment agreement, some of our employees are entitled to an annual bonus. We also contribute funds on behalf of some of our employees to an education fund and under the collective employment agreement to all employees after completing 3 years of employment with us.

We have entered into agreements with a number of services companies under which they provide us with temporary workers.

In the second quarter of 2016 and 2018 we launched, together with the employees representing labor union, voluntary retirement plans for employees, in each of which approximately 190 employees have retired, following which we incurred costs of approximately NIS 13 million and NIS 26 million, respectively.

#### E. SHARE OWNERSHIP

As of January 31, 2019, Koor beneficially owned 45,404,130 ordinary shares in addition to 5,809,838 ordinary shares which are held (through a lending transaction) by two Israeli shareholders, which are considered joint controlling shareholders with Koor, and the voting rights in an additional 3,412,500 ordinary shares are held by Koor. In addition, Koor also holds series 2 options exercisable for 1,578,550 ordinary shares issuable upon the exercise of our TASE-listed options held by Koor until June 2019. This does not include a total of 5,288,618 ordinary shares held as of January 23, 2019 by indirect subsidiaries of IDB Development Corporation Ltd., a company controlled by our controlling shareholder, or IDB, and DIC, all for members of the public through, among others, provident funds, mutual funds, pension funds, insurance policies and unaffiliated third-party client accounts, which are managed by these companies. Certain reporting persons under DIC's and Koor's Schedule 13D/A disclaim beneficial ownership of certain shares reported therein. Except as described above, none of our executive officers or directors beneficially owns 1% or more of our outstanding ordinary shares.

#### Share Incentive Plans

We have introduced two Share Incentive Plans, the first in September 2006 and the second in March 2015. The 2015 option plan, or the Plan, is open to all our employees, directors, consultants and sub-contractors and to those of our affiliates and our shareholders' affiliates. Under the plan, our Board of Directors (or an option committee to which such authority may be delegated by our Board of Directors) is authorized to determine the terms of the awards, including the identity of grantees, the number of options or restricted stock units ("RSUs") to be granted, the vesting schedule and the exercise price. The options or RSUs have a term of six years and vest in three equal installments on each of the first, second and third anniversary of the date of grant. Under the Plans, unvested options or RSUs terminate immediately upon termination of employment or service. The Plans define acceleration events of options or RSUs granted, including a merger, a consolidation, a sale of all or substantially all of our consolidated assets, or the sale or other disposition of all or substantially all of our outstanding shares. The Plan terminates upon the earlier of ten years from its adoption date or the termination of all outstanding options or RSUs pursuant to an acceleration event. The terms of the Plan provide for a net exercise mechanism, the result of which is to require us to issue a smaller number of ordinary shares than represented by the outstanding options. Unless the Board of Directors otherwise approves, the number of ordinary shares issuable by us upon the exercise of an option will represent a market value that is equal to the difference between the market price of the ordinary shares and the option exercise price of the exercised options, at the date of exercise. Distribution of cash dividends before the exercise of the options reduces the exercise price of each option by an amount equal to the gross amount of the dividend per share distributed.

In August 2015, our compensation committee and board of directors resolved to grant 2,660,000 options under the 2015 share incentive plan to certain non-director officers and senior employees, of which 1,740,000 options were granted to the Company's executive officers, including 525,000 options to Mr. Sztern, the Company's CEO, at an exercise price of NIS 25.65 per share. Mr. Sztern's grant was further subject to shareholders approval in accordance with the Companies Law, which was received in October 2015. In November 2016, our board of directors resolved to grant 63,000 options under the 2015 share incentive plan to certain senior employees, at an exercise price of NIS 29.97 per share. The options granted will be vested in three equal installments on each of the first, second and third anniversary of the date of grant. The options of the first installment may be exercised within 24 months from their vesting, and the options of the second and third installments may be exercised with 18 month from their vesting. We will record the total sum of approximately NIS 12 million, as a compensation cost related to these grants, over the vesting period (2015 – 2019).

In November 2017, senior employees and non-director officers of the Company sold an aggregate of 399,078 shares of the Company issued to them upon their exercise of vested options, constituting approximately 0.39% of the Company's issued share capital, to financial institutions. To our knowledge, the purchasers intended to place such shares for sale outside the United States to non-US investors.

As of December 31, 2018, an aggregate of 780,332 ordinary shares were issuable upon exercise of options according to the terms above.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### A. MAJOR SHAREHOLDERS

The following table sets forth information regarding beneficial ownership of our shares as of January 31, 2019, by each person, or group of affiliated persons, known to us to be the beneficial owner of 5% or more of our outstanding shares.

In accordance with the rules of the SEC, beneficial ownership includes voting or investment power with respect to securities and includes any shares issuable pursuant to options that are exercisable within 60 days of January 31, 2019. Any shares issuable pursuant to options are deemed outstanding for computing the percentage of the person holding such options but are not outstanding for computing the percentage of any other person. The percentage of beneficial ownership for the following table is based on 116,196,729 ordinary shares outstanding as of January 31, 2019. To our knowledge, except as indicated in the footnotes to this table and pursuant to applicable community property laws, our major shareholders do not have different voting rights and the persons named in the table have sole voting and investment power with respect to all ordinary shares held by them.

Name of Beneficial Owner	Shares Beneficially Owned	
	Number	Percent
Koor Industries Ltd., or Koor *	56,205,018	47.72 %
Psagot Investment House Ltd.**	5,902,248	5.08 %
Menora Mivtachim Holdings Ltd.***	10,437,103	8.98 %
Directors and executive officers as a group (17 persons)****	542,000	0.47 %

Koor is a private company, wholly owned by Discount Investment Corporation Ltd., or DIC. DIC, a public Israeli company traded on the Tel Aviv Stock Exchange, is owned approximately 84% by Dolphin IL Investment Ltd., or \* Dolphin IL, and Tyrus S.A., both private companies controlled by various companies controlled by Mr. Eduardo Elzstain.

Koor's holdings include: (1) 45,404,130 ordinary shares held by Koor directly; (2) 5,809,838 ordinary shares held by the two Israeli shareholders (2,904,919 shares each) who are considered joint controlling shareholders with Koor (through a lending transaction) (one of which is controlled by Mr. Mauricio Wior, the vice chairman of the Company, and one of which is controlled by Mr. Blejer, an officer of a company controlled by the Company's controlling shareholder); (3) 3,412,500 ordinary shares (representing approximately 2.94% of our issued and outstanding shares) held by a few shareholders whose voting rights are vested in Koor; and (4) 1,578,550 ordinary shares issuable upon the exercise of our TASE-listed series 2 options held by Koor that are fully exercisable. Does not include 5,264,621 ordinary shares (representing approximately 4.53 % of our issued and outstanding shares) held as of January 23, 2019 by Clal Insurance Enterprises Holdings Ltd., which is an affiliate of IDB Development Corporation Ltd., a company controlled by our controlling shareholder, or IDB, and 23,997 ordinary shares (representing approximately 0.02 % of our issued and outstanding shares) held as of January 23, 2019, held by another indirect subsidiary of DIC, all for members of the public through, among others, provident funds, mutual funds, pension funds, insurance policies and for unaffiliated third-party client accounts, which are managed by these companies.

The Israeli shareholders have appointed one member of our board of directors pursuant to our cellular license and our Articles of Association, and DIC's CEO serves as a member of our board of directors.

Approximately 82% of DIC's share capital has been pledged as collateral to IDB's debenture holders and IDB, in several pledges of varying ranks pursuant to the previously reported sale of DIC to Dolphin IL. Based on the foregoing, Dolphin IL (by reason of its control of DIC), DIC (by reason of its control of Koor), companies controlled by Eduardo Elzstain (as described above), and Eduardo Elzstain may be deemed to share with Koor the power to vote and dispose of our shares beneficially owned by Koor. Certain reporting persons under DIC's and Koor's Schedule 13D/A disclaim beneficial ownership of certain shares reported therein.

Based on a Schedule 13G filed by Psagot Investment House Ltd. with the SEC on February 19 and 25, 2019, it has \*\*shared dispositive power with respect to 5,902,248 shares and shared voting power with respect to 2,926,130 shares.

\*\*\* Based on a Schedule 13G filed by Menora Mivtachim Holdings Ltd. with the SEC on February 13, 2019, it has shared dispositive power and shared voting power with respect to all such shares.

\*\*\*\* Includes 542,000 ordinary shares issuable upon the exercise of stock options that are exercisable on, or within 60 days following January 31, 2019.

As of December 31, 2018, we had 18 holders of record of our equity securities who are, to our knowledge, located in the United States. The shares held by these holders of record represent 82% of our outstanding ordinary shares. However, this number is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are located because nearly all of such ordinary shares were held of record by Cede & Co. for the account of the brokers or other nominees, including the Tel Aviv Stock Exchange; approximately 44.08% of our ordinary shares owned directly and indirectly by Koor as of January 31, 2019 is also held of record by Cede & Co.

In 2018, DIC purchased approximately 1.5% of our issued share capital through the exercise of our series 1 options and on the TASE.

## B. RELATED PARTY TRANSACTIONS

### Agreements among our Shareholders

In January 2018, Koor entered into a lending transaction under which 5% of our outstanding share capital held by Koor was transferred to two Israeli Shareholders (2.5% to each), or the Transferred Shares. One of them is controlled by Mr. Mauricio Wior, the vice chairman of the Company, and the other is controlled by an officer of a company controlled by the Company's controlling shareholder. The main terms of the agreement are:

The agreement will be in force until December 31, 2018 and will be automatically extended by a one year term until terminated according to its terms.

Koor will have the right to terminate the agreement at any time and receive all or part of the Transferred Shares. The Israeli Shareholders will not be able to transfer the Transferred Shares without Koor's approval and subject to additional terms, including the transferees assuming the Israeli Shareholder's obligation towards Koor pursuant to the Agreement, the transferees being "Israeli Shareholders" under the Company's cellular license and the MOC's prior approval of such transfer, if required.

As long as such requirement exists in the Company's cellular license, the Israeli Shareholders will have the right to appoint 10% of our directors (currently – one director). The Israeli Shareholders will vote with Koor in all shareholders resolutions (including the nomination of directors suggested by Koor). The Israeli Shareholders will be considered as joint-holders with Koor in our shares according to the Israeli Securities Law and, therefore, joint controlling shareholders.

The Transferred Shares (including all rights or income therefrom) will be pledged by a first-degree pledge in favor of Koor, and any realization of such pledge will be subject to the receipt of the MOC's approval, if required.

In case of any dividend or other distribution (including rights by way of a rights offering), these will be transferred by the Israeli Shareholders to Koor. In case of other corporate actions, including conversion, sub-division, consolidation etc., Koor may notify the Israeli Shareholders, at its sole discretion, if such rights will be part of the Transferred Shares or shall be transferred to Koor.

### Minority shareholders agreements

Original minority shareholders (or their successors and assignees) currently own approximately 2.94% of our outstanding ordinary shares. These minority shareholders have granted the voting rights in these shares to Koor and are restricted from transferring these shares without the prior written consent of Koor and their transfer are subject to a right of first refusal in favor of Koor. Each of these minority shareholders has also committed not to compete, directly or indirectly, with our cellular communications business in Israel so long as he is a shareholder and for a period of one year thereafter.

## Migdal 2006 share purchase agreement

In 2006, DIC sold 4% of our then outstanding ordinary shares to Migdal Insurance Company Ltd. and two of its affiliates, or the Migdal shareholders. As part of this transaction, DIC granted the Migdal shareholders a tag along right, in the event it sells shares resulting in it no longer being a controlling shareholder. In return, DIC has the right to force the Migdal shareholders to sell their shares in a transaction in which DIC sells all of its shares to a purchaser outside DIC or IDB and their affiliates. To the best of our knowledge, no such right has materialized.

## Relationship with Affiliates

As of December 31, 2018, an aggregate amount of approximately NIS 8 million principal amount of our Series F through K Debentures were held by entities affiliated with DIC and IDB's principal shareholders or officers for the benefit of members of the public through provident funds, mutual funds, pension funds and unaffiliated third-party client accounts.

As of December 31, 2018, an aggregate of 5,288,618 of our ordinary shares were held by members of the public through, among others, provident funds, mutual funds, pension funds, insurance policies and unaffiliated third-party client accounts, which are managed by indirect subsidiaries of IDB and DIC. Such holdings are not included in the holdings set forth in the Beneficial Owners' table above.

In October 2006, we entered into an agreement with DIC pursuant to which DIC provided us with services in the areas of management, finance, business and accountancy and with employees and officers of DIC and its affiliates and subsidiaries to be directors of the Company, including the services of the chairman of our board of directors. In 2015, the agreement was amended so that the annual consideration for DIC's management services would be equal to the director's fees (both the annual fee and the meeting attendance fee) paid to our external and independent directors (see "– Executive Officer and Director Compensation" above), for each director that DIC nominates or proposes to our Board of Directors, but no more than five directors.

Under the Companies Law, an agreement with a controlling shareholder, such as our management services agreement with DIC, cannot continue for more than three consecutive years unless re-approved by the audit committee, board of directors and minority shareholders. Accordingly, our audit committee, board of directors and minority shareholders approved the agreement for a term ending in October 2018. In 2018, we paid such management fees to DIC for the services of Mr. Sholem Lapidot (since his election to office in March 2018). The agreement was not renewed for an additional term after October 2018.

In the ordinary course of business, from time to time, we purchase, lease, sell and cooperate in the sale of goods and services, or otherwise engage in transactions with DIC, IDB or affiliates thereof, entities affiliated with DIC or IDB's principal shareholders or officers and entities otherwise engaged with such DIC or IDB member or affiliates in a manner that may create a personal interest of our controlling shareholders or directors. We believe that all such transactions are on commercial terms comparable to those that we could obtain from unaffiliated parties. These transactions are subject to rigorous corporate governance rules, as described under Item 6.C under "Approval of Specified Related Party Transactions under Israeli Law".

## Registration Rights Agreement

In 2006, we entered into a registration rights agreement with DIC, two wholly-owned subsidiaries of DIC (one of whom ceased to exist in 2011) which are shareholders and six other shareholders (some of whom no longer hold the registrable shares). For a summary of the terms of the agreement, see “Item 10. Additional Information – C. Material Contracts.”

### C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

## ITEM 8. FINANCIAL INFORMATION

### A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

#### Consolidated Financial Statements

See Item 18.

#### Legal Proceedings General

We are served from time to time with claims concerning various matters, including disputes with customers, former employees, commercial disputes with third parties with whom we do business and disputes with government entities, including local planning and building committees and the Ministry of Communications. These include purported class actions, filed mainly by our subscribers, regarding claims such as alleged overcharging of tariffs, misleading representations, providing services not in compliance with applicable law, our license’s requirements or a subscriber’s agreement. The following is a summary of all significant or potentially significant litigation as well as all our purported class actions, pending as of the date of this annual report.

Increased number of requests for certification of class action lawsuits against us may increase our legal exposure as a result of such class action lawsuits and our legal costs in defending against such suits. See “Item 3. Key Information – D. Risk Factors – We are exposed to, and currently are engaged in, a variety of legal proceedings, including class action lawsuits.”

In cases where the claim is approved, all amounts noted below will be adjusted to reflect changes in the Israeli CPI and statutory interest, from the date that each claim was filed.

Based on advice of counsel, we believe it is more likely than not that substantially all the claims and disputes detailed below will be determined in our favor and accordingly, no provision has been made in the financial statements in respect of these claims and disputes. We have made a provision in the amount of approximately NIS 63 million for the claim/s and dispute/s we are willing to settle or for which we cannot reach a conclusion that it is more likely than not that the claim/s and dispute/s will be determined in our favor.



## Purported class actions

35 purported class actions have been filed against us in connection with allegations that we, among others (i) unlawfully, in violation of our license or agreements with our subscribers, charged or overcharged our subscribers for our services, (ii) misled our subscribers or unlawfully sent our subscribers and other parties commercial messages, (iii) unlawfully, in violation of our license or agreements with our subscribers, discriminated among our subscribers, or (iv) failed to provide customer care in accordance with the provisions of our license and applicable law. The amount claimed estimated by the plaintiffs in these purported class actions ranges from approximately NIS 3.2 million to NIS 405 million, or was not estimated by the plaintiffs if the lawsuits are certified as class actions or were filed against us and other defendants without specifying the amount claimed from us. In addition, in one purported class action the aggregate amount claimed estimated by the plaintiffs was approximately NIS 21 million and in one purported class action no amount claimed was estimated by the plaintiffs, were dismissed (in whole or in part) and appealed by the plaintiffs or us (for details of those which were approved and appealed see "-Class actions" below). In addition, in three purported class actions, for which the aggregate amount claimed estimated by the plaintiffs was approximately NIS 15 billion, and three purported class actions in which the amount claimed was not estimated by the plaintiffs, settlement agreements were filed with the court and the proceedings are still pending.

We have recorded appropriate provisions for each of the settlement agreements filed with the courts and described above.

In 2015, a purported class action was filed against us, by plaintiffs alleging to be subscribers of the Company, claiming compensation for non-monetary damages in connection with allegations that we unlawfully violated the privacy of our subscribers and were unlawfully enriched by so doing. The amount claimed from us, if the lawsuit is certified as class action is estimated by the plaintiffs to be NIS 15 billion. In February 2017, a settlement agreement was filed with the court and the proceedings are still pending.

## Class actions

In August 2016, the district court approved a request to certify a lawsuit filed against us in February 2015 as a class action, relating to an allegation that we unlawfully charged our subscribers with early termination fees. The total amount claimed was estimated by the plaintiff to be approximately NIS 15 million. In January 2018, a settlement agreement was filed with the court and the proceedings are still pending.

In October 2016, the district court approved a request to certify a lawsuit filed against us in January 2013 as a class action, relating to an allegation that we unlawfully charged our subscribers before the subscribers' portability to our network was completed. The total amount claimed was estimated by the plaintiff to be approximately NIS 19 million. In February 2019, a settlement agreement was filed with the court and the proceedings are still pending.

In December 2016, the district court partially approved a request to certify a lawsuit filed against us in July 2014 as a class action, relating to an allegation that the commercial messages we sent to our subscribers failed to meet the requirements of applicable law. In January 2017, the plaintiffs appealed the dismissal of the allegations which were not approved, to the Supreme Court. The total amount claimed was estimated by the plaintiffs to be approximately NIS 21 million.

In January 2017, the district court partially approved a request to certify a lawsuit filed against us in February 2013 as a class action, relating to an allegation that we failed to disconnect customers within the time frame set in our license and applicable law. In March 2017, the plaintiffs appealed the dismissal of the allegations which were not approved, to the Supreme Court. In September 2018 plaintiff's appeal was consensually dismissed. The total amount claimed had the purported class action been approved was estimated by the plaintiffs to be approximately NIS 72 million.



In December 2017, the district court partially approved a request to certify a lawsuit filed against us in May 2015 as a class action, relating to an allegation that we breached the agreements with our subscribers by charging them for a call details service, which was previously provided free of charge, without obtaining their consent. In February 2018, we appealed the approval of this allegation to the Supreme Court and the plaintiff appealed the dismissal of other allegations. In January 2019 our appeal was consensually dismissed and the plaintiff's appeal was consensually accepted. The total amount claimed was not estimated by the plaintiffs.

In April 2018, the district court approved a request to certify a lawsuit filed against us in December 2014 as a class action, relating to an allegation that we unlawfully charged our subscribers who disconnected from our services during a certain billing cycle for a full monthly payment. The total amount claimed was not estimated by the plaintiff.

#### Dividend Policy

Our dividend policy targets the distribution of at least 75% of our annual net income on a quarterly basis, subject to applicable law, our license and our contractual obligations and provided that such distribution would not be detrimental to our cash needs or to any plans approved by our Board of Directors. Our debentures and other credit facilities include additional limitations, including a covenant not to distribute more than 95% of the profits available for distribution according to the applicable Israeli law ("Profits"), provided that if net leverage (defined as the ratio of net debt to EBITDA over four consecutive quarters) exceeds 3.5:1, we will not distribute more than 85% of the Profits and if net leverage exceeds 4.0:1, we will not distribute more than 70% of the Profits. See "Item 5. Operating and Financial Review and Prospects – B. Liquidity and Capital Resources – Debt Service" and "– Other Credit Facilities". Our Board of Directors will consider, among other factors, our expected results of operation, including changes in pricing, regulation and competition, planned capital expenditure including for technological upgrades, and changes in debt service needs, including due to changes in interest rates or currency exchange rates, as well as our debentures' rating, in order to conclude whether there is no reasonable concern that a distribution of dividends will prevent us from satisfying our existing and foreseeable obligations as they become due. Dividend payments are not guaranteed and our Board of Directors may decide, in its absolute discretion, at any time and for any reason, not to pay dividends or to pay dividends at a ratio to net income that is less than that paid in the past. For example, our Board of Directors may determine not to distribute dividends in order to strengthen our balance sheet, that market conditions are uncertain or that our cash needs for debt service, capital expenditures or operations require that we do not pay dividends when considered. Accordingly, shareholders should not expect that any particular amount or at all will be distributed by us as dividends at any time, even if we have previously made dividend payments in such amount.

Our ability to pay dividends is subject to the following limitations under Israeli law: (1) dividends may only be paid out of cumulative retained earnings or out of retained earnings over the prior two years, provided that there is no reasonable concern that the payment of the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due; and (2) our license requires that we and our 10% or more shareholders maintain at least \$200 million of combined shareholders' equity. Our shareholders' equity on December 31, 2018 was over \$ 200 million.

When we declare dividends, we do so in NIS and convert them for payment in US\$ (where applicable) based upon the daily representative rate of exchange as published by the Bank of Israel prior to the distribution date.

In 2016, 2017 and 2018 our Board of Directors chose not to declare dividends given the intensified competition and its adverse effect on our results of operations and in order to strengthen our balance sheet.

**B. SIGNIFICANT CHANGES**

No significant change has occurred since December 31, 2018, except as otherwise disclosed in this annual report.

**ITEM 9. THE OFFER AND LISTING**

**A. OFFER AND LISTING DETAILS**

**Trading in Israel**

Our ordinary shares have traded on the Tel Aviv Stock Exchange, or the TASE, under the symbol CEL since July 1, 2007. Our ordinary shares do not trade on any other trading market in Israel.

**Trading in the United States**

Our ordinary shares have traded on the New York Stock Exchange, or NYSE, under the symbol CEL since February 7, 2007.

**B. PLAN OF DISTRIBUTION**

Not applicable.

**C. MARKETS**

Our ordinary shares are listed on the NYSE and TASE under the symbol “CEL.”

**D. SELLING SHAREHOLDERS**

Not applicable.

**E. DILUTION**

Not applicable.

F. EXPENSES OF THE ISSUE

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL

Not applicable.

B. MEMORANDUM AND ARTICLES OF ASSOCIATION

Objects and Purposes

Our registration number with the Israeli registrar of companies is 51-1930125. Our object is to engage, directly or indirectly, in any lawful undertaking or business whatsoever as determined by our Board of Directors, including, without limitation, as stipulated in our memorandum of association.

Transfer of Shares

Fully paid ordinary shares are issued in registered form and may be freely transferred unless the transfer is restricted or prohibited by our articles of association, applicable law, our licenses or the rules of a stock exchange on which the shares are traded. The ownership or voting of ordinary shares by non-residents of Israel is not restricted in any way by our articles of association or the laws of the State of Israel, except for ownership by nationals of some countries that are, or have been, in a state of war with Israel.

The restrictions included in our licenses regarding holding and transferring of our means of control are included in our articles of association. For more details relating to these restrictions, see "Item 4. Information on the Company – B. Business Overview – Government Regulations – Cellular Segment – Our Cellular License" and our principal license, a convenience translation of which has been filed with the SEC. See "Item 19 – Exhibits". The holding and transfer restrictions under our licenses are posted on our website at <http://investors.cellcom.co.il> under "Investor Relations – Corporate Governance – Legal and Corporate."

Voting

Holders of our ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders at a shareholder meeting. Shareholders may vote at shareholder meetings either in person, by proxy or by written ballot. Shareholder voting rights may be affected by the grant of special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future. As required under our license, our articles of association provide that any holdings of our ordinary shares that contravene the holding or transfer restrictions contained in our license (see "—Transfer of Shares" above) will not be entitled to voting rights. In addition, our license requires that as a condition to voting at any meeting of shareholders, in person or by proxy, each shareholder must certify that its holdings of our shares do not contravene the restrictions contained in our license.

## Election of Directors

Our ordinary shares do not have cumulative voting rights for the election of directors. Rather, under our articles of association our directors (other than external directors and directors appointed by Israeli Shareholders – see “Item 6.A – Directors and Senior Management—External Directors” and “-Israeli Appointed Directors.” above) are elected at a shareholders meeting by a simple majority of our ordinary shares. Directors may also be appointed by our Board of Directors, in which case they shall serve until the next annual general meeting of shareholders.

## Dividend and Liquidation Rights

Our board of directors may, subject to the Companies Law, our financing agreements, and our licenses, declare a dividend to be paid to the holders of ordinary shares on a pro rata basis. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares on a pro rata basis. This right may be affected by the grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

## Shareholders Meetings

We are required to convene an annual general meeting of our shareholders once every calendar year within a period of not more than 15 months following the preceding annual general meeting. Our board of directors is required to convene a special general meeting of our shareholders at the request of two directors or one quarter of the members of our Board of Directors or at the request of one or more holders of 5% or more of our share capital and 1% of our voting power or the holder or holders of 5% or more of our voting power. All shareholders meetings require prior notice of at least 21 days, or up to 35 days if required by applicable law or regulation. We provide at least 40 day advance written notice, in accordance with the NYSE’s rules. The chairperson of our Board of Directors presides over our general meetings. Subject to the provisions of the Companies Law and the regulations promulgated thereunder, shareholders entitled to participate and vote at general meetings are the shareholders of record on a date to be decided by the board of directors, which may be between four and 40 days prior to the date of the meeting.

## Quorum

Our articles of association provide that the quorum required for any meeting of shareholders shall consist of at least two shareholders present, in person or by proxy or written ballot, who hold or represent between them at least one-third of the voting power of our issued share capital. A meeting adjourned for lack of a quorum generally is adjourned to the same day in the following week at the same time and place or, if not set forth in the notice to shareholders, to a time and place set by the chairperson of the meeting with the consent of the holders of a majority of the voting power represented at the meeting and voting on the question of adjournment. At the reconvened meeting, the required quorum consists of at least two shareholders present, in person or by proxy or written ballot, unless the meeting was called pursuant to a request by our shareholders in which case the quorum required is the number of shareholders required to call the meeting as described under “—Shareholder Meetings.”

## Resolutions

An ordinary resolution at a shareholders meeting requires approval by a simple majority of the voting rights represented at the meeting, in person, by proxy or written ballot, and voting on the resolution. Under the Companies Law, unless otherwise provided in the articles of association or applicable law, all resolutions of the shareholders require a simple majority. A resolution for the voluntary winding up of the company requires the approval by holders of 75% of the voting rights represented at the meeting, in person or by proxy or written ballot, and voting on the resolution.

## Modification of Class Rights

The rights attached to any class, such as voting, liquidation and dividend rights, may be amended by written consent of holders of a majority of the issued shares of that class, or by adoption of a resolution by a simple majority of the shares of that class represented at a separate class meeting.

## Insurance, Indemnification and exemption of Directors and Officers

Under the Companies Law, an Israeli company may not exempt an office holder from liability for breach of his duty of loyalty, but may exempt in advance an office holder from liability to the company, in whole or in part, for a breach of his or her duty of care (except in connection with distributions), provided the articles of association of the company allow it to do so. Our articles of association allow us to do so.

Our articles of association provide that, subject to the provisions of the Companies Law, we may enter into a contract for insurance against liability of any of our office holders with respect to each of the following:

- a breach of his or her duty of care to us or to another person;
  - a breach of his or her duty of loyalty to us, provided that the office holder acted in good faith and had reasonable grounds to assume that his or her act would not prejudice our interests;
  - a financial liability imposed upon him or her in favor of another person concerning an act performed in the capacity as an office holder.
- reasonable litigation expenses, including attorney fees, incurred by the office holder as a result of an administrative enforcement proceeding instituted against him, including a payment imposed on the office holder in favor of an injured party as set forth in the Israeli Securities Law and expenses that the office holder incurred in connection with a relevant proceeding under the Israeli Securities Law, including reasonable legal expenses, which term includes attorney fees.

We maintain a liability insurance policy for the benefit of our officers and directors. See details under "Item 6. Directors, Senior Management and Employees - B. Compensation – Compensation Policy – Indemnification."

Our articles of association provide that we may indemnify an office holder against:

a financial liability imposed on or incurred by an office holder in favor of another person by any judgment, including a settlement or an arbitrator's award approved by a court concerning an act performed in his or her capacity as an office holder. Such indemnification may be approved (i) after the liability has been incurred or (ii) in advance, provided that the undertaking is limited to types of events which our Board of Directors deems to be foreseeable in light of our actual operations at the time of the undertaking and limited to an amount or criterion determined by our Board of Directors to be reasonable under the circumstances, and further provided that such events and amounts or criteria are set forth in the undertaking to indemnify;

reasonable litigation expenses, including attorney's fees, incurred by the office holder as a result of an investigation or proceeding instituted against him or her by a competent authority, provided that such investigation or proceeding was concluded without the filing of an indictment against him or her and either (A) concluded without the imposition of any financial liability in lieu of criminal proceedings or (B) concluded with the imposition of a financial liability in lieu of criminal proceedings but relates to a criminal offense that does not require proof of criminal intent; or in connection with an administrative enforcement proceeding or a financial sanction, including a payment imposed on the office holder in favor of an injured party as set forth in the Israeli Securities Law, and expenses that the office holder incurred in connection with a relevant proceeding under the Israeli Securities Law, including reasonable legal expenses, which term includes attorney fees; and

reasonable litigation expenses, including attorneys' fees, incurred by the office holder or charged to him or her by a court, in proceedings instituted by us or on our behalf or by another person, or in a criminal indictment from which he or she was acquitted, or a criminal indictment in which he or she was convicted for a criminal offense that does not require proof of intent, in each case relating to an act performed in his or her capacity as an office holder.

We have undertaken to indemnify our directors, officers and certain other employees for certain events listed in the indemnification letters given to them. In respect of office holders whom our controlling shareholders have a personal interest in their receiving indemnification letters from us, such indemnification was approved for a period of three years from our annual shareholder meeting held in 2011 and in 2014 and 2017 was extended by our audit committee and board of directors for a three year period until 2020, according to regulations promulgated under the Companies Law. Excluding reasonable litigation expenses, as described above, the aggregate amount payable to all directors and officers and other employees who may have been or will be given such indemnification letters is limited to the amounts we receive from our insurance policy plus 30% of our shareholders' equity as of December 31, 2001, or NIS 486 million, and to be adjusted by the Israeli CPI.

The Companies Law provides that a company may not exempt or indemnify an office holder, or enter into an insurance contract, which would provide coverage for any monetary liability incurred as a result of any of the following:

a breach by the office holder of his or her duty of loyalty unless, with respect to insurance coverage or indemnification, the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;



- a breach by the office holder of his or her duty of care if the breach was done intentionally or recklessly;
- any act or omission done with the intent to derive an illegal personal benefit; or
- any fine or penalty levied against the office holder.

Any exemption of, indemnification of, or procurement of insurance coverage for, our office holders must be approved according to the procedures required for the approval of compensation under "Item 6. Directors, Senior Management and Employment – C. Board Practices - Approval of Specified Related Party Transactions Under Israeli Law - Compensation Arrangements".

#### Mergers and Acquisitions under Israeli Law

The Companies Law requires that each company that is a party to a merger have the transaction approved by its board of directors and a vote of the majority of its shares at a shareholders meeting. Upon the request of a creditor of either party of the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger. In addition, a merger may not be completed unless at least (i) 50 days have passed from the time that the requisite proposal for the merger has been filed by each party with the Israeli Registrar of Companies and (ii) 30 days have passed since the merger was approved by the shareholders of each party.

The Companies Law also provides that an acquisition of shares of a public company must be made by means of a special tender offer if as a result of the acquisition the purchaser would become a 25% or greater shareholder of the company and there is no existing 25% or greater shareholder in the company. An acquisition of shares of a public company must also be made by means of a tender offer if as a result of the acquisition the purchaser would become a 45% or greater shareholder of the company and there is no existing 45% or greater shareholder in the company. These requirements do not apply if the (i) acquisition occurs in the context of a private placement by the company that received shareholder approval, (ii) the purchase of shares is from a 25% shareholder of the company and results in the acquirer becoming a 25% shareholder of the company or (iii) the purchase of shares is from a 45% shareholder of the company and results in the acquirer becoming a 45% shareholder of the company. The special tender offer must be extended to all shareholders but the offeror is not required to purchase shares representing more than 5% of the voting power attached to the company's outstanding shares, regardless of how many shares are tendered by shareholders. The special tender offer may be consummated only if (i) at least 5% of the voting power attached to the company's outstanding shares will be acquired by the offeror and (ii) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

If, as a result of an acquisition of shares, the acquirer will hold more than 90% of a company's outstanding shares, the acquisition must be made by means of a tender offer for all of the outstanding shares. If less than 5% of the outstanding shares are not tendered in the tender offer, all the shares that the acquirer offered to purchase will be transferred to it. The law provides for appraisal rights if any shareholder files a request in court within six months following the consummation of a full tender offer, but the acquirer may stipulate that any shareholder tendering his shares will not be entitled to appraisal rights. If more than 5% of the outstanding shares are not tendered in the tender offer, then the acquirer may not acquire shares in the tender offer that will cause his shareholding to exceed 90% of the outstanding shares.

Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to our shareholders who are not exempt from Israeli income tax under Israeli law or an applicable tax treaty. For example, Israeli tax law does not recognize tax-free share exchanges to the same extent as U.S. tax law. With respect to mergers, Israeli tax law allows for tax deferral in certain circumstances but makes the deferral contingent on the fulfillment of numerous conditions, including a holding period of two years from the date of the transaction during which sales and dispositions of shares of the participating companies by certain shareholders are restricted. Moreover, with respect to certain share swap transactions, the tax deferral is limited in time, and when such time expires, tax then becomes payable even if no actual disposition of the shares has occurred. For information regarding Israeli tax on the sale of our shares, see “Item 10.E - Taxation—Israeli Tax Considerations—Capital Gains Tax on Sales of Our Ordinary Shares.”

#### Anti-Takeover Measures under Israeli Law

The Companies Law allows us to create and issue shares having rights different from those attached to our ordinary shares, including shares providing certain preferred or additional rights to voting, distributions or other matters and shares having preemptive rights. We do not have any authorized or issued shares other than ordinary shares. In the future, if we do create and issue a class of shares other than ordinary shares, such class of shares, depending on the specific rights that may be attached to them, may delay or prevent a takeover or otherwise prevent our shareholders from realizing a potential premium over the market value of their ordinary shares. The authorization of a new class of shares will require an amendment to our articles of association and to our memorandum, which requires the prior approval of our shareholders by a simple majority of the shares represented and voted upon at a shareholders meeting. Our articles of association provide that our Board of Directors may, at any time in its sole discretion, adopt protective measures to prevent or delay a coercive takeover of us, including, without limitation, the adoption of a shareholder rights plan.

#### C. MATERIAL CONTRACTS

For a description of our material suppliers, see “Item 4. Information on the Company – B. Business Overview – – Network and Infrastructure – Cellular Segment – Network Sharing Agreements”, “ – Fixed-line Segment – Investment in IBC” and “–Suppliers” thereunder.

For a description of our debt agreements, see “Item 5. Operating and Financial Review and Prospects – B. Liquidity and Capital Resources – Debt Service” and “– Other Credit Facilities”.

#### Registration Rights Agreement

DIC and certain other shareholders entered into a registration rights agreement with us in 2006. As of January 31, 2019, 42,514,002 ordinary shares, held by Koor, are entitled to registration rights as well as any additional shares still held, if held, by the other shareholders who joined the agreement.

The registration rights holders are entitled to one demand registration per 12-month period, so long as such request is initiated by registration rights holders of at least 3.25% of the then outstanding registrable securities and the demand refers to a minimum of 3% of our then outstanding share capital, subject to customary deferral rights. In addition, in connection with any public offerings that we initiate in the future, if we propose to register any of our securities for our own account or for the account of any of our shareholders other than in a demand registration, the registration rights holders have piggyback rights to include their shares, subject to customary underwriters' cutback rights.

All registration rights terminate, with respect to any individual registration rights holder, at such time as all registrable shares of such holder may be sold without registration pursuant to Rule 144 under the Securities Act during any three-month period. We are required to pay all expenses incurred in carrying out the above registrations, as well as the reasonable fees and expenses of one legal counsel for the selling registration rights holders, except for underwriter discounts and commissions with respect to the shares of such holders. The agreement provides for customary indemnification and contribution provisions.

#### D. EXCHANGE CONTROLS

There are currently no Israeli currency control restrictions on payments of dividends or other distributions with respect to our ordinary shares or the proceeds from the sale of the shares, except for the obligation of Israeli residents to file reports with the Bank of Israel regarding certain transactions.

#### E. TAXATION

##### U.S. Federal Income Tax Considerations

The following is a general discussion of certain material U.S. federal income tax consequences to the U.S. holders described below of ownership and disposition of the Company's shares. This discussion does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a U.S. holder in light of the U.S. holder's particular circumstances and does not address U.S. state, local and non-U.S. tax consequences. This discussion does not address the potential application of the provisions of the Internal Revenue Code of 1986, as amended, or the Code, known as the Medicare contribution tax or any alternative minimum tax consequences. The discussion applies only to U.S. holders that hold the Company's shares as capital assets for U.S. federal income tax purposes, and it does not describe all of the tax consequences that may be relevant to U.S. holders subject to special rules, such as certain financial institutions, insurance companies, dealers or traders in securities, persons holding the shares as part of a hedge, straddle, conversion transaction or other integrated transaction, persons whose functional currency for U.S. federal income tax purposes is not the U.S. dollar, partnerships or other entities classified as partnerships for U.S. federal income tax purposes, tax-exempt organizations, shareholders that own or are deemed to own 10% or more of the Company's stock by vote or value, or shareholders that own our shares in connection with a trade or business conducted outside of the United States.

This discussion is based on the Code, administrative pronouncements, judicial decisions, final, temporary and proposed Treasury regulations and the U.S.-Israel income tax treaty, all as of the date hereof. These laws are subject to change, possibly on a retroactive basis. Shareholders are urged to consult their tax advisors regarding the U.S. federal, state, local and foreign tax consequences of purchasing, owning and disposing of the Company's shares in light of their particular circumstances.

The discussion below applies only to U.S. holders. As used herein, a "U.S. holder" is a person that is, for U.S. federal income tax purposes, a beneficial owner of the Company's shares and is either:

- a citizen or resident of the United States;
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States, any state therein or the District of Columbia; or
- an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

If an entity that is classified as a partnership for U.S. federal income tax purposes owns the Company's shares, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and upon the activities of the entity. Such entities and their partners or members should consult their tax advisors regarding the tax consequences of ownership of the Company's shares.

Except as described below, this discussion assumes that the Company is not a passive foreign investment company, or PFIC, for any taxable year.

#### Taxation of Distributions

Distributions paid on the Company's shares, other than certain pro rata distributions of ordinary shares, will be treated as dividends to the extent paid out of current or accumulated earnings and profits (as determined under U.S. federal income tax principles). Since the Company does not maintain calculations of its earnings and profits under U.S. federal income tax principles, U.S. holders will generally be required to treat such distributions as taxable dividends and include them in income on the date of receipt. Subject to applicable limitations, dividends paid to certain non-corporate U.S. holders will be taxable at favorable rates applicable to long-term capital gains. The dividend income will include any amounts withheld by the Company or its paying agent in respect of Israeli taxes. The dividend will be treated as foreign-source income and will not be eligible for the dividends-received deduction generally allowed to U.S. corporations under the Code.

Dividends paid in NIS will be included in a U.S. holder's income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date of receipt of the dividend, regardless of whether the payment is in fact converted into U.S. dollars. If the dividend is converted into U.S. dollars on the date of receipt, a U.S. holder generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. A U.S. holder may have foreign currency gain or loss if the dividend is converted into U.S. dollars after the date of receipt. Such gain or loss would generally be treated as U.S.-source ordinary income or loss.

Subject to applicable limitations that vary depending upon a U.S. holder's particular circumstances, Israeli taxes withheld from dividends at a rate not exceeding any applicable rate provided by the U.S.-Israel income tax treaty may be creditable against the U.S. holder's U.S. federal income tax liability. The limitation on a U.S. holder's eligibility for foreign tax credits is calculated separately with respect to specific classes of income. Instead of claiming a credit, a U.S. holder may, at the U.S. holder's election, deduct the otherwise creditable foreign taxes in computing the taxable income for the year, subject to generally applicable limitations under U.S. federal income tax law. An election to deduct foreign taxes instead of claiming foreign tax credits applies to all foreign taxes paid or accrued in the taxable year. The rules governing foreign tax credits are complex and U.S. holders should consult their tax advisors regarding the availability of foreign tax credits and the deductibility of foreign taxes in their particular circumstances.

#### Sale and Other Disposition of the Company's Shares

Gain or loss realized on the sale or other disposition of the Company's shares will be capital gain or loss, and will be long-term capital gain or loss if the U.S. holder owned the shares for more than one year. The amount of gain or loss will be equal to the difference between the U.S. holder's tax basis in the shares disposed of and the amount realized on the disposition, in each case as determined in U.S. dollars. Such gain or loss will generally be U.S.-source gain or loss for foreign tax credit purposes. The deductibility of capital losses is subject to limitations.

#### Passive Foreign Investment Company Rules

The Company believes that it was not a PFIC for the taxable year of 2018. However, since PFIC status depends upon the composition of a company's income and assets and the market value of its assets from time to time, there can be no assurance that the Company will not be a PFIC for any taxable year. If the Company were a PFIC for any taxable year during which a U.S. holder owned a share in the Company, certain adverse consequences could apply to the U.S. holder. Specifically, gain recognized by a U.S. holder on a sale or other disposition of a share would be allocated ratably over the U.S. holder's holding period for the share. The amounts allocated to the taxable year of the sale or other disposition and to any year before the Company became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, for that taxable year, and an interest charge would be imposed on the resulting tax liability. Further, any distribution in excess of 125% of the average of the annual distributions received by the U.S. holder on the Company's shares during the preceding three years or the U.S. holder's holding period, whichever is shorter, would be subject to taxation as described immediately above. Certain elections (such as a mark-to-market election) may be available to U.S. holders and may result in alternative tax treatment. In addition, if the Company were a PFIC for a taxable year in which we pay a dividend or the prior taxable year, the favorable dividend rates discussed above with respect to dividends paid to certain non-corporate holders would not apply. If the Company were a PFIC for any taxable year in which a U.S. holder owned the Company's shares, the U.S. holder would generally be required to file annual returns with the Internal Revenue Service, or the IRS, on IRS Form 8621.

## Information Reporting and Backup Withholding

Payment of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries may be subject to information reporting and backup withholding unless (i) the U.S. holder is a corporation or other exempt recipient or (ii) in the case of backup withholding, the U.S. holder provides a correct taxpayer identification number and certifies that the U.S. holder is not subject to backup withholding. The amount of any backup withholding from a payment to a U.S. holder will be allowed as a credit against the U.S. holder's U.S. federal income tax liability and may entitle the U.S. holder to a refund, provided that the required information is timely furnished to the IRS.

Certain U.S. holders who are individuals and certain specified entities may be required to report on IRS Form 8938 information relating to their holdings of the Company's shares, subject to certain exceptions (including an exception for securities held in accounts maintained by U.S. financial institutions). U.S. holders should consult their tax advisers regarding the application of these rules in the U.S. holders' particular circumstances.

## Israeli Tax Considerations

The following is a discussion of certain material Israeli tax consequences to purchasers of our ordinary shares. The discussion also contains a description of certain relevant material provisions of the current Israeli income tax system applicable to companies in Israel, with special reference to its effect on us. To the extent that the discussion is based on new tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the appropriate tax authorities or the courts will accept the views expressed in this discussion.

This discussion applies to shareholders that hold our ordinary shares as capital assets and does not address all of the tax consequences that may be relevant to holders of our ordinary shares in light of their particular circumstances or certain types of holders of our ordinary shares subject to special tax treatment. Because individual circumstances may differ, shareholders should consult their tax advisors to determine the applicability of the rules discussed below to them, including the application of Israeli or other tax laws. The discussion below is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

## Taxation of Israeli Companies

### General Corporate Tax Structure

Israeli companies are generally subject to corporate tax on their taxable income currently at the rate of 23%. Israeli companies are generally subject to capital gains tax at the corporate tax rate.

### Capital Gains Tax on Sales of Our Ordinary Shares

Israeli law generally imposes a capital gains tax on the sale of any capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of assets located in Israel, including shares in Israeli resident companies, by non-residents of Israel, sale of shares by non Israeli is generally exempt unless a specific exemption is available or unless a tax treaty between Israel and the shareholder's country of residence provides otherwise. In calculating capital gain, the law distinguishes between real gain and inflationary surplus. The inflationary surplus is the portion of the total capital gain equal to the increase in the relevant asset's value that is attributable to the increase in the Israeli CPI between the date of purchase and the date of sale. The real capital gain is the excess of the total capital gain over the inflationary surplus. A non-resident that invests in taxable assets with foreign currency, may elect to calculate the amount of inflationary surplus in that foreign currency. (if exempted there is no relevance)

## Taxation of Israeli Residents

The tax rate generally applicable to real capital gains derived from the sale of shares, whether listed on a stock market or not, is 25% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 30%. Additionally, if such shareholder is considered a significant shareholder at any time during the 12-month period preceding such sale, the tax rate will be 30%. For this purpose, a significant shareholder is one that holds, directly or indirectly, including with others, at least 10% of any of the means of control in a company (including, among other things, the right to receive profits of the company, voting rights, the right to receive the company's liquidation proceeds and the right to appoint a director). However, different tax rates will apply to dealers in securities, whose income from the sale of securities is considered "business income". An additional tax of 3% will be imposed on individuals whose annual taxable income exceeds a certain threshold (NIS 649,560 for 2019). Individual and corporate shareholders dealing in securities in Israel are taxed at the tax rates applicable to "business income": currently, 23% for corporations and a marginal tax rate of up to 47% for individuals, plus an additional tax of 3%, which is imposed on individuals whose annual taxable income exceeds a certain threshold (NIS 649,560 for 2019).

Israeli companies are generally subject to the corporate tax rate (see above) on capital gains derived from the sale of shares listed on a stock market at the rate of 23%.

## Taxation of Non-Israeli Residents

Non-Israeli residents (individuals and entities) are generally exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on the Tel Aviv Stock Exchange or a recognized stock exchange outside of Israel (including the New York Stock Exchange), provided that such shareholders did not acquire their shares prior to the issuer's initial public offering (in which case a partial exemption may be available) and that the gains were not derived from a permanent establishment maintained by such shareholders in Israel. Shareholders that do not engage in activity in Israel generally should not be subject to such tax. However, non-Israeli entities will not be entitled to the exemption from capital gains tax if Israeli residents (i) have a controlling interest of more than 25% in such non-Israeli entity or (ii) are the beneficiaries of, or are entitled to, 25% or more of the revenues or profits of such non-Israeli entities, whether directly or indirectly.

In addition, a sale of securities may be exempt from Israeli capital gains tax under the provisions of an applicable tax treaty. For example, under the U.S.-Israel income tax treaty, the sale of our ordinary shares by a shareholder who qualifies as a resident of the United States within the meaning of the U.S.-Israel income tax treaty and who is entitled to claim the benefits afforded to such person by the U.S.-Israel income tax treaty, referred to as a treaty U.S. resident, and who holds the ordinary shares as a capital asset, is also exempt from Israeli capital gains tax unless (i) the treaty U.S. resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, (ii) the capital gains arising from such sale are attributable to a permanent establishment of the treaty U.S. resident that is located in Israel, or (iii) the U.S. resident, if an individual, is present in Israel for a period or periods of 183 days or more in the aggregate during the tax year. However, under the U.S.-Israel income tax treaty, a treaty U.S. resident would be permitted to claim a credit for taxes paid in Israel against the U.S. federal income tax imposed on the sale, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel income tax treaty does not relate to U.S. state or local taxes. Eligibility to benefit from tax treaties is conditioned upon the shareholder presenting a withholding certificate issued by the Israel Tax Authority prior to the applicable payment.

## Taxation of Dividends Paid on Our Ordinary Shares

### Taxation of Israeli Residents

Individuals who are Israeli residents are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares at the rate of 25%, unless the recipient is a significant shareholder (as defined above) at any time during the 12-month period preceding the distribution, in which case the applicable tax rate is 30%. The company distributing the dividend is required to withhold tax at the rate of 25% (a different rate may apply to dividends paid on shares deriving from the exercise of stock options or other equity-based awards granted as compensation to employees or office holders of the company). Companies which are Israeli residents are generally exempt from income tax on the receipt of dividends from another Israeli company, unless the source of such dividends is located outside of Israel.

Moreover, an additional tax of 3% will be imposed on individuals whose annual taxable income exceeds a certain threshold (NIS 649,560 for 2019).

### Taxation of Non-Israeli Residents

Non-residents of Israel (whether individuals or entities) are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares at the rate of 25% unless the recipient is a significant shareholder at any time during the 12-month period preceding the distribution, in which case the applicable tax rate will be 30%. The company distributing the dividend is required to withhold tax at the source at the rate of 25%.

Under the U.S.-Israel income tax treaty, the maximum rate of tax withheld in Israel on dividends paid to a holder of our ordinary shares who is a treaty U.S. resident is 25%. The maximum rate of withholding tax on dividends may be reduced to 12.5% in certain circumstances where the recipient of the dividend is a U.S. corporation holding 10% or more of our outstanding voting power during the part of the tax year which precedes the date on which the dividend is distributed as well as the previous tax year and certain other conditions under the U.S.-Israel income tax treaty are met. Eligibility for such reduced rate is conditioned upon presenting a withholding certificate issued by the Israel Tax Authority allowing for withholding at such reduced rate. The aforementioned rates under the U.S.-Israel income tax treaty will not apply if the dividend income was derived through a permanent establishment of the U.S. resident in Israel.

A non-resident of Israel who has dividend income derived from or accrued in Israel, from which tax was withheld at source, is generally exempt from the obligation to file tax returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by such non-Israeli resident.



F. DIVIDENDS AND PAYING AGENTS

Not applicable.

G. STATEMENT BY EXPERTS

Not applicable.

H. DOCUMENTS ON DISPLAY

We are subject to the information reporting requirements of the Securities Exchange Act of 1934, as amended, referred to as the Exchange Act, applicable to foreign private issuers. As a foreign private issuer, we are exempt from certain rules and regulations under the Exchange Act prescribing the content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act, with respect to their purchase and sale of our ordinary shares. In addition, we are not required to file reports and financial statements with the SEC as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act. However, we file annual reports with the SEC on Form 20-F containing financial statements audited by an independent accounting firm. We also furnish reports to the SEC on Form 6-K containing unaudited financial information for the first three quarters of each fiscal year and other material information, in accordance with the reporting requirements applicable to us as a dual listed company and as required due to our controlling shareholder's reporting obligations with respect to us. Substantially all of our SEC filings are available to the public at the SEC's website at <http://www.sec.gov> and as of July 2007 also at the TASE's website at <http://maya.tase.co.il> and at the Israeli Securities Authority's website at <http://www.magna.isa.gov.il>.

I. SUBSIDIARY INFORMATION

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the course of our normal operations, we are exposed to market risks including fluctuations in foreign currency exchange rates, interest rates and the Israeli CPI. We are exposed to currency risks primarily as a result of purchasing inventory and fixed assets mainly in U.S. dollars while almost all of our cash receipts are in NIS. A substantial amount of our cash payments are incurred in, or linked to foreign currencies. In particular, in 2017 and 2018, such payments represented approximately 16% and 17%, respectively, of total cash outflows (including payments of principal and interest on our debentures). Also, we are exposed to interest rate risks through our hedging instruments and to possible fluctuations in the Israeli CPI through our Series F, H and J debentures.

In order to protect ourselves from fluctuations in foreign currency exchange rates, we have established a foreign currency hedging program. Under this program, we currently hedge part of our U.S. dollar liabilities, firm commitments and budgeted expenditures for up to 12 months using foreign currency forward exchange contracts and currency options. A foreign currency forward exchange contract is a contract whereby we agree to buy or sell a foreign currency at a predetermined exchange rate at a future date. A currency option is an option to buy or sell a foreign currency at a predetermined exchange rate at a future date. The exchange rate fluctuations that impact our foreign currency denominated financial liabilities, firm commitments and budgeted expenditures are intended to be offset by gains and losses on these hedging instruments.

The goal of our hedging program is to limit the impact of exchange rate fluctuations on our transactions denominated in U.S. dollars. We do not hold derivative financial instruments for trading purposes. Nevertheless, under IFRS, we are required to treat our hedges of budgeted expenditures for which there is no contractual commitment as though they were speculative investments. As a result, we are required to value these hedge positions at the end of each fiscal quarter and record a gain or loss equal to the difference in their market value from the last balance sheet date, without any reference to the change in value to the related budgeted expenditures. Accordingly, these differences could result in significant fluctuations in our reported net income.

As of December 31, 2018, we had three outstanding series of debentures, which are linked to the Israeli CPI, in an aggregate principal amount of approximately NIS 1.4 billion. As of December 31, 2018, we had forward Israeli CPI / NIS transactions, in a total amount of approximately NIS 0.4 billion, with an average maturity period of eight months, in order to hedge our exposure to fluctuations in the Israeli CPI. We periodically review the possibility of entering into additional transactions in order to lower the exposure in respect of the debentures.

Set forth below is the composition of the derivative financial instruments (excluding embedded derivatives) at the following dates:

	As of December 31,					
	2016		2017		2018	
	Par	Fair	Par	Fair	Par	Fair
	Value	Value	Value	Value	Value	Value
	(In NIS millions)					
Forward contracts on foreign currency exchange rate (mainly US\$–NIS)	95	1	105	(1 )	203	4
Forward contracts on Israeli CPI rate	800	(22 )	500	(17 )	400	(1 )
Options on the foreign currency exchange rate (mainly US\$–NIS)	(95 )	1	(105)	1	(147)	0
Total	800	(20 )	500	(17 )	456	3

#### Sensitivity information

Without taking into account our hedging instruments and based upon our debt outstanding as at December 31, 2018, fluctuations in foreign currency exchange rates, or the Israeli CPI would affect us as follows:

an increase of 1% of the Israeli CPI would result in an increase of approximately NIS 6 million in our financing expenses.

For additional details see note 21 to our financial statements, included elsewhere in this report.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended) as of December 31, 2018, have concluded that, as of such date, our disclosure controls and procedures were effective and ensured that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure and is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms.

Management Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition and use of disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting, as of December 31, 2018. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (2013).

Based on our assessment, management believes that as of December 31, 2018 our internal control over financial reporting is effective based on these criteria.

#### Attestation Report of the Registered Public Accounting Firms

The effectiveness of management's internal control over financial reporting as of December 31, 2018 has been audited by our joint independent registered public accounting firms, Somekh Chaikin, a member firm of KPMG International, and Keselman & Keselman, a member of PricewaterhouseCoopers International Limited, and their report as of March 18, 2019, expresses an unqualified opinion on the Company's internal control over financial reporting.

This report is included in page F-3 of this Form 20-F.

#### Changes in Internal Control Over Financial Reporting

During the period covered by this annual report, the changes in our internal control over financial reporting that occurred that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting were:

In connection with the forthcoming implementation of IFRS 16, a new accounting standard for leases that replaces IAS 17 and is applicable for annual periods as of January 1, 2019 the Company has designed an internal control over the process of identifying existing leases and calculating the effect of the new standard on the Company's financial reporting as at December 31, 2018. During 2019, the Company will implement an internal control process for the ongoing implementation of this standard so as to ensure effective internal control for the prevention of errors in financial reporting in the leasing process.

#### ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Ms. Baytel qualifies as "audit committee financial expert" as defined in Item 16A of Form 20-F. Ms. Baytel qualifies as an independent director under the independence standards applicable to listed company audit committee members, pursuant to Rule 10A-3 under the Securities Exchange Act.

## ITEM 16B. CODE OF ETHICS

Our Code of Ethics applies to all of our officers, directors and employees. We have posted a copy of our Code of Ethics on our website at <http://investors.cellcom.co.il> under “Investor Relations – Corporate Governance – Legal and Corporate - Code of Ethics.”

## ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Somekh Chaikin, a member firm of KPMG International, served as our sole independent registered public accounting firm until December 31, 2018. From January 1, 2019, Somekh Chaikin and Keselman & Keselman, a member of PricewaterhouseCoopers International Limited, served as our joint independent registered public accounting firms. In our 2019 Annual General Shareholders Meeting, our shareholders will be asked to approve the nomination of Keselman & Keselman as our sole independent registered public accounting firm. See Item 16F below.

These accountants billed the following fees to us for professional services in each of those fiscal years:

	2017	2018
	(NIS in thousands)	
Audit Fees	2,370	2,450
Tax Fees	73	263
Total	2,443	2,713

“Audit Fees” are the aggregate fees billed for the audit of our annual financial statements. This category also includes services that generally the independent accountant provides, such as consents and assistance with and review of documents filed with the SEC. These fees also include accounting consultations regarding the accounting treatment of matters that occur in the regular course of business, implications of new accounting pronouncements and other accounting issues that occur from time to time. “Tax Fees” are the aggregate fees billed for professional services rendered for tax compliance, tax advice, other than in connection with the audit. Tax compliance involves audit of original and amended tax returns, tax planning and tax advice.

Our Audit Committee has adopted a pre-approval policy for the engagement of our independent accountant to perform certain audit and non-audit services. Pursuant to this policy, which is designed to assure that such engagements do not impair the independence of our auditors, the audit committee pre-approves a maximum amount for certain potential services and approval is provided prior to any service performed by the independent accountant. Prior to any engagement of the independent accountant by the Company or its subsidiaries to render audit or non-audit services, a detailed description of the particular service to be performed as well as the fee structure are pre-approved by the Company's audit committee.

The Audit Committee has delegated part of its pre-approval authority to the chairman of the Audit Committee, subject to ratification by the entire Audit Committee.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

None.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

None.

ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

From May 2016 until July 2017, Somekh Chaikin, a member of KPMG International, and Keselman & Keselman, a member of PricewaterhouseCoopers International Limited, served as our joint independent registered public accounting firms. On July 25, 2017, Keselman & Keselman declined to stand for re-election as our joint independent registered public accounting firm together with Somekh Chaikin by mutual consent with us and Somekh Chaikin returned to being our sole independent registered public accounting firm. Keselman & Keselman's audit report on our consolidated financial statements for the fiscal year ended December 31, 2016 did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles. During our fiscal year ended December 31, 2016 and the subsequent interim period through July 2017, there were no disagreements between us and Keselman & Keselman on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to Keselman & Keselman's satisfaction, would have caused Keselman & Keselman to make reference to the matters in connection with their reports on our consolidated financial statements. During our fiscal year ended December 31, 2016 and the subsequent interim period through July 2017, there were no "reportable events," as that term is described in Item 16F(a)(1)(v) of Form 20-F.

At our annual shareholders' meeting for 2019, planned for March 2019 after publication of the Company's consolidated financial statements for the fiscal year ended December 31, 2018, Somekh Chaikin, one of the Company's joint independent registered public accounting firms, will not stand for re-election as the Company's joint independent registered public accounting firm. Keselman & Keselman, a member of PricewaterhouseCoopers International Limited, the Company's other joint independent registered public accounting firm, will stand for re-election to serve as the Company's sole independent registered public accounting firm.

Somekh Chaikin's audit reports on the consolidated financial statements for the fiscal years ended December 31, 2018 and 2017 of Cellcom Israel Ltd. did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principle except as follows: Somekh Chaikin's report on the consolidated financial as of and for the year ended December 31, 2018, contained a separate paragraph stating that "As discussed in Note 2F to the consolidated financial statements, the Company changed the manner in which it accounts for financial instruments in 2018". Somekh Chaikin's report on the consolidated financial as of and for the year ended December 31, 2017, contained a separate paragraph stating that "As discussed in Note 2F to the consolidated financial statements, the Company has changed its method of accounting for revenue recognition as of January 1, 2017 due to the adoption of International Financial Reporting Standard No. 15 Revenue from Contracts with Customers". The audit reports of Somekh Chaikin on the effectiveness of internal control over financial reporting as of December 31, 2018 and 2017 did not contain any adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles. During the Company's fiscal years ended December 31, 2018 and 2017 and thereafter, there were no disagreements between the Company and Somekh Chaikin on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to Somekh Chaikin's satisfaction, would have caused Somekh Chaikin to make reference to the matters in their reports on the Company's consolidated financial statements for such periods. During the Company's fiscal years ended December 31, 2018 and 2017 and thereafter, there have been no reportable events (as defined in S-K 304(a)(1)(v)).



## ITEM 16G. CORPORATE GOVERNANCE

The following are the significant ways in which our corporate governance practices differ from those followed by domestic companies under the listing standards of the NYSE:

**Nominating/Corporate Governance Committee** - Under Section 303A.04 of the NYSE Listed Companies Manual, or LCM, a U.S. domestic listed company, other than a controlled company, must have a nominating/corporate governance committee composed entirely of independent directors. We do not have a nominating/corporate governance committee as we are not required to have such a committee under the Companies Law.

**Compensation Committee** - Under Section 303A.05 of the LCM, a U.S. domestic listed company, other than a controlled company, must have a compensation committee composed entirely of independent directors that operates pursuant to a written charter addressing its purpose, responsibilities and membership qualifications and may receive counseling from independent consultants, after evaluating their independence. We have a compensation committee whose purpose, responsibilities and membership qualifications are governed by the Companies Law. There are no specific independence evaluation requirements for outside counsel. The Companies Law requires our compensation committee to include a majority of external directors (who are also independent directors). Our compensation committee is currently composed entirely of independent directors.

**Separate Meetings of Non-Management Directors** - Under Section 303A.03 of the LCM, the non-management directors of each U.S. domestic listed company must meet at regularly scheduled executive sessions without management. We do not have a similar requirement under the Companies Law, and our independent directors do not meet separately from directors who are not independent, other than in the context of audit committee meetings.

**Audit Committee** - Under Section 303A.06 of the LCM, domestic listed companies are required to have an audit committee that complies with the requirements of Rule 10A-3 of the Securities and Exchange Act of 1934. Rule 10A-3 requires the audit committee of a U.S. company to be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review, or attest services, and that each such firm must report directly to the audit committee. However, Rule 10A-3 provides that foreign private issuers may comply with applicable home country law that (i) requires or permits shareholders to appoint the registered public accounting firm or (ii) prohibits the delegation of responsibility to the issuer's audit committee without being in conflict with Rule 10A-3. Pursuant to the Companies Law, our registered public accounting firm is appointed by the shareholders at the annual meeting of shareholders. Our audit committee is responsible for recommending to the shareholders the appointment of our registered public accounting firm and to pre-approve the amounts to be paid to our registered public accounting firm. Pursuant to our audit committee charter, our audit committee is responsible for overseeing the work of our registered public accounting firms.



Equity Compensation Plans - Under Section 303A.08 of the LCM, shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with certain limited exemptions as described in the Rule. We follow the requirements of the Companies Law, under which approval of equity-compensation plans and material revisions thereto is within the authority of the board of directors. However, any compensation to directors, the chief executive officer or office holders with relation to whom our controlling shareholders have a personal interest, including equity based compensation, generally requires the approval of the compensation committee, the board of directors and the shareholders, in that order. The compensation of office holders is generally required to comply with a shareholder-approved compensation policy, which is required to include a monetary cap on the value of equity compensation that may be granted to any office holder. Our compensation policy complies with that requirement.

Corporate Governance Guidelines - Under Section 303A.09 of the LCM, domestic listed companies must adopt and disclose their corporate governance guidelines. We do not have a similar requirement under the Companies Law and therefore, other than as disclosed in this annual report on Form 20-F, we do not to disclose our corporate governance guidelines.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

See Item 18.

ITEM 18. FINANCIAL STATEMENTS

See pages F-1 through F-82 of this annual report.

ITEM 19. EXHIBITS

Exhibit Number	Description
<u>1.1</u>	<u>Updated Articles of Association and Memorandum of Association <sup>(5)</sup></u>
<u>2.1</u>	<u>Form of Ordinary Share Certificate<sup>(1)</sup></u>
<u>4.7</u>	<u>Shelf Prospectus Indenture dated March 7, 2012, between Cellcom and Strauss Lazar Trust Company (1992) Ltd. <sup>(2)</sup></u>
<u>4.7.1</u>	<u>Amendment and Addendum no. 1 to the Indenture from January 19, 2012, dated March 7, 2012, between Cellcom and Strauss Lazar Trust Company (1992) Ltd. <sup>(2)</sup></u>
<u>4.8</u>	<u>Series H and I Indenture dated June 23, 2014, between Cellcom and Mishmeret Trust Services Company Ltd., as amended in Addendum no.1 dated June 26, 2014<sup>(3)</sup></u>
<u>4.9</u>	<u>Series J and K Indenture dated September 25, 2016, between Cellcom and Mishmeret Trust Services Company Ltd. <sup>(4)</sup></u>
<u>4.10</u>	<u>Series L Indenture dated January 21, 2018, between Cellcom and Strauss Lazar Trust Company (1992) Ltd.<sup>(5)</sup></u>
<u>4.12</u>	<u>Registration Rights Agreement dated March 15, 2006 among Cellcom, Goldman Sachs International, DIC, DIC Communications and Technology Ltd, and PEC Israel Economic Corporation<sup>(1)</sup></u>
<u>4.13</u>	<u>Amended Non-Exclusive General License for the Provision of Mobile Radio Telephone Services in the Cellular Method dated June 27, 1994*</u>
<u>4.15</u>	<u>Amended 2015 Share Incentive Plan<sup>(6)</sup></u>
<u>8.1</u>	<u>Subsidiaries of the Registrant<sup>(*)</sup></u>
<u>12.1</u>	<u>Certification of Principal Executive Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to §302 of the Sarbanes-Oxley Act *</u>
<u>12.2</u>	<u>Certification of Principal Financial Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to §302 of the Sarbanes-Oxley Act *</u>
<u>13.1</u>	<u>Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act *</u>
<u>15.1</u>	<u>Consent of Independent Registered Public Accounting Firm - Somekh Chaikin *</u>
<u>15.2</u>	<u>Consent of Independent Registered Public Accounting Firm - Keselman &amp; Keselman*</u>
<u>15.3</u>	<u>Letter of Somekh Chaikin addressed to the SEC pursuant to Item 16F *</u>
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Exhibit Number	Description
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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\* Filed herewith.

<sup>(1)</sup> Incorporated by reference to our registration statement on Form F-1 (registration no. 333-140030) filed with the SEC on January 17, 2007.

<sup>(2)</sup> Incorporated by reference to our annual report on Form 20-F for the year 2011 filed with the SEC on March 7, 2012.

<sup>(3)</sup> Incorporated by reference to our annual report on Form 20-F for the year 2014 filed with the SEC on March 16, 2015.

<sup>(4)</sup> Incorporated by reference to our annual report on Form 20-F for the year 2016 filed with the SEC on March 20, 2017.

<sup>(5)</sup> Incorporated by reference to our annual report on Form 20-F for the year 2017 filed with the SEC on March 26, 2018.

<sup>(6)</sup> Incorporated by reference to our registration statement on Form S-8 filed with the SEC on August 13, 2015.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Cellcom Israel Ltd.

By: /s/ Nir Sztern

Name: Nir Sztern

Title: President and Chief Executive Officer

Date: March 18, 2019

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Cellcom Israel Ltd.  
and Subsidiaries

Consolidated Financial  
Statements

As at December 31, 2018  
(Audited)

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## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of  
Cellcom Israel Ltd.

### Opinions on the Consolidated Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated statement of financial position of Cellcom Israel Ltd. and its subsidiaries (the “Company”) as of December 31, 2018, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the year then ended, including the related notes (collectively the “consolidated financial statements”). We also have audited the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and the results of its operations and its cash flows for the year then ended, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

### Change in Accounting Principle

As discussed in Note 2F to the consolidated financial statements, the Company changed the manner in which it accounts for financial instruments in 2018.

### Convenience Translation

The consolidated financial statements as of and for the year ended December 31, 2018 have been translated into United States dollars (“dollars”) solely for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in New Israeli Shekels have been translated into dollars on the basis set forth in Note 2D to the consolidated financial statements.

### Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting appearing under Item 15. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audit of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

#### Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Kesselman & Kesselman  
Certified Public Accountants (Isr.)

A member of PricewaterhouseCoopers International Limited

/s/ Somekh Chaikin  
Certified Public Accountants (Isr.)  
Member Firm of KPMG  
International

Kesselman & Kesselman have served as the Company's auditor since 2018 and previously as it relates to the audit of the 2016 financial statements. Somekh Chaikin have served as the Company's auditor since 1994.

Tel Aviv, Israel  
March 18, 2019



Somekh Chaikin  
KPMG Millennium Tower  
17 Ha'arba'a Street, PO Box 609 Tel Aviv 61006 Israel  
+972 3 684 8000

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors  
Cellcom Israel Ltd.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated statement of financial position of Cellcom Israel Ltd. and subsidiaries (the Company) as of December 31, 2017, the related consolidated statement of income, comprehensive income, changes in equity, and cash flows for the year ended December 31, 2017, and the related notes (collectively, the consolidated financial statements).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017, and the results of its operations and its cash flows for the year ended December 31, 2017, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Change in Accounting Principle

As discussed in Note 2F to the consolidated financial statements, the Company has changed its method of accounting for revenue recognition as of January 1, 2017 due to the adoption of International Financial Reporting Standard No. 15 Revenue from Contracts with Customers.

Basis for Opinion

The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audit of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

/s/ Somekh Chaikin  
Certified Public Accountants (Isr.)  
Member Firm of KPMG International

We have served as the Company's auditor since 1994.

Tel Aviv, Israel  
March 25, 2018

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Report of Independent Registered Public Accounting Firms

To the Shareholders of  
Cellcom Israel Ltd.

We have audited the accompanying consolidated statements of income, comprehensive income, changes in equity, and cash flows of Cellcom Israel Ltd. (the Company) and subsidiaries for the year ended December 31, 2016. The Company's management and Board of Directors are responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement in all material respects. Our audit of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements assessing the accounting principles used and significant estimates made by management and Board of Directors, and evaluating the overall financial statement presentation. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and subsidiaries as of December 31, 2016 and the results of their operations and their cash flows for the year ended December 31, 2016, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

/s/ Somekh Chaikin  
Certified Public Accountants (Isr.)  
Member Firm of KPMG International  
Tel Aviv, Israel

/s/ Kesselman & Kesselman  
Certified Public Accountants (Isr.)  
A member firm of PricewaterhouseCoopers  
International Limited

March 14, 2017

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## Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Financial Position

		December 31, 2017 NIS millions	December 31, 2018 NIS millions	Convenience translation into US dollar (Note 2D) December 31, 2018 US\$ millions
Assets				
Cash and cash equivalents	8	527	1,202	321
Current investments, including derivatives		364	404	108
Trade receivables	9	1,280	1,152	307
Current tax assets	28	4	11	3
Other receivables	9	89	84	22
Inventory	10	70	94	25
Total current assets		2,334	2,947	786
Trade and other receivables	9	895	852	227
Property, plant and equipment, net	11	1,598	1,652	441
Intangible assets and others, net	12	1,260	1,298	346
Total non- current assets		3,753	3,802	1,014
Total assets		6,087	6,749	1,800
Liabilities				
Current maturities of debentures and of loans from financial institutions	17	618	620	165
Trade payables and accrued expenses	13	652	696	186
Current tax liabilities	28	4	-	-
Provisions	14	91	105	28
Other payables, including derivatives	15	277	257	68
Total current liabilities		1,642	1,678	447
Long-term loans from financial institutions	17	462	334	89
Debentures	17	2,360	2,911	777
Provisions	14	21	20	5
Other long-term liabilities	16	15	16	4
Liability for employee rights upon retirement, net	18	15	14	4
Deferred tax liabilities	28	131	99	26
Total non- current liabilities		3,004	3,394	905

Total liabilities		4,646	5,072	1,352
Equity attributable to owners of the Company	19			
Share capital		1	1	-
Share premium		-	325	87
Receipts on account of share options		-	10	3
Retained earnings		1,436	1,339	358
Non-controlling interests		4	2	-
Total equity		1,441	1,677	448
Total liabilities and equity		6,087	6,749	1,800

Date of approval of the consolidated financial statements: March 18, 2019.

The accompanying notes are an integral part of these consolidated financial statements.

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## Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Income

					Convenience translation into US dollar (Note 2D)	
		Year ended December 31, 2016	Year ended December 31, 2017	Year ended December 31, 2018	Year ended December 31, 2018	
	Note	NIS millions	NIS millions	NIS millions	US\$ millions	
Revenues	22	4,027	3,871	3,688	984	
Cost of revenues	23	(2,702)	(2,680)	(2,661)	(710)	)
Gross profit		1,325	1,191	1,027	274	
Selling and marketing expenses	24	(574)	(479)	(567)	(151)	)
General and administrative expenses	25	(420)	(426)	(360)	(96)	)
Other income (expenses), net	26	(21)	11	(26)	(7)	)
Operating profit		310	297	74	20	
Financing income		46	52	46	12	
Financing expenses		(196)	(196)	(190)	(51)	)
Financing expenses, net	27	(150)	(144)	(144)	(39)	)
Profit (loss) before taxes on income		160	153	(70)	(19)	)
Tax benefit (Taxes on income)	28	(10)	(40)	6	2	
Profit (loss) for the year		150	113	(64)	(17)	)
Attributable to:						
Owners of the Company		148	112	(62)	(17)	)
Non-controlling interests		2	1	(2)	-	)
Profit (loss) for the year		150	113	(64)	(17)	)
Earnings (loss) per share	19					
Basic earnings (loss) per share (in NIS)		1.47	1.11	(0.58)	(0.15)	)
Diluted earnings (loss) per share (in NIS)		1.47	1.10	(0.58)	(0.15)	)
Weighted-average number of shares used in the calculation of basic earnings (loss) per share (in shares)		100,604,578	100,654,935	107,499,543	107,499,543	
Weighted-average number of shares used in the calculation of diluted earnings (loss) per share (in shares)		100,698,306	100,889,661	107,499,543	107,499,543	

shares)

The accompanying notes are an integral part of these consolidated financial statements.

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## Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Comprehensive Income

	Year ended December 31, 2016 NIS millions	Year ended December 31, 2017 NIS millions	Year ended December 31, 2018 NIS millions	Convenience translation into US dollar (Note 2D) Year ended December 31, 2018 US\$ millions
Profit (loss) for the year	150	113	(64 )	(17 )
Other comprehensive income items that after initial recognition in comprehensive income were or will be transferred to profit or loss				
Changes in fair value of cash flow hedges transferred to profit or loss, net of tax	1	1	-	-
Total other comprehensive income for the year that after initial recognition in comprehensive income was or will be transferred to profit or loss, net of tax	1	1	-	-
Other comprehensive income items that will not be transferred to profit or loss				
Re-measurement of defined benefit plan, net of tax	(1 )	-	(1 )	-
Total other comprehensive loss for the year that will not be transferred to profit or loss, net of tax	(1 )	-	(1 )	-
Total other comprehensive income (loss) for the year, net of tax	-	1	(1 )	-
Total comprehensive income (loss) for the year	150	114	(65 )	(17 )
Total comprehensive income (loss) attributable to:				
Owners of the Company	148	113	(63 )	(17 )
Non-controlling interests	2	1	(2 )	-
Total comprehensive income (loss) for the year	150	114	(65 )	(17 )

The accompanying notes are an integral part of these consolidated financial statements.



## Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Changes in Equity

	Attributable to owners of the Company						Non-controlling interests	Legal equity	Convenience translation into US dollar (Note 2D)
	Share capital	Share premium	Receipts on account of share options	Capital reserve	Retained earnings	Total			
	NIS millions								US\$ millions
Balance as of January 1, 2016	1	-	-	(2 )	1,170	1,169	16	1,185	
Comprehensive income for the year									
Profit for the year	-	-	-	-	148	148	2	150	
Other comprehensive income (loss) for the year, net of tax	-	-	-	1	(1 )	-	-	-	
Transactions with owners, recognized directly in equity									
Share based payments	-	-	-	-	5	5	1	6	
Dividend to non-controlling interest in a subsidiary	-	-	-	-	-	-	(1 )	(1 )	
Balance as of December 31, 2016	1	-	-	(1 )	1,322	1,322	18	1,340	
Comprehensive income for the year									
Profit for the year	-	-	-	-	112	112	1	113	
Other comprehensive income for the year, net of tax	-	-	-	1	-	1	-	1	
Transactions with owners, recognized directly in equity									
Share based payments	-	-	-	-	2	2	-	2	
Derecognition of non-controlling interests due to loss of control in a consolidated company	-	-	-	-	-	-	(15 )	(15 )	
Balance as of December 31, 2017	1	-	-	-	1,436	1,437	4	1,441	384
Effect of initial application of IFRS 9*	-	-	-	-	(36 )	(36 )	-	(36 )	(9 )
Balance as of January 1, 2018 after initial application	1	-	-	-	1,400	1,401	4	1,405	375

Comprehensive income (loss) for the year

Loss for the year	-	-	-	-	(62 )	(62 )	(2 )	(64 )	(17 )
Other comprehensive loss for the year, net of tax	-	-	-	-	(1 )	(1 )	-	(1 )	-
Transactions with owners, recognized directly in equity									
Share based payments	-	-	-	-	2	2	-	2	-
Equity offering (see Note 19)	-	259	17	-	-	276	-	276	74
Exercise of share options	-	66	(7 )	-	-	59	-	59	16
Balance as of December 31, 2018	1	325	10	-	1,339	1,675	2	1,677	448

\* See Note 2, regarding Basis of Preparation of the Financial Statements - Application of a new standard effective January 1, 2018 - International Financial Reporting Standard 9 (2014), Financial Instruments ("IFRS 9" or "the standard"). According to the transitional method that was elected, comparative data were not restated.

The accompanying notes are an integral part of these consolidated financial statements.

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## Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Cash Flows

				Convenience translation into US dollar (Note 2D)
	Year ended December 31, 2016 NIS millions	Year ended December 31, 2017 NIS millions	Year ended December 31, 2018 NIS millions	Year ended December 31, 2018 US\$ millions
Cash flows from operating activities				
Profit (loss) for the year	150	113	(64 )	(17 )
Adjustments for:				
Depreciation and amortization	534	555	584	156
Share based payments	6	2	2	1
Loss (gain) on sale of property, plant and equipment	10	(1 )	-	-
Gain on sale of shares in a consolidated company	-	(10 )	-	-
Income tax expense (tax benefit)	10	40	(6 )	(2 )
Financing expenses, net	150	144	144	39
Changes in operating assets and liabilities:				
Change in inventory	21	(6 )	(24 )	(6 )
Change in trade receivables (including long-term amounts)	(28 )	132	193	51
Change in other receivables (including long-term amounts)	(5 )	(191 )	(21 )	(6 )
Change in trade payables, accrued expenses and provisions	-	(27 )	(26 )	(7 )
Change in other liabilities (including long-term amounts)	20	28	11	2
Payments for derivative hedging contracts, net	-	(3 )	-	-
Income tax paid	(88 )	(44 )	(23 )	(6 )
Income tax received	1	42	-	-
Net cash from operating activities	781	774	770	205
Cash flows used in investing activities				
Acquisition of property, plant, and equipment	(295 )	(346 )	(356 )	(95 )
Additions to intangible assets and others	(73 )	(237 )	(237 )	(63 )
Change in current investments, net	(9 )	(77 )	(56 )	(15 )
Proceeds from sale of property, plant and equipment	2	1	1	-
Interest received	11	12	14	4
Receipts from other derivative contracts, net	-	-	3	1
Proceeds from sale of shares in a consolidated company, net of cash disposed	-	3	-	-
Net cash used in investing activities	(364 )	(644 )	(631 )	(168 )

The accompanying notes are an integral part of these consolidated financial statements.



## Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Cash Flows (cont'd)

				Convenience translation into US dollar (Note 2D)
	Year ended December 31, 2016 NIS millions	Year ended December 31, 2017 NIS millions	Year ended December 31, 2018 NIS millions	Year ended December 31, 2018 US\$ millions
Cash flows used in financing activities				
Payments for derivative contracts, net	(13 )	(3 )	(15 )	(4 )
Receipt of (Payments for) long-term loans from financial institutions	340	200	(78 )	(21 )
Repayment of debentures	(732 )	(864 )	(556 )	(148 )
Proceeds from issuance of debentures, net of issuance costs	653	-	997	266
Dividend paid	(1 )	(1 )	-	-
Interest paid	(185 )	(175 )	(126 )	(34 )
Acquisition of non-controlling interests	-	-	(19 )	(5 )
Equity offering (see Note 19)	-	-	275	73
Proceeds from exercise of share options	-	-	59	16
Net cash from (used in) financing activities	62	(843 )	537	143
Changes in cash and cash equivalents	479	(713 )	676	180
Cash and cash equivalents as at the beginning of the year	761	1,240	527	141
Effects of exchange rate changes on cash and cash equivalents	-	-	(1 )	-
Cash and cash equivalents as at the end of the year	1,240	527	1,202	321

The accompanying notes are an integral part of these consolidated financial statements.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 1 - Reporting Entity

Cellcom Israel Ltd. ("the Company") is a company incorporated and domiciled in Israel and its official address is 10 Hagavish Street, Netanya 4250708, Israel. The consolidated financial statements of the Group as at December 31, 2018, comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's holdings in included entities. The Group operates and maintains a cellular mobile telephone system in Israel and provides cellular telecommunications services, landline telephony services, internet services, international calls services, television over the internet services and transmission services. The Company is controlled by Koor Industries Ltd. (directly and indirectly and through agreements with other shareholders of the Company), a wholly owned subsidiary of Discount Investment Corporation Ltd. ("DIC"), which is controlled by companies controlled by Mr. Eduardo Elsztein. The Company's shares are traded on the Tel Aviv Stock Exchange (TASE) and on the New York Stock Exchange (NYSE).

Note 2 - Basis of Preparation of the Financial Statements

A. Statement of compliance

The consolidated financial statements have been prepared by the Group in accordance with International Financial Reporting Standards (IFRSs), as issued by the International Accounting Standards Board (IASB).

These consolidated financial statements were approved by the Company's Board of Directors on March 18, 2019.

B. Functional and presentation currency

These consolidated financial statements are presented in New Israeli Shekels ("NIS"), which is the Group's functional currency, and are rounded to the nearest million unless otherwise indicated. NIS is the currency that represents the primary economic environment in which the Group operates.

C. Basis of measurement

These consolidated financial statements have been prepared on the basis of historical cost except for the following assets and liabilities: current investments and derivative financial instruments that are measured at fair value through profit or loss, deferred tax assets and liabilities, provisions, assets and liabilities in respect of employee benefits and Investments in associates and joint ventures.

For further information regarding the measurement of these assets and liabilities see Note 3, regarding Significant Accounting Policies.

D. Convenience translation into U.S. dollars ("dollars" or "\$")

For the convenience of the reader, the reported NIS figures as of December 31, 2018 and for the year then ended, have been presented in dollars, translated at the representative rate of exchange as of December 31, 2018 (NIS 3.748 = US\$ 1.00). The dollar amounts presented in these financial statements should not be construed as representing amounts that are receivable or payable in dollars or convertible into dollars, unless otherwise indicated.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 2 - Basis of Preparation of the Financial Statements (cont'd)

E. Use of estimates and judgments

Information about estimates, uncertainty and critical judgments about provisions and contingent liabilities, is described in Notes 14 and 31. In addition, information about critical estimates, made while applying accounting policies and that have the most significant effect on the consolidated financial statements are described below:

Impairment testing of trade and other receivables

The financial statements include an impairment loss in trade and other receivables which properly reflect, according to management's estimation, the potential loss from non-recoverable amounts. The Group provides for impairment loss based on its experience in collecting past debts, as well as on information on specific debtors. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets. See also Note 21.

Impairment testing and useful life of assets

The Group regularly reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. See also Note 3H.

The useful economic life of the Group's assets is determined by management at the time the asset is acquired and regularly reviewed for appropriateness. The Group defines useful life of its assets in terms of the assets' expected utility to the Group. This judgment is based on the experience of the Group with similar assets. The useful economic life of licenses is based on the duration of the license agreement. The useful economic life of capitalized customer acquisition costs is based on the expected service period from these contracts. See also Notes 3D and 3F.

Impairment testing of goodwill

The Group reviews a cash generating unit containing goodwill for the purpose of testing it for impairment at least once a year. Determining the recoverable amount requires management to make an estimate of the projected future cash flows from the continuing use of the cash-generating unit and also to choose a suitable discount rate for those cash flows which represents market estimates as for the time value of the money and the specific risks that are related to the cash-generating unit. Determining the estimates of the future cash flows is based on management past experience and management best estimates as for the economic conditions that will exist over the rest of the remaining useful life of the cash generating unit. Further details are given in Note 3H.

Legal claims

In estimating the likelihood of outcome of legal claims filed against the Company and its investees, the Group takes into consideration the opinion of its legal counsels and their best professional judgment, the stage of proceedings and historical legal precedents in respect of the different issues. Since the outcome of the claims will be determined in courts, the results could differ from these estimates. See also Note 31.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 2 - Basis of Preparation of the Financial Statements (cont'd)

E. Use of estimates and judgments (cont'd)

Uncertain tax positions

When assessing amounts of current and deferred taxes, the Group takes into consideration the effect of the uncertainty that its tax positions will be accepted and of the Group incurring any additional tax and interest expenses.

The Group is of the opinion that the cumulative tax liability is fair for all the years in respect of which final tax assessments have not yet been received, based on an analysis of a number of matters including interpretations of tax laws and the Group's past experience. This assessment is based on estimates and assumptions that may also include assessments and exercising judgment regarding future events. It is possible that new information will become known in future periods that will require the Group to change its estimate regarding the tax liability that was recognized, and any such changes will be expensed immediately in that period. See also Note 28.

Recognition of deferred tax asset in respect of tax losses

The Group assesses the probability that in the future there will be taxable profits against which carried forward losses can be utilized and accordingly the Group recognizes (or not recognizes) a deferred tax asset in respect of losses carried forward. In the absence of certainty for the existence of taxable income, deferred taxes are not recognized as an asset in the carrying amount. The possible effects of this estimate is the recognition or cancellation of deferred tax assets in statement of income.

For information on losses for which a deferred tax asset was recognized, see Note 28 regarding taxes on income.

Change in estimates

During the year ended December 31, 2017 management has updated estimates as follows:

- Towards the end of the Company's 2G and 3G frequencies (the "Frequencies") original amortization period, the
1. Company's annual depreciation committee examined the estimated useful life of the Frequencies. Based on Company's estimate, the Company will continue to use the Frequencies at least for the next 10 years.

The estimated useful life of the Frequencies was determined in the past according to the period of the Company's cellular license (until 2022).

According to applicable law, the Company's cellular license may be extended for additional 6-year periods, subject to the requirements set in the license. The Company estimates that based on its experience and acquaintance with the communications market in Israel, if current conditions continue, there is high probability that the license will be extended for an additional term of 6 years.

In light of the aforesaid, the estimated useful life of the Frequencies has been re-evaluated for the first time, for an additional period of ten years, starting from the beginning of the second quarter of 2017 and ending in 2028 (instead of 18-20 years ending in 2022, as originally estimated).

2. In light of the accumulated experience in the Group's operation in connection with internet services and television over the internet services, the Company's annual depreciation committee examined the estimated useful life of certain fixed asset items that are used for these services. Following this examination, the estimated useful life of these items has been re-evaluated for the first time, starting from the beginning of the fourth quarter of 2017 to 3-6



years from their purchase date (instead of 2-3 years, as originally estimated).

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 2 - Basis of Preparation of the Financial Statements (cont'd)

## E. Use of estimates and judgments (cont'd)

The effect of these changes on the consolidated financial statements, in current and future years is as follows:

	2017	2018	2019	2020	2021	Subsequently
	NIS millions					
Decrease (Increase) in depreciation expenses	19	33	17	5	6	(80 )

## F. Changes in the accounting policies

## Initial application of new standards, amendments to standards and interpretations

## IFRS 9 (2014), Financial Instruments

As from January 1, 2018 the Group applies IFRS 9, Financial Instruments (in this item: “the standard” or “IFRS 9”), which replaces IAS 39, Financial Instruments: Recognition and Measurement (in this item “IAS 39”).

Additionally, following the application of IFRS 9, the Group has adopted consequential amendments to IFRS 7, Financial Instruments: Disclosures, and to IAS 1, Presentation of Financial Statements.

The Group has chosen to apply the standard and the amendment to the standard as from January 1, 2018 (in this item: “date of initial application”) without amendment of the comparative data, with an adjustment to the balance of retained earnings and other components of equity as at the date of initial application.

The table hereunder summarizes the effects of the transition to IFRS 9 on the opening balances of assets and liabilities and retained earnings, including the tax effect:

	According to the Effect of previous the standard* According to IFRS 9		
	NIS millions		
Trade and other receivables (including long-term amounts) (1)	2,175	(12 )	2,163
Debentures, including current maturities (2)	(2,900)	(34 )	(2,934 )
Deferred tax liabilities	(131 )	10	(121 )
Retained earnings	(1,436)	36	(1,400 )

1) The standard includes a new ‘expected credit loss’ model, which following its application, the amount of the provision for impairment of all the financial assets decreased by an amount of NIS 12 million as at January 1, 2018.

2) According to the standard, in cases that a change in terms or exchange of financial liabilities is immaterial and does not lead to de-recognition, the new cash flows should be discounted at the original effective interest rate, with the difference between the present value of the financial liability having the new terms and the present value of the original financial liability being recognized in profit or loss. As a result of applying the standard, the carrying amount of a Series of debentures whose terms were changed and for which a new effective interest rate was

calculated at the time of the change in terms according to IAS 39, was recalculated from the date of the change in terms using the original effective interest rate. Accordingly, the balance of the liability decreased by the amount of NIS 34 million.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 2 - Basis of Preparation of the Financial Statements (cont'd)

F.Changes in the accounting policies (cont'd)

Initial application of new standards, amendments to standards and interpretations (cont'd)

(1) IFRS 9 (2014), Financial Instruments (cont'd)

Classification and measurement of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through profit or loss and fair value through other comprehensive income. The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminates the previous IAS 39 categories of investment held to maturity, loans and receivables and available for sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities.

For further information on how the Group classifies and measures financial instruments and accounts for related gains and losses under IFRS 9, see Note 21.

Impairment of financial assets

Non - derivative financial assets

IFRS 9 replaces the impairment model of IAS 39 with an 'expected credit loss' (ECL) model. The model applies to financial assets measured at amortized cost, investments in debt instruments measured at fair value, contract assets (as defined in IFRS 15), but not to investments in equity instruments.

The Group recognizes the provision for expected credit losses in respect of measured at amortized cost. The Group measures the provision for expected credit losses at an amount equal to the full lifetime expected credit losses, other than the provisions hereunder that are measured at an amount equal to the 12-month expected credit losses:

- Debt instruments that are determined to have low credit risk at the reporting date; and
- Other debts instruments and deposits, for which credit risk has not increased significantly since initial recognition.

The Group has elected to measure the provision for expected credit losses in respect of trade receivables, at an amount equal to the full lifetime credit losses of the instrument.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition, and when estimating expected credit losses, the Group considers reasonable and supportable information that is relevant and available with no undue cost or effort. Such information includes quantitative and qualitative information, and an analysis, based on the Group's past experience and informed credit assessment, and it includes forward looking information.

The maximum period considered when assessing expected credit losses is the maximum contractual period over which the Group is exposed to credit risk.

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 2 - Basis of Preparation of the Financial Statements (cont'd)

## F.Changes in the accounting policies (cont'd)

## Initial application of new standards, amendments to standards and interpretations (cont'd)

## (1)IFRS 9 (2014), Financial Instruments (cont'd)

## Measurement of expected credit losses

Expected credit losses are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of the difference between the cash flows due to the Group in accordance with the contract and the cash flows that the Group expects to receive.

Expected credit losses are discounted at the effective interest rate of the financial asset.

## G.Exchange rates and known Consumer Price Indexes are as follows:

	Exchange rates of US\$	Consumer Price Index (points)*
As of December 31, 2018	3.748	224.00
As of December 31, 2017	3.467	221.35
As of December 31, 2016	3.845	220.68
Change during the year:		
Year ended December 31, 2018	8.10	% 0.30 %
Year ended December 31, 2017	(9.83	)% 0.30 %
Year ended December 31, 2016	(1.46	)% (0.30 )%

\*According to 1993 base index.

## Note 3 - Significant Accounting Policies

The accounting policies set out below have been applied consistently by the Group for all periods presented in these consolidated financial statements, except as described in changes in the accounting policies section in Note 2, regarding Basis of Preparation of the Financial Statements.

## A.Basis of consolidation

## 1.Subsidiaries

Subsidiaries are entities controlled directly or indirectly by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control is

lost. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

## 2. Non-controlling interests

Non-controlling interests comprise the equity of a subsidiary that cannot be attributed, directly or indirectly, to the parent company.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

A. Basis of consolidation (cont'd)

2. Non-controlling interests (cont'd)

Measurement of non-controlling interests on the date of the business combination

Non-controlling interests that are instruments that give rise to a present ownership interest and entitle the holder to a share of net assets in the event of liquidation (for example: ordinary shares), are measured at the date of the business combination at either fair value, or at their proportionate interest in the identifiable assets and liabilities of the acquiree, on a transaction-by-transaction basis.

Allocation of profit or loss and other comprehensive income to the shareholders

Profit or loss are allocated to the owners of the Company and the non-controlling interests. Total profit or loss is allocated to the owners of the Company and the non-controlling interests even if the result is a negative balance of non-controlling interests.

Issuance of put option to non-controlling interests

A put option issued by the Group to non-controlling interests that is settled in cash or another financial instrument is recognized as a liability at the present value of the exercise price. In subsequent periods, changes in the value of the liability in respect of put options by the Group to non-controlling interests are recognized in profit or loss according to the effective interest method.

The Group's share of a subsidiary's profits includes the share of the non-controlling interests to which the Group issued a put option.

3. Investment in associates and joint ventures (equity accounted investees)

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies. There is a rebuttable presumption that significant influence exists when the Group holds between 20% and 50% of another entity. In assessing significant influence, potential voting rights that are currently exercisable or convertible into shares of the investee are taken into account.

Joint ventures are joint arrangements in which the Group has rights to the net assets of the arrangement.

Associates and joint ventures are accounted for using the equity method and are recognized initially at cost. The cost of the investment includes transaction costs. Transaction costs that are directly attributable to an expected acquisition of an associate or joint venture are recognized as an asset as part of the item of deferred expenses in the statement of financial position. These costs are added to the cost of the investment on the acquisition date.

The consolidated financial statements include the Group's share of the income and expenses in profit or loss of equity accounted investees, after adjustments to align the accounting policies with those of the Group, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases.





Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

A. Basis of consolidation (cont'd)

4. Transactions eliminated on consolidation

Intra-group balances and transactions in the Group, and any unrealized income and expenses arising from intra-group transactions, were eliminated in preparing the consolidated financial statements.

B. Foreign currency transactions

Transactions in foreign currencies are translated to NIS at the prevailing foreign exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies as of the reporting date are translated to NIS at the prevailing foreign exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured in terms of historical cost, are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to NIS at the exchange rate at the date that the fair value was determined. Foreign exchange differences arising on translation are recognized in profit and loss.

C. Financial instruments

(1) Non-derivative financial assets – policy applicable as from January 1, 2018

Initial recognition and measurement of financial assets

The Group initially recognizes trade receivables and debt instruments issued on the date that they are created. All other financial assets are recognized initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

A financial asset is initially measured at fair value plus transaction costs that are directly attributable to the acquisition or issuance of the financial asset. A trade receivable without a significant financing component is initially measured at the transaction price. Receivables originating from contract assets are initially measured at the carrying amount of the contract assets on the date classification was changed from contract asset to receivables.

Derecognition of financial assets

Financial assets are derecognized when the contractual rights of the Group to the cash flows from the asset expire, or the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. When the Group retains substantially all of the risks and rewards of ownership of the financial asset, it continues to recognize the financial asset.

Classification of financial assets into categories and the accounting treatment of each category

Financial assets are classified at initial recognition to one of the following measurement categories: amortized cost or fair value through profit or loss.

Financial assets are not reclassified in subsequent periods unless, and only if, the Group changes its business model for the management of financial debt assets, in which case the affected financial debt assets are reclassified at the

beginning of the period following the change in the business model.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

C. Financial instruments (cont'd)

(1) Non-derivative financial assets – policy applicable as from January 1, 2018 (cont'd)

Classification of financial assets into categories and the accounting treatment of each category (cont'd)

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated at fair value through profit or loss:

- It is held within a business model whose objective is to hold assets so as to collect contractual cash flows; and
- The contractual terms of the financial asset give rise to cash flows representing solely payments of principal and interest on the principal amount outstanding on specified dates.

All financial assets not classified as measured at amortized cost or financial assets designated at fair value through profit or loss, are measured at fair value through profit or loss. On initial recognition, the Group designates financial assets at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The Group has balances of trade and other receivables that are held within a business model whose objective is collecting contractual cash flows. The contractual cash flows of these financial assets represent solely payments of principal and interest that reflects consideration for the time value of money and the credit risk. Accordingly, these financial assets are measured at amortized cost.

Assessment of the business model for debt assets

The Group assesses the objective of the business model within which the financial asset is held on the level of the portfolio, since this best reflects the manner by which the business is managed and information is provided to management. The following considerations are taken into account in the assessment of the Group's business model:

The stated policies and objectives for the portfolio and the operation of those policies in practice. These include whether management's strategy focuses on earning contractual interest income, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of any related liabilities or expected cash outflows or realizing cash flows through the sale of the assets;

How the performance of the business model and the financial assets within the model is evaluated and reported to the entity's key management people;

The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

C. Financial instruments (cont'd)

(1) Non-derivative financial assets – policy applicable as from January 1, 2018 (cont'd)

Assessment whether cash flows are solely payments of principal and interest

For the purpose of assessing whether the cash flows are solely payments of principal and interest, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making this assessment, the Group considers:

- Contingent events that would change the timing or amount of the cash flows;
- Terms that may change the stated interest rate, including variable interest;
- Extension or prepayment features; and
- Terms that limit the Group's claim to cash flows from specified assets.

Subsequent measurement and gains and losses

Financial assets at fair value through profit or loss

These assets are subsequently measured at fair value. Net gains and losses, including any interest income or dividend income, are recognized in profit or loss (other than certain derivatives designated as hedging instruments).

Financial assets at amortized cost

These assets are subsequently measured at amortized cost using the effective interest method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized in profit or loss. Any gain or loss on derecognition is recognized in profit or loss. Financial assets at amortized cost comprise cash and cash equivalents and trade and other receivables. Cash and cash equivalents include cash balances available for immediate use and call deposits. Cash equivalents include short-term highly liquid investments (with original maturities of three months or less) that are readily convertible into known amounts of cash and are exposed to insignificant risks of change in value.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

C. Financial instruments (cont'd)

(2) Non-derivative financial assets – policy applicable before January 1, 2018

Initial recognition and measurement of financial assets

The Group initially recognizes loans and receivables and deposits on the date that they are created. All other financial assets acquired in a regular way purchase, including assets designated at fair value through profit or loss, are recognized initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument, meaning on the date the Group undertook to purchase or sell the asset. Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables, and cash and cash equivalents.

Financial assets are initially measured at fair value. If the subsequent measurement of the financial asset is not at fair value through profit and loss, then the initial measurement includes transaction costs that can be directly attributed to the acquisition or creation of the asset.

Derecognition of financial assets

Financial assets are derecognized when the contractual rights of the Group to the cash flows from the asset expire, or the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

Regular way sales of financial assets are recognized on the trade date, meaning on the date the Group undertook to sell the asset. As to the Group's policy on impairment see Paragraph H.

Classification of financial assets into categories and the accounting treatment of each category

The Group classifies its financial assets according to the following categories:

Financial assets at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy, providing that the designation is intended to prevent an accounting mismatch, or the asset is a combined instrument including an embedded derivative.

Attributable transaction costs are recognized in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

Financial assets classified as held-for-trading comprise securities that are held to support the Group's short-term liquidity needs.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Loans and receivables comprise cash and cash equivalents and trade and other receivables.

Cash and cash equivalents include cash balances available for immediate use and call deposits. Cash equivalents include short-term highly liquid investments (with original maturities of three months or less) that are readily convertible into known amounts of cash and are exposed to insignificant risks of change in value.

Offset of financial instruments - See section 3 below.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

C. Financial instruments (cont'd)

(3) Non-derivative financial liabilities

Non-derivative financial liabilities include: debentures, loans from financial institutions, and trade and other payables.

Initial recognition of financial liabilities

The Group initially recognizes debt securities issued on the date that they originated. All other financial liabilities are recognized initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

Subsequent measurement of financial liabilities

Financial liabilities are recognized initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method.

Financial liabilities are designated at fair value through profit or loss if the Group manages such liabilities and their performance is assessed based on their fair value in accordance with the Group's documented risk management strategy, providing that the designation is intended to prevent an accounting mismatch.

Transaction costs directly attributable to an expected issuance of an instrument that will be classified as a financial liability are recognized as an asset in the framework of deferred expenses in the statement of financial position. These transaction costs are deducted from the financial liability upon its initial recognition, or are amortized as financing expenses in the statement of income when the issuance is no longer expected to occur.

Derecognition of financial liabilities

Financial liabilities are derecognized when the obligation of the Group, as specified in the agreement, expires or when it is discharged or cancelled.

Substantial modification in terms of debt instruments

An exchange of debt instruments having substantially different terms, is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Furthermore, a substantial modification of the terms of an existing financial liability, or an exchange of debt instruments having substantially different terms between an existing borrower and lender, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability at fair value.

In such cases the entire difference between the amortized cost of the original financial liability and the fair value of the new financial liability is recognized in profit or loss as financing income or expense.

The terms are substantially different if the discounted present value of the cash flows according to the new terms, including any commissions paid, less any commissions received and discounted using the original effective interest rate, is different by at least ten percent from the discounted present value of the remaining cash flows of the original financial liability.

In addition to the aforesaid quantitative criterion, the Group examines, inter alia, whether there have also been changes in various economic parameters inherent in the exchanged debt instruments, therefore, as a rule, exchanges of CPI-linked debt instruments with unlinked instruments are considered exchanges with substantially different terms



even if they do not meet the aforementioned quantitative criterion.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

C. Financial instruments (cont'd)

(3) Non-derivative financial liabilities (cont'd)

Non-substantial modification in terms of debt instruments - policy applicable after January 1, 2018

In a non-substantial modification in terms (or exchange) of debt instruments, the new cash flows are discounted using the original effective interest rate, and the difference between the present value of the new financial liability and the present value of the original financial liability is recognized in profit or loss.

Offset of financial instruments

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Expansion of debentures for cash

When expanding debentures for cash, debentures are initially measured at their fair value, which is the proceeds received from the issuance (since this is the best market which the issuer has an immediate access to), with no effect on profit or loss in respect of the difference between the proceeds from issuance and the market value of the tradable debentures close to their issuance.

(4) Derivative financial instruments, including hedge accounting

The Group holds derivative financial instruments to hedge its foreign currency and CPI risks exposures.

Measurement of derivative financial instruments

Derivatives are recognized initially at fair value; attributable transaction costs are recognized in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below:

Economic hedges

Hedge accounting is not applied to derivative instruments that economically hedge financial assets and liabilities denominated in foreign currencies or CPI-linked. Changes in the fair value of such derivatives are recognized in profit or loss under financing income or expenses.

Derivatives that do not serve hedging purposes

The changes in fair value of derivatives that do not serve hedging purposes are recognized in profit or loss, as financing income or expense.

(5) Assets and liabilities linked to the Israeli CPI that are not measured at fair value

The value of CPI-linked financial assets and liabilities, which are not measured at fair value, is re-measured every period in accordance with the actual increase/decrease in the CPI.



Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

C. Financial instruments (cont'd)

(6) Issuance of parcel of securities

The consideration received from the issuance of a parcel of securities is attributed initially to financial liabilities that are measured each period at fair value through profit or loss, and then to financial liabilities that are measured only upon initial recognition at fair value. The remaining amount is the value of the equity component. When a number of equity components are issued in a parcel of securities, the consideration of the parcel attributes to their relative fair value. The fair value of each of the components of the package, are based on the average market prices of the securities three business days after their issuance.

Direct issuance costs are attributed to the specific securities in respect of which they were incurred. Joint issuance costs are attributed to the securities on a proportionate basis according to the allocation of the consideration from the issuance of the parcel, as described above. Issuance costs that allocated to equity components are presented net from equity.

D. Property, plant and equipment

Fixed asset items are measured at cost less accumulated depreciation and accumulated impairment losses.

(1) Recognition and measurement

The cost of fixed assets includes expenditure that is directly attributable to the acquisition of the asset.

The cost of self-constructed assets includes the cost of materials and direct labor, any other costs directly attributable to bringing the assets to a working condition for their intended use, an estimate of the costs of dismantling and removing the items and restoring the site on which they are located (when the Group has an obligation to dismantle and remove the asset or to restore the site), and capitalized borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

Communications networks consist of several significant components with different useful lives. Each component is treated separately and is depreciated over its estimated useful life.

Changes in the obligation to dismantle and remove the items and to restore the site on which they are located, other than changes deriving from the passing of time, are added or deducted from the cost of the asset in the period in which they occur. The amount deducted from the cost of the asset shall not exceed the balance of the carrying amount on the date of change, and any balance is recognized in profit or loss.

Gains or losses on disposal of an item of property, plant and equipment are determined by comparing the net disposal net proceeds with the carrying amount of property, plant and equipment and are recognized net within "other expenses, net" in statement of income.



## Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 3 - Significant Accounting Policies (cont'd)

## D. Property, plant and equipment (cont'd)

## (2) Subsequent costs

The cost of replacing part of a fixed asset item is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of day-to-day servicing are recognized in profit or loss as incurred.

## (3) Depreciation

Depreciation is a systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount is the cost of the asset, or other amount substituted for cost, less its residual value.

An asset is depreciated from the date it is ready for use, meaning the date it reaches the location and condition required for it to operate in the manner intended by management.

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of the fixed asset item, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

The annual depreciation rates for the current and comparative periods are as follows:

	%
Communications network	5-15
Control and testing equipment	15-25
Vehicles	15-20
Computers and hardware	15-33
Furniture and landline communications equipment	6-33
Equipment and infrastructure for television services	15-33

Leasehold improvements are depreciated over the shorter of their estimated useful lives or the expected lease terms.

Depreciation methods, useful lives and residual values are reviewed at least at the end of each reporting year and adjusted if appropriate.

## E. Rights of use of communications lines

The Group implements IFRIC 4, "Determining Whether an Arrangement Contains a Lease", which defines criteria for determining at the beginning of the arrangement, whether the right to use asset constitutes a lease arrangement.

According to IFRIC 4, as mentioned above, acquisition transactions of irrevocable rights of use of underwater cables capacity are treated as service receipt transactions. The amount which was paid for the rights of use of communications lines is recognized as a prepaid expense and is amortized on a straight-line basis over the period

stated in the agreements, including the option period, which constitutes the estimated useful life of those capacities.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

F. Intangible assets and others

(1) Goodwill

Goodwill that arises upon the acquisition of subsidiaries is presented as part of intangible assets. In subsequent periods goodwill is measured at cost less accumulated impairment losses.

(2) development

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalized to intangible assets only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Group has the intention and sufficient resources to complete development and to use or sell the asset.

Direct development costs associated with internally developed information system software, and payroll costs for employees devoting time to the software projects, incurred during the application development stage, are capitalized and recognized as an intangible asset. Other development expenditure is recognized in profit or loss as incurred.

In subsequent periods, capitalized development expenditures are measured at cost less accumulated amortization, from the date which the asset is ready for use, and accumulated impairment losses.

(3) Incremental customer acquisition costs

Incremental customer acquisition costs are capitalized to asset, from January 1, 2017, following the adoption IFRS 15, when it is expected that the Group will recover these costs. Costs of obtaining a contract that would have been incurred regardless of the contract being obtained are recognized as an expense when incurred. Costs incurred to fulfill a contract with a customer are recognized as an asset when they: relate directly to a contract the Group can specifically identify; they generate or enhance resources of the Group that will be used in satisfying performance obligations in the future; and they are expected to be recovered. In any other case the costs are recognized as an expense when incurred. Accordingly, incremental incentives and commissions paid to Group employees and resellers for securing contracts with customers, are recognized as intangible assets. In subsequent periods, customer acquisition costs are measured at cost less accumulated amortization according to the specific anticipated contract period and accumulated impairment losses.

(4) Other intangible assets

Customer relationships that are formed upon the acquisition of subsidiaries have a finite useful life and are amortized according to the expected benefits rate from these assets in each period.

Other intangible assets and others - licenses and frequencies, software and information systems costs are measured at cost less accumulated amortization and accumulated impairment losses and including direct costs necessary to prepare the asset for its intended use.

(5) Subsequent expenditure



Subsequent expenditure is capitalized to intangible asset only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognized in profit or loss as incurred.

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## Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 3 - Significant Accounting Policies (cont'd)

## F. Intangible assets and others (cont'd)

## (6) Amortization

Amortization is a systematic allocation of the amortizable amount of an intangible asset over its useful life. The amortizable amount is the cost of the asset less its residual value.

Amortization is recognized in profit or loss on a straight-line basis, (except for customer relationships as aforementioned (up to 2019)), over the estimated useful lives of the intangible assets from the date they are available for use, since these methods most closely reflect the expected pattern of consumption of the future economic benefits embodied in each asset. Goodwill and intangible assets having an indefinite useful life are not systematically amortized but are tested for impairment at least once a year.

Internally generated intangible assets are not systematically amortized as long as they are not available for use, i.e. they are not yet on site or in working condition for their intended use. Accordingly, these intangible assets, such as development costs, are tested for impairment at least once a year, until such date as they are available for use.

The annual amortization rates for the current and comparative periods are as follows:

	%	
Licenses and Frequencies	4-7	(mainly 4)
Information systems	25	
Software	15-25	
Customer acquisition costs	33-50	

Amortization methods, useful lives and residual values are reviewed at least each year-end and adjusted if appropriate.

The Group examines the useful life of an intangible asset that is not periodically amortized at least once a year in order to determine whether events and circumstances continue to support the decision that the intangible asset has an indefinite useful life.

## G. Inventory

Inventory of cellular phone equipment, accessories and spare-parts are measured at the lower of cost and net realizable value. Cost is determined by the moving average method and includes expenditure incurred in acquiring the inventories and the costs incurred in bringing them to their existing location and condition. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The Group periodically evaluates the condition and age of inventories and makes provisions for impairment of inventories accordingly.



Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

H. Impairment

(1) Non-derivative financial assets – policy applicable as from January 1, 2018

Financial assets and contract assets

The Group recognizes a provision for expected credit losses in respect of Financial assets at amortized cost and Contract assets (as defined in IFRS 15).

The Group has elected to measure the provision for expected credit losses in respect of trade receivables, contract assets and lease receivables at an amount equal to the full lifetime credit losses of the instrument.

Lifetime expected credit losses are expected credit losses that result from all possible default events over the expected life of the financial asset. The maximum period considered when assessing expected credit losses is the maximum contractual period over which the Group is exposed to credit risk.

Measurement of expected credit losses

Expected credit losses are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of the difference between the cash flows due to the Group in accordance with the contract and the cash flows that the Group expects to receive.

Expected credit losses are discounted at the effective interest rate of the financial asset.

Credit-impaired financial assets

At each reporting date, the Group assesses whether financial assets carried at amortized cost are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Presentation of provision for expected credit losses in the statement of financial position

Provisions for expected credit losses of financial assets measured at amortized cost are deducted from the gross carrying amount of the financial assets.

Write-off

The gross carrying amount of a financial asset is written off when the Group does not have reasonable expectations of recovering a financial asset at its entirety or a portion thereof. This is usually the case when the Group determines that the debtor does not have assets or sources of income that may generate sufficient cash flows for paying the amounts being written off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due. Write-off constitutes a de-recognition event.



Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

H. Impairment (cont'd)

(2) Non-derivative financial assets – policy applicable before January 1, 2018

A financial asset not carried at fair value through profit or loss is tested for impairment when objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Accounting for impairment losses of financial assets measured at amortized cost

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and reflected in a provision for loss against the balance of the financial asset measured at amortized cost.

Reversal of impairment loss

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost, the reversal is recognized in profit or loss.

(3) Property, plant and equipment and intangible assets and others

Timing of impairment testing

The carrying amounts of the Group's property, plant and equipment and finite lived intangible assets are reviewed at each reporting date, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, then the asset's recoverable amount is estimated.

Once a year and on the same date, or more frequently if there are indications of impairment, the Group estimates the recoverable amount of each cash generating unit that contains goodwill, or intangible assets that have indefinite useful lives or are unavailable for use.

Determining cash-generating units

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

Measurement of recoverable amount

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit, for which the estimated future cash flows from the asset or cash-generating unit were not adjusted.



Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

H. Impairment (cont'd)

Allocation of goodwill to cash generating units

Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, cash-generating units to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes.

Goodwill acquired in a business combination is allocated to groups of cash-generating units, including those existing in the Group before the business combination, that are expected to benefit from the synergies of the combination.

Recognition of impairment loss

An impairment loss is recognized if the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. As regards cash-generating units that include goodwill, an impairment loss is recognized when the carrying amount of the cash-generating unit, after including the balance of goodwill, exceeds its recoverable amount. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the cash-generating unit on a pro rata basis.

Reversal of impairment loss

An impairment loss in respect of goodwill is not reversed. In respect of other assets, for which impairment losses were recognized in prior periods, an assessment is performed at each reporting date for any indications that these losses have decreased or no longer exist. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

I. Employee benefits

(1) Post-employment benefits

Part of the Group's liability for post-employment benefits is covered by a defined contribution plan financed by deposits with insurance companies or with funds managed by a trustee. A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and has no legal or constructive obligation to pay further amounts. The Group's obligation of contribution to defined contribution pension plan is recognized as an expense in profit and loss in the periods during which services are rendered by employees. In addition, the Group has a net obligation in respect of defined benefit plan. A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. This benefit is presented at present value deducting the fair value of any plan assets and is determined using actuarial assessment techniques which involves, among others, determining estimates regarding the capitalization rates, anticipated return on the assets, the rate of the increase in salary and the rates of employee turnover. There is significant uncertainty in respect to these estimates because of the long-term programs. For further information, see Note 18.



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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

I. Employee benefits (cont'd)

(1) Post-employment benefits (cont'd)

The Group recognizes immediately, directly in retained earnings through other comprehensive income, all re-measurements gains and losses arising from defined benefit plans. Interest costs and interest income on plan assets that were recognized in profit or loss are presented under financing income and expenses, respectively.

(2) Termination benefits

Termination benefits are recognized as an expense when the Group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary retirement. Termination benefits for voluntary retirements are recognized as an expense if the Group has made an offer of voluntary retirement, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

(3) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably. The employee benefits are classified, for measurement purposes, as short-term benefits or as other long-term benefits depending on when the Group expects the benefits to be wholly settled.

(4) Share-based payment transactions

The grant date fair value of options granted to employees is recognized as salaries and related expenses, with a corresponding increase in retained earnings, over the period that the employees become unconditionally entitled to the options.

Fair value is measured using the Black-Scholes model. The expected life used in the model has been adjusted, based on management's best estimate, to consider exercise restrictions and behavioral considerations.

J. Provisions

A provision is recognized if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the reporting date.

The Group recognizes a reimbursement asset if, and only if, it is virtually certain that the reimbursement will be received if the Company settles the obligation. The amount recognized in respect of the reimbursement does not exceed the amount of the provision.

A provision for claims is recognized if, as a result of a past event, the Company has a present legal or constructive obligation and it is more likely than not that an outflow of economic benefits will be required to settle the obligation and the amount of obligation can be estimated reliably.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

K. Revenue

The accounting policy that was applied in periods prior to January 1, 2017

Revenues derived from services, including cellular services, internet services, international calls services, fixed local calls, interconnect, roaming revenues, content and value added services, transmission services and television over the internet services, are recognized when the services are provided, in proportion to the stage of completion of the transaction and all other revenue recognition criteria are met.

The sale of equipment to the customer is executed with no contractual obligation of the client to consume services in a minimal amount for a predefined period. As a result, the Group refers to the sale transaction as a separate transaction and recognizes revenue from sale of equipment upon delivery of the equipment to the customer. Revenue from services is recognized and recorded when the services are provided.

In case the customer is obligated towards the Group to consume services in a minimal amount for a predefined period, the contract is characterized as a multiple element arrangement and thus, revenue from sale of equipment is recorded in an amount not higher than the fair value of the said equipment, which is not contingent upon delivery of additional components (such as services) and is recognized upon delivery to the customer and when the criteria for revenue recognition are met. The Group determines the fair value of the individual elements based on prices at which the deliverable is regularly sold on a standalone basis, after considering discounts where appropriate.

The Group also offers other services, such as extended equipment warranty plans, which are provided for a monthly fee and are either sold separately or bundled and included in packaged rate plans. Revenues from those services are recognized over the service period.

Revenue from the sale of goods in the ordinary course of business is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenues from long-term credit arrangements are recognized on the basis of the present value of future cash flows, discounted according to market interest rates at the time of the transaction. The difference between the original credit and its present value is recorded as interest income over the credit period.

Prepaid wireless airtime sold to customers is recorded as deferred revenue prior to the commencement of services and is recognized when the airtime is used or expires.

When the Group acts as an agent or an intermediary without bearing the risks and rewards resulting from the transaction, revenues are presented on a net basis (as a profit or a commission). However, when the Group acts as a principal supplier and bears the risks and rewards resulting from the transaction, revenues are presented on a gross basis, distinguishing the revenue from the related expenses.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

K. Revenue (cont'd)

The accounting policy applied as from January 1, 2017 following the adoption of IFRS 15

The Group recognizes revenue when the customer obtains control over the promised goods or services. The revenue is measured according to the amount of the consideration to which the Group expects to be entitled in exchange for the goods or services promised to the customer, other than amounts collected for third parties.

Revenues derived from services, including cellular services, internet services, international calls services, fixed local calls, interconnect, roaming revenues, content and value added services, transmission services and television over the internet services, are recognized when the services are provided, in proportion to the stage of completion of the transaction and all other revenue recognition criteria are met.

Usually, the sale of equipment to the customer is executed with no contractual obligation of the client to consume services in a minimal amount for a predefined period. As a result, the Group refers to the sale transaction as a separate transaction and recognizes revenue from sale of equipment upon delivery of the equipment to the customer. Revenue from services is recognized and recorded when the services are provided.

Identifying the contract

The Group accounts for a contract with a customer only when the following conditions are met:

- (a) The parties to the contract have approved the contract (in writing, orally or according to other customary business practices) and they are committed to satisfying the obligations attributable to them;
- (b) The Group can identify the rights of each party in relation to the goods or services that will be transferred;
- (c) The Group can identify the payment terms for the goods or services that will be transferred;
- (d) The contract has a commercial substance (i.e. the risk, timing and amount of the entity's future cash flows are expected to change as a result of the contract); and
- (e) It is probable that the consideration, to which the Group is entitled to in exchange for the goods or services transferred to the customer, will be collected.

For the purpose of paragraph (e) the Group examines, inter alia, the percentage of the advance payments received and the spread of the contractual payments, past experience with the customer and the status and existence of sufficient collateral.

If a contract with a customer does not meet all of the above criteria, consideration received from the customer is recognized as a liability until the criteria are met or when one of the following events occurs: the Group has no remaining obligations to transfer goods or services to the customer and any consideration promised by the customer has been received and cannot be returned; or the contract has been terminated and the consideration received from the customer cannot be refunded.

Identifying performance obligations

On the contract's inception date the Group assesses the goods or services promised in the contract with the customer and identifies as a performance obligation any promise to transfer to the customer one of the following:

- (a) Goods or services (or a bundle of goods or services) that are distinct; or
- (b) A series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

K. Revenue (cont'd)

The accounting policy applied as from January 1, 2017 following the adoption of IFRS 15 (cont'd)

Identifying performance obligations (cont'd)

The Group identifies goods or services promised to the customer as being distinct when the customer can benefit from the goods or services on their own or in conjunction with other readily available resources and the Group's promise to transfer the goods or services to the customer is separately identifiable from other promises in the contract. In order to examine whether a promise to transfer goods or services is separately identifiable, the Group examines whether it is providing a significant service of integrating the goods or services with other goods or services promised in the contract into one integrated outcome that is the purpose of the contract.

Option to purchase additional goods or services

An option that grants the customer the right to purchase additional goods or services constitutes a separate performance obligation in the contract only if the option grants the customer a material right it would not have received without the original contract.

Determining the transaction price

The transaction price is the amount of the consideration to which the Group expects to be entitled in exchange for the goods or services promised to the customer, other than amounts collected for third parties. The Group takes into account the effects of determining the transaction price and the existence of a significant financing component.

Variable consideration

The transaction price includes fixed amounts and amounts that may change as a result of discounts, refunds, credits, price concessions, incentives, performance bonuses, penalties, claims and disputes and contract modifications that the consideration in their respect has not yet been agreed by the parties.

The Group includes variable consideration, or part of it, in the transaction price only when it is highly probable that its inclusion will not result in a significant revenue reversal in the future when the uncertainty has been subsequently resolved. At the end of each reporting period and if necessary, the Group revises the amount of the variable consideration included in the transaction price.

Allocating the transaction price to performance obligations

In a multiple performance obligations transaction, the transaction price is allocated between the components of the transaction according to the ratio of their stand-alone selling prices.

Existence of a significant financing component

In order to measure the transaction price, the Group adjusts the amount of the promised consideration in respect of the effects of the time on the value of money if the timing of the payments agreed between the parties provides to the customer or the Group a significant financing benefit. In these cases, the contract contains a significant financing component. When assessing whether a contract contains a significant financing component, the Group examines, inter alia, the expected length of time between the date the Group transfers the promised goods or services to the customer and the date the customer pays for these goods or services, as well as the difference, if any, between the amount of the

consideration promised and the cash selling price of the promised goods or services.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

K. Revenue (cont'd)

The accounting policy applied as from January 1, 2017 following the adoption of IFRS 15 (cont'd)

Existence of a significant financing component (cont'd)

When the contract contains a significant financing component, the Group recognizes the amount of the consideration using the discount rate that would be reflected in a separate financing transaction between it and the customer on the contract's inception date. The financing component is recognized as interest income or expenses over the period, which are calculated according to the effective interest method.

In cases where the difference between the time of receiving payment and the time of transferring the goods or services to the customer is one year or less, the Group applies the practical exemption included in the standard and does not separate a significant financing component.

Satisfaction of performance obligations

Revenue is recognized when the Group satisfies a performance obligation by transferring control over promised goods or services to the customer.

Incremental customer acquisition costs

Incremental costs of obtaining a contract with a customer are recognized as an asset when the Group is expected to recover these costs. For further information, see Note 3 F (3).

Warranty

In order to assess whether a warranty provides a distinct service to the customer and is therefore a distinct performance obligation, the Group examines, inter alia, the following characteristics: does the customer have the option to purchase the warranty separately; is the warranty required by law; the period of the warranty and the nature of the actions the Group promises to execute.

In respect to contracts with customers, the Group provides warranty services to customers in accordance with the contract, the Regulations of the Law or as is customary in the industry. Warranty services are provided to ensure the quality of the work and to meet the specifications agreed between the parties and do not constitute additional service provided to the customer. Therefore, the Group does not recognize the liability as a separate performance obligation, but treats it in accordance with the Instructions of IAS 37 and recognizes the provision for liability according to the estimated cost of the said services.

Principal or agent

When another party is involved in providing goods or services to the customer, the Group examines whether the nature of its promise is a performance obligation to provide the defined goods or services themselves, which means the Group is a principal provider and therefore recognizes revenue in the gross amount of the consideration, or obligation to arrange that another party provides the goods or services which means the Group is an agent and therefore recognizes revenue in the amount of the net commission.

The Group is a principal provider when it controls the promised goods or services before their transfer to the customer. Indicators that the Group controls the goods or services before their transfer to the customer include, inter alia, as follows: the Group is the primary obligor for fulfilling the promises in the contract; the Group has inventory risk before the goods or services are transferred to the customer; and the Group has discretion in setting the prices of the goods or services.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

L. Cost of revenues

Cost of revenues mainly include equipment purchase costs, salaries and related expenses, value added services costs, royalties expenses, ongoing license fees, interconnection and roaming expenses, cell site leasing costs, depreciation and amortization expenses and maintenance expenses, directly related to services rendered.

The Group recognizes discounts from suppliers as a decrease in Cost of Sales. Therefore, discounts in respect of purchases that are added to the closing inventory balance are treated as inventory and the remainder as a decrease in Cost of Sales.

M. Advertising expenses

Advertising costs are expensed as incurred.

N. Lease payments

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

O. Financing income and expenses

Financing income is comprised of interest income on installment sale transactions and funds invested, changes in the fair value of financial instruments measured at fair value through profit or loss and income from exchange rate differences. Interest income is recognized in the profit and loss using the effective interest method.

Financing expenses are comprised of interest expenses, linkage expenses, discount amortization expenses, changes in fair value of financial instruments measured at fair value through profit or loss, losses from exchange rate differences and unwinding of the discount on provisions. All borrowing costs are recognized in profit and loss using the effective interest method.

Changes in the fair value of financial assets at fair value through profit or loss also include income from dividends and interest.

Gains and losses from exchange rate differences and changes in the fair value of financial instruments measured at fair value through profit or loss, are presented on a net basis, as financing income or financing expenses.

In the statements of cash flows, payments for derivative contracts which are used for economic hedges of financial liabilities arising from financing activities, are presented as part of cash flows from financing activities.

Payments for derivative contracts which are used for economic hedges of handset and network related acquisitions and international roaming services activity, and changes in the fair value of those derivatives, are presented as part of cash flows from operating activities.

Interest received and dividends received are presented as part of cash flows from investing activities.

Interest paid and dividends paid are presented as part of cash flows from financing activities.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

P. Taxes on income

Taxes on income comprise current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or are recognized directly in equity or in other comprehensive income to the extent they relate to items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable (or receivable) on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Current tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and there is intent to settle current tax liabilities and assets on a net basis or the tax assets and liabilities will be realized simultaneously.

A provision for uncertain tax positions, including additional tax and interest expenses, is recognized when it is more probable than not that the Group will have to use its economic resources to pay the obligation.

Deferred tax is recognized for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted at the reporting date.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred tax liabilities and assets are not recognized for temporary differences between the carrying amount and tax bases of investments in its subsidiaries and the Group's holdings in included entities, where the company is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax assets and liabilities on a net basis or their current tax assets and liabilities will be realized simultaneously.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

Q. Earnings per share

The Company presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit and loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options and share options granted to employees.

R. Accounting policy for new transactions or events

Issuance of parcel of securities

The consideration received from the issuance of a parcel of securities is attributed initially to financial liabilities that are measured each period at fair value through profit or loss, and then to financial liabilities that are measured only upon initial recognition at fair value. The remaining amount is the value of the equity component. When a number of equity components are issued in a parcel of securities, the consideration of the parcel attributes to their relative fair value. The fair value of each of the components of the package, are based on the average market prices of the securities three business days after their issuance.

Direct issuance costs are attributed to the specific securities in respect of which they were incurred. Joint issuance costs are attributed to the securities on a proportionate basis according to the allocation of the consideration from the issuance of the parcel, as described above. Issuance costs that allocated to equity components are presented net from equity.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

R. Accounting policy for new transactions or events (cont'd)

New standards not yet adopted

(1) IFRS 16, Leases (hereinafter in this section: "IFRS 16" or "the standard")

The standard replaces IAS 17, Leases and its related interpretations. The standard's instructions annul the existing requirement from lessees to classify leases as operating or finance leases. Instead of this, for lessees, the new standard presents a unified model for the accounting treatment of all leases according to which the lessee has to recognize a right-of-use asset and a lease liability in its financial statements. Nonetheless, IFRS 16 includes two exceptions to the general model whereby a lessee may elect to not apply the requirements for recognizing a right-of-use asset and a liability with respect to short-term leases of up to one year and/or leases where the underlying asset has a low value. In addition, IFRS 16 permits the lessee to apply the definition of the term lease according to one of the following two alternatives consistently for all leases: retrospective application for all the lease agreements, which means reassessing the existence of a lease for each separate contract, or alternatively to apply a practical expedient that permits continuing with the assessment made regarding existence of a lease based on the guidance in IAS 17, Leases, and IFRIC 4, Determining whether an Arrangement contains a Lease, with respect to leases entered into before the date of initial application. Furthermore, the standard determines new and expanded disclosure requirements from those required at present. IFRS 16 is applicable for annual periods as of January 1, 2019.

IFRS 16 includes various alternative transitional provisions, so that companies can choose between one of the following alternatives at initial application consistently for all leases: full retrospective application or recognizing a cumulative effect, which means application (with the possibility of certain practical expedients) as from the mandatory effective date with an adjustment to the opening balance of retained earnings at that date.

Method of application and expected effects

The Group plans to adopt IFRS 16 as from January 1, 2019 using the cumulative effect method, therefore, application of the standard is not expected to have an effect on the balance of retained earnings at the date of initial application.

Expedients:

- (1) retain the definition and/or assessment of whether an arrangement is a lease in accordance with current guidance with respect to agreements that exist at the date of initial implementation;
- (2) apply a single discount rate to a portfolio of leases with reasonably similar characteristics;
- (3) exclude initial direct costs from measurement of the right-of-use asset at the date of initial implementation;
- (4) use hindsight when determining the lease term if the contract includes an extension or termination option;
- (5) assess whether a contract is onerous in accordance with IAS 37 immediately before the date of initial implementation instead of assessing impairment of right-of-use assets.

The Standard is expected to affect the accounting treatment of leases of cell sites, real estate and vehicles of the Group, in which the Group is the lessee and which were classified before the date of initial implementation as operating leases.

The Group will recognize a right-of-use asset and a lease liability at initial implementation for all the leases that award it control over the use of identified assets for a specified period of time.

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**Cellcom Israel Ltd. and Subsidiaries**

**Notes to the Consolidated Financial Statements**

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Note 3 - Significant Accounting Policies (cont'd)

R. Accounting policy for new transactions or events (cont'd)

New standards not yet adopted (cont'd)

(1) IFRS 16, Leases (hereinafter in this section: "IFRS 16" or "the standard") (cont'd)

Material changes and expected effects:

The Group plans to elect to apply the transitional provision of recognizing a lease liability at the date of initial application, for all the leases that award it control over the use of identified assets for a specified period of time, and except for when the Group has elected to apply the standard's expedients as aforesaid, according to the present value of the future lease payments discounted at the incremental borrowing rate of the lessee at that date, and concurrently recognizing a right-of-use asset at the same amount of the liability, adjusted for any prepaid or accrued lease payments that were recognized as an asset or liability before the date of initial application. Therefore, application of the standard is not expected to have an effect on the balance of retained earnings at the date of initial application.

These changes are expected to result in an increase of NIS 0.8 billion in the balance of right-of-use assets and other receivables, an increase of NIS 0.2 billion in the balance of the current lease liabilities and an increase of NIS 0.6 billion in the balance of the non-current lease liabilities at the date of initial application.

Accordingly, depreciation and amortization expenses will be recognized in subsequent periods in respect of the right-of-use asset, and the need for recognizing impairment of the right-of-use asset will be examined in accordance with IAS 36. Furthermore, financing expenses will be recognized in respect of the lease liability. Therefore, as from the date of initial application and in subsequent periods, depreciation expenses and financing expenses will be recognized instead of lease expenses relating to assets leased under an operating lease, which were presented as part of the general and administrative expenses item in the income statement.

Therefore, subject to the aforementioned reservations, in 2019, the Group estimates that applying the Standard is expected to cause a decrease in lease expenses of approximately NIS 0.2 billion and an increase in depreciation expenses and financing expenses in a similar amount. In addition, in 2019, the implementation of the Standard is expected to cause an increase in cash flows from operating activities of approximately NIS 0.2 billion and a decrease in cash flows from financing activities in a similar amount.

The Group expects a change in principal financial ratios such as: an increase in the leverage ratio, a decrease in the interest coverage ratio and a decrease in the current ratio. The Group does not expect that its ability to satisfy financial covenants applicable to it as described in Note 17, regarding Debentures and Long-term Loans from Financial Institutions, will be affected by these changes in financial ratios.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

R. Accounting policy for new transactions or events (cont'd)

New standards not yet adopted (cont'd)

Amendment to IAS 28, Investments in Associates and Joint Venture: Long-Term Interests in Associates or Joint Ventures

The Amendment clarifies that for long-term interests that form part of the entity's net investment in the associate or joint venture, the entity shall first apply the requirements of IFRS 9 and then apply the instructions of IAS 28 with respect to the remainder of those interests, so that the long-term interests are in the scope of both IFRS 9 and IAS 28. The Amendment is effective retrospectively (with certain reliefs) for annual periods beginning on or after January 1, 2019. The Group has examined the effects of applying the Amendment, and in its opinion the effect on the financial statements will be immaterial.

Amendment to IFRS 9, Financial Instruments: Prepayment Features with "Negative Compensation"

The Amendment clarifies that financial instruments with a prepayment feature that may lead to a situation in which reasonable compensation is received or paid upon early termination of the contract can meet the SPPI (solely payment of principal and interest) criterion and therefore be measured at amortized cost or fair value through other comprehensive income. The basis for conclusions of the Amendment clarifies that prepayment for the fair value of the instrument does not necessarily meet the SPPI criterion. The Amendment is effective for annual periods beginning on or after January 1, 2019.

The Group has examined the effects of applying the Amendment, and in its opinion the effect on the financial statements will be immaterial.

IFRIC 23, Uncertainty Over Income Tax Treatments

IFRIC 23 clarifies how to apply the recognition and measurement requirements of IAS 12 for uncertainties in income taxes. According to IFRIC 23, when determining the taxable profit (loss), tax bases, unused tax losses, unused tax credits and tax rates when there is uncertainty over income tax treatments, the entity should assess whether it is probable that the tax authority will accept its tax position. Insofar as it is probable that the tax authority will accept the entity's tax position, the entity will recognize the tax effects on the financial statements according to that tax position. On the other hand, if it is not probable that the tax authority will accept the entity's tax position, the entity is required to reflect the uncertainty in its accounts by using one of the following methods: the most likely outcome or the expected value. IFRIC 23 clarifies that when the entity examines whether or not it is probable that the tax authority will accept the entity's position, it is assumed that the tax authority with the right to examine any amounts reported to it will examine those amounts and that it has full knowledge of all relevant information when doing so. Furthermore, according to IFRIC 23 an entity has to consider changes in circumstances and new information that may change its assessment. IFRIC 23 also emphasizes the need to provide disclosures of the judgments and assumptions made by the entity regarding uncertain tax positions.

IFRIC 23 is effective for annual reporting periods beginning on or after January 1, 2019. The interpretation includes two alternatives for applying the transitional provisions, so that companies can choose between retrospective application or prospective application as from the first reporting period in which the entity initially applied the

interpretation. The Group has examined the effects of applying IFRIC 23, and in its opinion the effect on the financial statements will be immaterial.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 4 - Fair Value

A. Determination of Fair Value

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

1. Trade and other receivables

The fair value of trade and other receivables is estimated as the present value of future cash flows, discounted at the appropriate interest rate at the reporting date.

2. Current investments and derivatives

The fair value of forward exchange contracts is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using market interest rates appropriate for similar instruments, including the adjustment required for the parties' credit risks.

The fair value of investments in debt securities and investments in equity instruments are based on quoted market prices.

3. Non-derivative financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

4. Share-based payment transactions

Fair value of employee stock options is measured using the Black-Scholes formula. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behavior) and the risk-free interest rate (based on government bonds). Service conditions attached to the transactions are not taken into account in determining fair value.

B. Fair Value Hierarchy

When determining the fair value of an asset or liability, the Group uses observable market data as much as possible. There are three levels of fair value measurements in the fair value hierarchy that are based on the data used in the measurement, as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical instruments.
- Level 2: inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly.
- Level 3: inputs that are not based on observable market data (unobservable inputs).

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 5 - Financial Risk Management

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Group's financial risk management framework. The Board has established a sub-committee for financial exposures management, which is responsible for developing and monitoring the Group's financial exposures management policies. The sub-committee recommends to the Board of Directors changes in the Group's financial exposures management policy.

The Group's risk management policies are established to identify and analyze the financial risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities through training and procedures. The Group aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group's Audit Committee oversees how management monitors compliance with the Group's financial risk management policies and procedures, and reviews the adequacy of the financial risk management framework in relation to the risks faced by the Group. The Group Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee. See also Note 21, regarding Financial Instruments.

Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. The Group's credit risk arises principally from the Group's receivables from customers and investments in debt instruments. The carrying amounts of financial assets and contract assets represent the Group's maximum credit risk exposure.

Trade receivables, other receivables and contract assets

The Group conducts credit evaluations on receivables over a certain amount, and requires financial guarantees against them. Management monitors outstanding receivable balances and the financial statements include appropriate allowances for estimated irrecoverable amounts. The Group is exposed to credit risk arising mainly from its operation in Israel.

Cash and cash equivalents

Most of the Group's cash and cash equivalents are maintained with major banking institutions in Israel.

Investments in debt instruments

The Group limits its exposure to credit risk by investing only in liquid debt instruments and only with counterparties that have a credit rating of at least "AA-" from S&P Maalot. Management actively monitors credit ratings and given these high credit ratings, management does not expect any counterparty to fail to meet its obligations.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 5 - Financial Risk Management (cont'd)

Derivatives

The counterparties of the derivatives held by the Group are major banks in Israel.

At the reporting date, there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivatives, in the consolidated statement of financial position. Financial instruments that could potentially subject the Group to credit risks consist primarily of trade receivables. Credit risk with respect to these receivables is limited due to the composition of the subscriber base, which includes a large number of individuals and businesses.

Assessment of expected credit losses for individual customers

The Group uses a provision matrix that is based on, inter alia, an aging of trade receivables, to measure the expected credit losses from individual customers, which comprise a very large number of small balances.

Loss rates are calculated based on the probability of a receivable progressing through successive stages of delinquency to write-off. The loss rates are calculated separately for exposures in different segments based on the following common credit risk characteristics – age of debt and period of delinquency, geographic region, age of customer relationship and type of product purchased.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and extreme conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The cash surpluses held by Group companies that are not required for financing their current activity, are invested in interest-bearing investment channels such as: short-term deposits and debentures.

These investment channels are chosen based on future forecasts of the cash Group will require in order to meet its liabilities.

The Group examines current forecasts of its liquidity requirements so as to make certain that there is sufficient cash for its operating needs, and it is careful at all times to have enough unused credit facilities so that the Group does not exceed its credit limits and is in compliance with its financial covenants. These forecasts take into consideration matters such as the Group's plan to use debt for financing its activity, compliance with required financial covenants, and compliance with external requirements such as laws or regulation.

The Group has contractual commitments to purchase inventories, fixed assets and other current services. For further information about material commitments see Note 30, regarding Commitments.

Market risk

In the ordinary course of business, the Group buys and sells derivatives, and also incurs financial liabilities, in order to manage market risks. All such transactions are carried out according to the policy established by the Board of Directors.



Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 5 - Financial Risk Management (cont'd)

Interest rate and CPI risks

The Group is exposed to fluctuations in the interest rate, including changes in the CPI, as part of its borrowings are linked to the CPI. As part of its risk management policy the Group has entered into forward contracts that partially hedge the exposure to changes in the CPI. All such transactions are carried out within the policy established by the Board of Directors.

Currency risk

The Group's operating income and cash flows are exposed to currency risk, mainly due to handset and network related acquisitions, purchase of TV content, purchase of telecommunications capacity and its international roaming services activity. The Group also manages bank accounts that are denominated in a currency other than its respective functional currency, primarily USD and Euro. As part of its financial exposures hedging policy, the Group uses forward and option contracts to partially hedge the exposure to fluctuations in foreign exchange rates.

Other market price risk

Equity price risk arises from equity securities that are measured through profit and loss. Management monitors the mix of debt and equity securities in its investment portfolio based on market indices.

Capital management

The Group's capital management aim is to ensure a sound and efficient capital structure which takes into consideration, among others, the following factors:

A gearing ratio that supports the Group's cash flow needs with respect to its potential cash flow generation and also supporting its dividend policy, considering the limitation imposed on dividend distribution as established in the indenture of the Group's Series F through L debentures and in the Company's long term loans and deferred loan agreements, while maintaining a Net Debt to Adjusted EBITDA ratio (see definition in Note 17, regarding Debentures and long-term loans from financial institutions) as established in such documents, and that meets the industry standards. The Group considers Net Debt to Adjusted EBITDA ratio to be an important measure for investors, debentures holders, analysts, and rating agencies. This ratio is a non-GAAP figure not governed by International Financial Reporting Standards and its definition and calculation may vary from one company to another. The Group's debt mainly consists of short and long-term debentures traded publicly in the Tel Aviv Stock Exchange and loans from financial institutions.

The definition of Adjusted EBITDA (as defined in note 6 below) is identical to the definition of EBITDA (which the Group used in previous periods).



## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 6 - Operating Segments

The Group operates in two reportable segments, as described below, which are the Group's strategic business units. The strategic business unit's allocation of resources and evaluation of performance are managed separately. The operating segments were determined based on internal management reports reviewed by the Group's chief operating decision maker (CODM). The CODM does not examine the balance of assets or liabilities for those segments and therefore, they are not presented.

Cellular segment - the segment includes the cellular communications services, cellular equipment and supplemental services.

Fixed-line segment - the segment includes landline telephony services, internet services, television services, transmission services, landline equipment and supplemental services.

The accounting policies of the reportable segments are the same as described in the annual financial statements in Note 3, regarding Significant Accounting Policies.

Year ended December 31, 2018  
NIS millions

	Cellular	Fixed-line	Reconciliation for consolidation	Consolidated	Reconciliation of subtotal Adjusted segment EBITDA to loss for the year
External revenues	2,371	1,317	-	3,688	
Inter-segment revenues	14	147	(161)	) -	
Adjusted segment EBITDA*	391	269			660
Depreciation and amortization					(584 )
Tax benefit					6
Financing income					46
Financing expenses					(190 )
Share based payments					(2 )
Loss for the year					(64 )

Year ended December 31, 2017  
NIS millions

Cellular	Fixed-line	Reconciliation for consolidation	Consolidated	Reconciliation of subtotal Adjusted segment
----------	------------	--	--------------	--

					EBITDA to loss for the year
External revenues	2,685	1,186	-	3,871	
Inter-segment revenues	14	162	(176	) -	
Adjusted segment EBITDA*	595	258			853
Depreciation and amortization					(555 )
Taxes on income					(40 )
Financing income					52
Financing expenses					(196 )
Other income					1
Share based payments					(2 )
Profit for the year					113

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 6 - Operating Segments (cont'd)

Year ended December 31, 2016 NIS millions					Reconciliation of subtotal Adjusted segment EBITDA to loss for the year
	Cellular	Fixed-line	Reconciliation for consolidation	Consolidated	
External revenues	2,981	1,046	-	4,027	
Inter-segment revenues	17	183	(200)	-	
Adjusted segment EBITDA*	625	233			858
Depreciation and amortization					(534)
Taxes on income					(10)
Financing income					46
Financing expenses					(196)
Other expenses					(8)
Share based payments					(6)
Profit for the year					150

\* Adjusted segment EBITDA as reviewed by the Group's CODM, represents earnings before interest (financing expenses, net), taxes, other income (expenses) (except for expenses in respect of voluntary retirement plans for employees, and gain (loss) due to sale of subsidiaries), depreciation and amortization and share based payments, as a measure of operating profit. Adjusted Segment EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies.

## Note 7 - Subsidiaries

A. Presented hereunder is a list of the Group's significant subsidiaries:

	The Group's ownership interest in the subsidiary for the year ended December 31	
Principal location	2017	2018

		of the subsidiary's activity	
<u>Name of subsidiary</u>			
Cellcom Fixed Line			
Communication L.P. Israel		100 %	100 %
Dynamica Cellular			
Ltd.	Israel	100 %	100 %

B. In 2017, following the Ministry of Communication's requirement to unify the unified licenses held by each communications group into one unified license, the Company completed a reorganization of its subsidiaries, following which all the Company's fixed-line operation under the unified license are unified under the Company's wholly owned subsidiary Cellcom Fixed Line Communications, Limited Partnership.

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 8 - Cash and Cash Equivalents

## Composition

	December 31,	
	2017	2018
	NIS	NIS
	millions	millions
Bank balances	59	50
Call deposits	468	1,152
	527	1,202

The Group's exposure to interest rate risk and sensitivity analysis for financial assets and liabilities are disclosed in Note 21.

## Note 9 - Trade and Other Receivables

## Composition

	December 31,	
	2017	2018
	NIS	NIS
	millions	millions
<u>Current</u>		
Trade Receivables*		
Open accounts	475	423
Checks and credit cards receivables	173	141
Accrued income	109	122
Current maturity of long-term receivables	523	466
	1,280	1,152
Other Receivables		
Prepaid expenses	76	66
Others	13	18
	89	84
	1,369	1,236
<u>Non-current</u>		
Trade receivables*	412	370
Rights of use of communications lines	337	342
Deposits and other receivables	30	22
Loan to a customer	107	114
Other	9	4
	895	852
	2,264	2,088

\* Net of allowance for doubtful debts.

The Group is exposed to credit risks and impairment losses related to trade and other receivables as disclosed in Note 21.

Non-current trade receivables balances are in respect of equipment sold in installments (mainly 36 monthly payments) which current amount as of December 31, 2018, is calculated at a 3.3% annual discount rate (December 31, 2017 - 3.3%).

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 10 - Inventory

## A. Composition

	December 31,	
	2017	2018
	NIS	NIS
	millions	millions
Handsets	53	69
Accessories	9	14
Spare parts	8	11
	70	94

B. In 2018, the Group tested slow moving inventory for impairment and wrote down inventory to its net realizable value by the amount of NIS 4 million (2017 - NIS 3 million). The write-down is included in Cost of Sales.

## Note 11 - Property, Plant and Equipment, net

	Communications network	Control and testing equipment	Vehicles	Computers, furniture and landline communications equipment	Leasehold improvements	Total
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cost						
Balance at January 1, 2017	5,064	79	5	370	124	5,642
Additions	189	-	2	151	6	348
Disposals	(262)	) (20	) -	(25	) (17	) (324)
Discontinuance of consolidation	(2	) (1	) (1	-	-	(4)
Balance at December 31, 2017	4,989	58	6	496	113	5,662
Additions	265	5	1	157	2	430
Disposals	(180)	) -	(1	(90	) (15	) (286)
Balance at December 31, 2018	5,074	63	6	563	100	5,806
Accumulated Depreciation						
Balance at January 1, 2017	3,673	62	5	160	83	3,983
Depreciation for the year	273	7	1	105	11	397
Disposals	(252)	) (20	) (1	(24	) (17	) (314)

Discontinuance of consolidation	(2	)	-	-	-	-	(2	)	
Balance at December 31, 2017	3,692		49	5	241	77	4,064		
Depreciation for the year	258		5	1	101	9	374		
Disposals	(179	)	-	(1	)	(90	)	(284	)
Balance at December 31, 2018	3,771		54	5	252	72	4,154		

## Carrying amounts

At January 1, 2017	1,391	17	-	210	41	1,659
At December 31, 2017	1,297	9	1	255	36	1,598
At December 31, 2018	1,303	9	1	311	28	1,652

In the ordinary course of business, the Group acquires property, plant and equipment on credit. The cost of acquisitions, which has not yet been paid at the reporting date, amounted to NIS 221 million (December 31, 2017 and 2016, NIS 143 million and NIS 120 million, respectively).



## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 12 - Intangible Assets and Others, net

	Licenses and Frequencies NIS millions	Information systems NIS millions	Software NIS millions	Customer acquisition costs NIS millions	Goodwill NIS millions	Customer relationships and other NIS millions	Total NIS millions
Cost							
Balance at January 1, 2017	552	304	53	-	830	308	2,047
Additions	-	72	4	120	-	6	202
Disposals	-	(48 )	(12 )	-	-	-	(60 )
Discontinuance of consolidation	-	(3 )	-	-	(21 )	-	(24 )
Balance at December 31, 2017	552	325	45	120	809	314	2,165
Additions	-	71	8	138	-	1	218
Disposals	-	(100 )	(12 )	-	-	-	(112 )
Balance at December 31, 2018	552	296	41	258	809	315	2,271
Accumulated Amortization							
Balance at January 1, 2017	382	122	30	-	-	306	840
Amortization for the year	19	68	9	27	-	3	126
Disposals	-	(48 )	(12 )	-	-	-	(60 )
Discontinuance of consolidation	-	(1 )	-	-	-	-	(1 )
Balance at December 31, 2017	401	141	27	27	-	309	905
Amortization for the year	15	74	8	80	-	3	180
Disposals	-	(100 )	(12 )	-	-	-	(112 )
Balance at December 31, 2018	416	115	23	107	-	312	973
Carrying amounts							
At January 1, 2017	170	182	23	-	830	2	1,207
At December 31, 2017	151	184	18	93	809	5	1,260
At December 31, 2018	136	181	18	151	809	3	1,298

In the ordinary course of business, the Group acquires Intangible assets on credit. The cost of acquisitions, which has not yet been paid at the reporting date, amounted to NIS 37 million (December 31, 2017 and 2016, NIS 28 million and NIS 32 million, respectively).

## A. Impairment testing for cash-generating unit containing goodwill

For the purpose of impairment testing, goodwill is allocated mainly to the Fixed-line segment, which represents the lowest level within the Group, at which goodwill is monitored for internal management purposes, which is not higher than the reported operating segments. See Note 6, regarding Operating Segments.

The aggregate carrying amount of goodwill allocated to the Fixed-line segment as of December 31, 2018, is NIS 732 million (December 31, 2017 - NIS 732 million).

The recoverable amount of the Fixed-line segment was based on its value in use and was determined by discounting the expected future cash flows to be generated from the continuing use. The recoverable amount of the Fixed-line segment as of December 31, 2018, was determined to be higher than its carrying amount and thus, no impairment loss has been recognized.

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 12 - Intangible Assets and Others, net (cont'd)

## B. Key assumptions used in calculation of recoverable amount

Key assumptions used in the calculation of recoverable amounts are discount rate and terminal value growth rate. These assumptions are as follows:

Actual results may differ from those assumed in the Company's valuation method. It is reasonably possible that the Company's assumptions described above could change in future periods. If any of these were to vary materially from the Company's plans, it may record impairment of goodwill in the future.

These assumptions are as follows:

## (1) Pre-tax discount rate and terminal value growth rate

	Pre-tax discount rate		Terminal value growth rate	
	2017	2018	2017	2018
Fixed-line segment	10.3 %	10.6 %	1.5 %	1.5 %

- The discount rate and the terminal value growth rate are denominated in real terms.
- The Fixed-line segment has cash flows for 5 years, as included in its discounted cash flow model.
- The long-term growth rate has been determined as 1.5% which represents, among others, the natural population growth rate.
- The pre-tax discount rate is estimated and calculated using several assumptions, among others, Fixed-line segment's Cost of Equity, risk premium for normative debt leveraging of the Group and estimates of the normative leverage ratio for the industry.

## (2) Sensitivity to changes in assumptions

The estimated recoverable amount of the Fixed-line segment exceeds its carrying amount by approximately NIS 96 million (2017: approximately NIS 105 million). Management has identified two key assumptions for which there reasonably could be a possible change that could cause the carrying amount to exceed the recoverable amount. The table below shows the amount that these two assumptions are required to change individually in order for the estimated recoverable amount to be equal to the carrying amount:

	2017	2018
Pre-tax discount rate	10.8 %	11.0 %
Terminal value growth rate	0.9 %	1.0 %

## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 13 - Trade Payables and Accrued Expenses

## Composition

	December 31,	
	2017	2018
	NIS	NIS
	millions	millions
Trade payables	256	288
Accrued expenses	396	408
	652	696

The credit balance as of December 31, 2018 in respect of reverse factoring of trade payables transactions includes approximately NIS 95 million on short-term and approximately NIS 11 million on the long term, that repaid trade payables balances in this amount as of the balance sheet date and are due for repayable between January 2019 until January 2020.

## Note 14 - Provisions

## Composition

	Dismantling and restoring sites		Litigations		Other contractual obligations		Total
	NIS		NIS		NIS		NIS
	millions		millions		millions		millions
Balance as at January 1, 2017	30		60		48		138
Provisions made during the year	2		14		11		27
Provisions reversed during the year	(11)	)	(25)	)	(17)	)	(53)
Balance as at January 1, 2018	21		49		42		112
Provisions made during the year	-		21		12		33
Provisions reversed during the year	(1)	)	(7)	)	(12)	)	(20)
Balance as at December 31, 2018	20		63		42		125
Non-current	20		-		-		20
Current	-		63		42		105
	20		63		42		125

## Dismantling and restoring sites

The Group is required to incur certain costs in respect of a liability to dismantle and remove assets and to restore sites on which the assets were located. These dismantling costs are calculated on the basis of the identified costs for the current financial year, extrapolated for future years using the best estimate of future trends in prices, inflation, etc., and are discounted at a risk-free rate. Forecast of estimated site departures or asset returns is revised in light of future changes in regulations or technological requirements.

#### Litigations

The Group is involved in a number of legal and other disputes with third parties. The Group's management, after taking legal advice, has established provisions which take into account the facts of each case. The timing of cash outflows associated with legal claims cannot be reasonably determined. For detailed information regarding legal proceedings against the Group, refer to Note 31.

#### Other contractual obligations

Provisions for other contractual obligations and exposures include various obligations that are derived either from a constructive obligation or legislation for which there is a high uncertainty regarding the timing and amount of future expenditure required for settlement.

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 15 - Other Payables, Including Derivatives

## Composition

	December 31,	
	2017	2018
	NIS	NIS
	millions	millions
Employees and related liabilities	133	116
Government institutions	29	32
Interest payable	54	63
Accrued expenses	1	4
Deferred revenue	42	41
Derivative financial instruments	18	1
	277	257

## Note 16 - Other Long-term Liabilities

## Composition

	December 31,	
	2017	2018
	NIS	NIS
	millions	millions
Long-term trade payables	1	12
Deferred revenue	3	4
Other	11	-
	15	16

## Note 17 - Debentures and Long-term Loans from Financial Institutions

This note provides information about the contractual terms of the Group's debentures and long-term loans from financial institutions, which are measured at amortized cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see Note 21.

	December 31,	
	2017	2018
	NIS	NIS
	millions	millions
Non- current liabilities		
Debentures	2,360	2,911
Long-term loans from financial institutions	462	334
	2,822	3,245
Current liabilities		
Current maturities of debentures	540	492
Current maturities of loans from financial institutions	78	128



## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 17 - Debentures and Long-term Loans from Financial Institutions (cont'd)

## Debentures

The terms and debt repayment schedule

The terms and repayment schedule of the Company's debentures are as follows\*:

				December 31, 2017 NIS millions		December 31, 2018 NIS millions	
	Currency	Nominal interest rate	Year of maturity	Face value	Carrying amount	Face value	Carrying amount
Debentures (Series F)** - linked to the Israeli CPI	NIS	4.60 %	2017-2020	643	659	429	444
Debentures (Series G)** - unlinked	NIS	6.99 %	2017-2019	228	228	86	86
Debentures (Series H) - linked to the Israeli CPI	NIS	1.98 %	2018-2024	950	849	836	777
Debentures (Series I) - unlinked	NIS	4.14 %	2018-2025	804	761	724	701
Debentures (Series J) - linked to the Israeli CPI	NIS	2.45 %	2021-2026	103	102	103	104
Debentures (Series K) - unlinked	NIS	3.55 %	2021-2026	304	301	711	705
Debentures (Series L) - unlinked	NIS	2.50 %	2023-2028	-	-	614	586
Total Debentures				3,032	2,900	3,503	3,403

\* In January 2019, after the end of the reporting period, the Company repaid interest and principal of debentures in a total sum of approximately NIS 373 million, following which Debentures Series G were fully repaid.

In June 2013, the Company's rating was updated from an "ilAA-/negative" to an "ilA+/stable" rating, in relation to the Company's debentures traded on the Tel Aviv Stock Exchange. Following this update of rating and since this was \*\*the second downgrade in the Debentures' rating since their issuance, the annual interest rate that the Company pays for its Series F and G debentures has been increased by 0.25% to 4.60% and 6.99%, respectively, beginning July 5, 2013.

The Company's outstanding debentures were issued based on the then current Israeli shelf prospectus and are listed on the Tel Aviv Stock Exchange, or TASE.

The Company's debentures are unsecured and contain standard terms and conditions in addition to certain additional undertakings by the Company, as follows:

In connection with the issuance of Series F debentures, the Company has undertaken to comply with certain financial and other covenants. Inter alia:

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a Net Leverage\* exceeding 5, or exceeding 4.5 during four consecutive quarters, shall constitute an event of default; As of December 31, 2018, the Net Leverage is 3.45.

not to distribute more than 95% of the profits available for distribution according to the Israeli Companies law ("Profits"); provided that if the Net Leverage\* exceeds 3.5:1, the Company will not distribute more than 85% of its Profits and if the Net Leverage\* exceeds 4:1, the Company will not distribute more than 70% of its Profits. Failure to comply with this covenant shall constitute an event of default;

cross default, excluding following an immediate repayment initiated in relation to a liability of NIS 150 million or less, shall constitute an event of default;

a negative pledge, subject to certain exceptions. Failure to comply with this covenant shall constitute an event of default;

an obligation to pay additional interest of 0.25% for two-notch downgrade in the debentures' rating and additional interest of 0.25% for each additional one-notch downgrade and up to a maximum addition of 1%, in comparison to the rating given to the debentures prior to their issuance;

failure to have the debentures rated over a period of 60 days, shall constitute an event of default.

Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 17 - Debentures and Long-term Loans from Financial Institutions (cont'd)

Debentures (cont'd)

\* Net Leverage - the ratio of Net Debt to Adjusted EBITDA, excluding one-time influences. Net Debt defined as credit and loans from banks and others and debentures, net of cash and cash equivalents and current investments in tradable securities. Adjusted EBITDA defined as in relation to the twelve month period preceding the Group's most updated consolidated financial statements and calculated as profit before depreciation and amortization, other expenses/ income, net, financing expenses/ income, net and taxes on income.

The definition of Adjusted EBITDA as defined above is identical to the definition of EBITDA (which the Group used in previous periods).

In connection with the issuance of Series H and Series I debentures in July 2014, the Company undertook additional undertakings, in addition to those previously undertaken by the Company in its Series F and G indenture (as detailed above), including: (1) in addition to being an event of default, meeting the financial covenants previously undertaken by the Company (a maximum net leverage ratio (Net Debt to Adjusted EBITDA ratio) in excess of 5.0:1, or in excess of 4.5:1 for four consecutive quarters) would be a condition for dividend distribution; and (2) meeting such financial covenants would also be a condition for the issuance of additional debentures of each of the two series. In addition, the Series H and Series I Indenture contains substantially similar events of default to those found in the Series F and Series G Indenture, with the exception of certain new events of default that do not appear in the Series F and Series G Indenture as well as certain modifications to the events of default that are found in the Series F and Series G Indenture, including: (1) breach of the above limitation on dividend distributions; (2) the minimum amount required for triggering a cross default shall not apply to a cross default triggered by another series of debentures; (3) the existence of a real concern that the Company shall not meet its material undertakings towards the debenture holders; (4) the inclusion in the Company's financial statements during a period of two consecutive quarters of a note regarding the existence of significant doubt as to the Company's ability to continue as a going concern; and (5) breach of the Company's undertakings regarding the issuance of additional debentures.

The Series J and Series K debentures contain standard terms and conditions in addition to certain additional undertakings by the Company, generally similar to the terms of the Company's existing Series H and I debentures.

In January 2018, the Company issued a new series of debentures, Series L debentures, in a principal amount of approximately NIS 401 million, at an interest rate of 2.5% per annum (annual effective interest rate of 2.66%). Series L debentures principal will be payable in six installments, of which the first four installments of 15% of the principal each will be paid on January 5 of the years 2023 through 2026, and the remaining two installments of 20% of the principal each will be paid on January 5 of the years 2027 and 2028. The interest on the outstanding principal of the Series L debentures is payable on January 5 and on July 5 of each of the years 2019 through 2028. The series was issued at par value (NIS 1,000 per unit). The total net consideration received by the Company was approximately NIS 400 million. The debentures (principal amount and interest) are without any linkage.

The Series L debentures are unsecured and contain standard terms and conditions in addition to certain additional undertakings by the Company, generally similar to the terms of the Company's existing Series J and K debentures, with a change to the additional interest to be paid in case of a two-notch downgrade in the debentures' credit rating to 0.5% (with no change to the maximum additional interest).

According to the Company's June 2017 undertaking in an agreement with certain Israeli institutional investors, according to which the Company irrevocably undertook to issue to the institutional investors, and the institutional investors irrevocably undertook to purchase from the Company, NIS 220 million aggregate principal amount of additional debentures of the existing series K debentures (which are listed on the Tel Aviv Stock Exchange, or TASE), on July 1, 2018, the Company issued the debentures as aforesaid, at an interest rate of 3.55% per annum (annual effective interest rate of 3.6%). The total consideration received by the Company was approximately NIS 222 million (approximately NIS 220 million net).

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 17 - Debentures and Long-term Loans from Financial Institutions (cont'd)

## Debentures (cont'd)

In December 2018, the Company issued additional Series K debentures in an aggregate principal amount of approximately NIS 187 million in exchange for total consideration of approximately NIS 187 million, representing an effective interest rate of 3.89% per annum. series K debentures of the company are listed on the Tel Aviv Stock Exchange, or TASE.

In December 2018, the Company issued additional Series L debentures in an aggregate principal amount of approximately NIS 213 million in exchange for total consideration of approximately NIS 193 million, representing an effective interest rate of 4.53% per annum. series L debentures of the company are listed on the Tel Aviv Stock Exchange, or TASE.

As of December 31, 2018, the Group is in compliance with the above covenants.

## Long-term loans from financial institutions

The terms and repayment schedule of the Company's long-term loans are as follows:

				December 31, 2017		December 31, 2018	
				NIS millions		NIS millions	
	Currency	Nominal interest rate	Year of maturity	Face value	Carrying amount	Face value	Carrying amount
Loan from financial institution	NIS	4.60 %	2018-2021	200	200	150	150
Loan from financial institution	NIS	5.10 %	2019-2022	200	200	200	200
Loan from bank	NIS	4.90 %	2018-2022	140	140	112	112
Total loans				540	540	462	462

The Company's outstanding long-term loans contain standard terms and conditions in addition to certain additional undertakings by the Company, including: that the loans' interest rates may be subject to certain adjustments; the Company may prepay the loans, subject to a prepayment fee; generally include the negative pledge, limitations on distributions, events of default and financial covenants applicable to the Company's series F and H through I debentures. In addition, the loan from a bank includes: certain modifications to such events of default, including foreclosure, materialization of a pledge, execution actions, receivership and (subject to certain exclusions) sale of assets, in a specified certain lower amount, a failure to operate in a field which is material to the Company's operations and mergers and changes of formation (with more limited exclusions) will trigger an event of default; certain events which if not approved by the bank allow the bank to notify the Company of an acceleration of the repayment of the loan; and in case the Company provides stricter financial covenants to another financial institution or debenture holder, those will apply to this agreement as well.



## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 17 - Debentures and Long-term Loans from Financial Institutions (cont'd)

## Long-term loans from financial institutions (cont'd)

## Deferred loan from bank

In June 2017, the Company entered into a loan agreement with the Israeli bank that provided the Company a similar loan in August 2015 (the "2015 Loan Agreement"), according to which the bank has agreed, subject to certain customary conditions, to provide the Company a deferred loan in a principal amount of NIS 150 million, unlinked, which will be provided to the Company in March 2019, and will bear an annual fixed interest of 4%. The loan's principal amount will be payable in four equal annual payments on March 31 of each of the years 2021 through and including 2024 and the interest will be payable in ten semi-annual installments on March 31 and September 30 of each calendar year commencing September 30, 2019 through and including March 31, 2024. Until the provision of the loan, the Company is required to pay the bank a commitment fee.

The agreement includes similar terms and obligations to those included in the Company's August 2015 loan agreement and applies the right to demand immediate repayment of either or both agreements due to certain events of default under either agreement.

As of December 31, 2018, the Group is in compliance with the above covenants.

## Movement in liabilities deriving from financing activities

	Loans	Debentures	Derivatives	Interest payable	Put options to non-controlling interests	Total
	NIS millions					
Balance as at January 1, 2017	(340)	(3,729 )	(17 )	(86 )	(11 )	(4,183)
Changes from financing cash flows						
Payments for derivative contracts, net	-	-	3	-	-	3
Receipt of long-term loans from financial institutions	(200)	-	-	-	-	(200 )
Repayment of debentures	-	864	-	-	-	864
Interest paid	-	-	-	175	-	175
Dividend paid	-	-	-	-	1	1
Total net financing cash flows	(200)	864	3	175	1	843
Financing expenses recognized in profit or loss	-	(35 )	(3 )	(143 )	(1 )	(182 )
Balance as at December 31, 2017	(540)	(2,900 )	(17 )	(54 )	(11 )	(3,522)
Effect of initial application of IFRS 9	-	(34 )	-	-	-	(34 )
Balance as at January 1, 2018	(540)	(2,934 )	(17 )	(54 )	(11 )	(3,556)
Changes from financing cash flows						
Payments for derivative contracts, net	-	-	15	-	-	15
Repayment of long-term loans from financial institutions	78	-	-	-	-	78

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Repayment of debentures	-	556	-	-	-	556
Proceeds from issuance of debentures, net of issuance costs	-	(997 )	-	-	-	(997 )
Interest paid	-	-	-	126	-	126
Acquisition of non-controlling interests	-	-	-	-	19	19
Total net financing cash flows	78	(441 )	15	126	19	(203 )
Financing expenses recognized in profit or loss	-	(28 )	1	(135 )	(8 )	(170 )
Balance as at December 31, 2018	(462)	(3,403 )	(1 )	(63 )	-	(3,929)

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 18 - Liability for Employee Rights upon Retirement, Net

The obligation of the Group, under law and labor agreements, to pay severance pay to employees who are not covered by the pension or insurance plans as mentioned in section A below, as of December 31, 2018 and 2017 is NIS 14 million and NIS 15 million respectively, as included in the consolidated statements of financial position, under Liability for employee rights upon retirement, net.

A. Post-employment benefit plans - defined contribution plan

The Group's liability for severance pay for its Israeli employees is calculated pursuant to Israeli Severance Pay Law. The Group's liability is mostly covered by monthly deposits with severance pay funds, insurance policies and by an accrual on the consolidated statements of financial position. For most of the Group's employees, the payments to pension funds and to insurance companies exempt the Group from any obligation towards its employees, in accordance with Section 14 of the Severance Pay Law-1963. Accumulated amounts in pension funds and in insurance companies are not under the Group's control or management and accordingly, neither those amounts nor the corresponding accrual for severance pay are presented in the consolidated statements of financial position.

B. Post-employment benefit plans - defined benefit plan

The portion of the severance payments which is not covered by deposits in defined contribution plans, as aforementioned, is accounted for by the Group as a defined benefit plan, according to which a liability for employee benefits is recognized and in respect of which, the Group deposits amounts in central severance pay funds and in appropriate insurance policies. The total liability as at December 31, 2018 is NIS 26 million (2017 - NIS 27 million). The fair value of the plan assets, the severance pay fund, is NIS 20 million (2017 - NIS 20 million). The expense recognized in the consolidated statement of income for the year ended December 31, 2018 in respect of defined benefit plans, is NIS 2 million (2017 - NIS 3 million).

C. As of December 31, 2018 the Group's liability for adaptation grants to employees is NIS 8 million (2017 - NIS 8 million).



## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 19 - Capital and Reserves

## Share capital

	2016 NIS	2017	2018
Issued and paid at January 1	1,006,046	1,006,046	1,010,446
Equity offering	-	-	121,212
Exercise of share options	-	4,400	30,310
Issued and paid at December 31	1,006,046	1,010,446	1,161,968

The share capital is comprised of ordinary shares of NIS 0.01 par value each.

In June 2018, The Company issued in an offering to the public Israel only for immediate total net consideration of approximately NIS 275 million:

- 12,121,200 ordinary shares of the Company (par value NIS 0.01 per share, or ordinary shares).
- 3,030,300 Series 1 Options. Each Series 1 Option entitles the holder thereof to purchase one ordinary share at an exercise price of NIS 19.50, until December 24, 2018. Series 1 Options were exercised for a total consideration of NIS 59 million.
- 3,030,300 Series 2 Options. Each Series 2 Option entitles the holder thereof to purchase one ordinary share at an exercise price of NIS 20, until June 24, 2019.

The offering was made under the Company's 2017 shelf prospectus and the securities were registered for trading on the Tel Aviv Stock Exchange.

At December 31, 2018, the authorized share capital was comprised of 300 million ordinary shares (December 31, 2016, 2017 - 300 million each). The holders of ordinary shares are entitled to receive dividends as declared.

## Basic and diluted earnings (loss) per share

The calculation of basic earnings (loss) per share was based on the profit (loss) attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding (100,604,578, 100,654,935 and 107,499,543 during the years 2016, 2017 and 2018, respectively). The calculations of diluted earnings (loss) per share was based on the profit (loss) attributable to ordinary shares and the weighted average number of ordinary shares in the basic earnings (loss) per share in addition of 93,728, 234,726 incremental shares (NIS 0.01 par value each) that would be issued resulting from exercise of all options for the years ended December 31, 2016, 2017, respectively.

In addition, 780 thousand options (2017 and 2016 - 78 thousand and 1,060 thousand options, respectively) and 262,615 shares that would be issued resulting from exercise of all options for the year ended December 31, 2018, were excluded from the diluted weighted average number of ordinary shares calculation as their effect would have been anti-dilutive.

The average market value of the Company's shares for purposes of calculating the dilutive effect of share options was based on quoted market prices for the period that the options were outstanding.

## Dividends

In 2016-2018 the Company did not pay dividend to the shareholders of the Company.

#### Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred or exercised.

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 20 - Share-Based Payments

In March 2015, the Company's board of directors approved shared based incentive plan - "2015 Share Incentive Plan" for employees, directors, consultants and sub-contractors of the Company and the Company's affiliates. Under the plan, the Company's board of directors is authorized to determine the terms of the grants, including the identity of grantees, the number of options or restricted stock units ("RSUs") to be granted, the vesting schedule and the exercise price. The terms of the share based payments include a dividend adjustment mechanism. The options will be exercised at net exercise mechanism, with no cash transfer.

Grant date/employees entitled	Number of instruments In thousands	Vesting conditions	Contractual life of options	Adjusted exercise price per share as of December 31, 2018
Share options granted in August 2015 and October 2015 to senior employees	2,660	Three equal installments over three years of employment	4.5 years	NIS 25.65
Share options granted in November 2016 to senior employees	63	Three equal installments over three years of employment	4.5 years	NIS 29.97

The total compensation expense during the year ended December 31, 2018, related to the options granted is NIS 2 million (2017 - NIS 2 million, 2016 - NIS 6 million).

The changes in the balances of the options were as follows:

	Number of options 2016	Weighted average of exercise price (US Dollars)	Number of options 2017	Weighted average of exercise price (US Dollars)	Number of options 2018	Weighted average of exercise price (US Dollars)
Balance as at January 1	2,873,190	7.40	2,764,334	7.15	963,665	8.07
Granted during the year	63,000	7.79	-	-	-	-
Forfeited during the year	(171,856 )	11.43	(146,334 )	11.26	(159,000)	9.77
Exercised during the year	-	-	(1,654,335)	7.40	(24,333 )	6.84
Total options outstanding as at December 31	2,764,334	7.15	963,665	8.07	780,332	6.91

Total of exercisable options as at December 31*	1,020,000	7.89	106,000	12.98	766,332	6.89
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\* The weighted average of the remaining contractual life of options outstanding as at December 31, 2018 is 1.1 years.

2016	2017	2018
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Fair value of share options and assumptions:

	NIS		
Fair value at grant date	6.3	-	-

Fair value assumptions:

	NIS		
Share price at grant date	27.75	-	-

	NIS		
Exercise price	29.97	-	-

Expected volatility (weighted average)	42.8 %	-	-
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	2.3		
Option life (expected weighted average life)	years	-	-

Risk free interest rate	0.4 %	-	-
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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments

## Credit risk

## Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	December 31, 2017 NIS millions	December 31, 2018 NIS millions
Trade receivables including long-term amounts	1,692	1,522
Loans and other receivables including long-term amounts	146	138
Investment in debt securities	325	362
Cash and cash equivalents in banks	527	1,202
Derivative financial instrument	3	6
	2,693	3,230

The maximum exposure to credit risk of financial assets at the reporting date by type of counterparty is:

	December 31, 2017 NIS millions	December 31, 2018 NIS millions
Receivables from subscribers	1,511	1,318
Receivables from distributors and other operators	158	160
Investment in government of Israel debt securities	90	80
Investment in institutional debt securities	235	282
Cash and cash equivalents in banks	527	1,202
Other	172	188
	2,693	3,230

## Impairment losses

The aging of financial assets at the reporting date was as follows:

	Gross 2017 NIS millions	Impairment NIS millions	Gross 2018 NIS millions	Impairment NIS millions
Not past due	2,580	12	3,138	28

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Past due less than one year	143	53	126	35
Past due more than one year	157	122	162	133
	2,880	187	3,426	196

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

	2017	2018
	NIS	NIS
	millions	millions
Balance at January 1	185	187
Effect of initial application of IFRS 9	-	12
Balance as at January 1	185	199
Impairment loss recognized	(44 )	(40 )
Doubtful debt expenses	46	37
Balance at December 31	187	196

The allowance accounts in respect of trade receivables is used to record impairment losses unless the Group is satisfied that no recovery of the amount owing is possible. At that point, the amount considered irrecoverable is written off against the trade receivable directly.

## Liquidity risk

The following are the maturities of contractual financial liabilities and other non-contractual liabilities, including estimated interest payments and excluding the impact of netting agreements:

December 31, 2018	Carrying Contractual						More than
	amount	Cash flows	1 <sup>st</sup> year	2 <sup>nd</sup> year	3 <sup>rd</sup> year	4-5 years	5 years
	NIS millions						
Debentures*	(3,466)	(4,008 )	(610 )	(506)	(466)	(988 )	(1,438)
Long-term loans from financial institutions	(462 )	(503 )	(147 )	(141)	(135)	(80 )	-
Trade and other payables	(815 )	(815 )	(815 )	-	-	-	-
Forward exchange contracts on CPI	(1 )	(1 )	(1 )	-	-	-	-
Other long-term liabilities	(13 )	(13 )	(13 )	-	-	-	-
	(4,757)	(5,340 )	(1,586)	(647)	(601)	(1,068)	(1,438)

\* Including accrued interest on debentures.

December 31, 2017	Carrying Contractual						More than
	amount	Cash flows	1 <sup>st</sup> year	2 <sup>nd</sup> year	3 <sup>rd</sup> year	4-5 years	5 years
	NIS millions						
Debentures*	(2,954)	(3,435 )	(658 )	(577)	(473)	(739 )	(988 )

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Long-term loans from financial institutions	(540 )	(605 )	(102 )	(147)	(141)	(215 )	-
Trade and other payables	(784 )	(784 )	(784 )	-	-	-	-
Forward exchange contracts on foreign currencies	(1 )	(1 )	(1 )	-	-	-	-
Forward exchange contracts on CPI	(17 )	(17 )	(17 )	-	-	-	-
Other long-term liabilities	(12 )	(12 )	-	(12 )	-	-	-
	(4,308)	(4,854 )	(1,562)	(736)	(614)	(954 )	(988 )

\* Including accrued interest on debentures.

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Currency risk and CPI

The Group's exposure to foreign currency risk and CPI is as follows:

	December 31, 2017			December 31, 2018		
	In or linked to foreign currency (mainly USD) to CPI NIS millions			In or linked to foreign currency (mainly USD) to CPI NIS millions		
Current assets						
Cash and cash equivalents	29	-	498	13	-	1,189
Current investments, including derivatives	13	135	181	20	171	177
Trade receivables	61	-	1,219	56	-	1,096
Other receivables	-	-	8	-	1	1
Non- current assets						
Long-term receivables	-	54	495	-	57	449
Current liabilities						
Current maturities of debentures and of loans from financial institutions	-	(322 )	(297 )	-	(328 )	(292 )
Trade payables and accrued expenses	(115)	-	(537 )	(182)	-	(514 )
Other current liabilities, including derivatives	(1 )	(42 )	(161 )	-	(20 )	(164 )
Non- current liabilities						
Long-term loans from financial institutions	-	-	(462 )	-	-	(334 )
Debentures	-	(1,288)	(1,071 )	-	(998 )	(1,914 )
Other non-current liabilities	(1 )	-	(11 )	(12 )	-	-
	(14 )	(1,463)	(138 )	(105)	(1,117)	(306 )

The Group's exposure to linkage and foreign currency risk in respect of derivatives is as follows:

	December 31, 2018		Notional Fair Value value NIS millions	
	Currency/ linkage receivable	Currency/ linkage payable		
Instruments not used for hedging				
Forward exchange contracts on foreign currencies	USD	NIS	203	4
Forward exchange contracts on CPI	CPI	NIS	400	(1 )

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Foreign currency put options	NIS	USD	(147)	-
Embedded derivative in lease contracts	USD	NIS	15	1

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Currency risk and CPI (cont'd)

	December 31, 2017 Currency/ linkage receivable	Currency/ linkage payable	Notional Value NIS millions	Fair value
Instruments not used for hedging				
Forward exchange contracts on foreign currencies	USD	NIS	105	(1 )
Forward exchange contracts on CPI	CPI	NIS	500	(17 )
Foreign currency put options	NIS	USD	(105)	1
Embedded derivative in lease contracts	USD	NIS	16	2

## Sensitivity analysis

A change of the CPI as at December 31, 2018 and 2017 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2017.

	Change	Equity NIS millions	Net income NIS millions
December 31, 2018			
Increase in the CPI of 2.0 %	(11 )	(11 )	
Increase in the CPI of 1.0 %	(6 )	(6 )	
Decrease in the CPI of (1.0 )%	2	2	
Decrease in the CPI of (2.0 )%	1	1	
December 31, 2017			
Increase in the CPI of 2.0 %	(9 )	(9 )	
Increase in the CPI of 1.0 %	(2 )	(2 )	
Decrease in the CPI of (1.0 )%	-	-	
Decrease in the CPI of (2.0 )%	-	-	

Sensitivity of change in foreign exchange rate is immaterial as at December 31, 2018 and 2017.

## Interest rate risk

## Profile

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments, not including derivatives, was:

	Carrying amount	
	2017	2018
	NIS	NIS
	millions	millions
Fixed rate instruments		
Financial assets	679	355
Financial liabilities	(3,440)	(3,865 )
	(2,761)	(3,510 )
Variable rate instruments		
Financial assets	221	1,179

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Fair value sensitivity analysis for fixed rate instruments

A change of interest rates at the end of the reporting period would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	Equity				Profit or loss			
	1.0% increase	1.0% decrease	0.5% increase	0.5% decrease	1.0% increase	1.0% decrease	0.5% increase	0.5% decrease
	NIS millions				NIS millions			
December 31, 2018								
Fair value sensitivity (net)	(10)	10	(5 )	5	(10)	10	(5 )	5
	Equity				Profit or loss			
	1.0% increase	1.0% decrease	0.5% increase	0.5% decrease	1.0% increase	1.0% decrease	0.5% increase	0.5% decrease
	NIS millions				NIS millions			
December 31, 2017								
Fair value sensitivity (net)	(9)	9	(5 )	5	(9)	9	(5 )	5

## Cash flow sensitivity analysis for variable rate instruments

A change of 1% in interest rates at the end of the reporting period would have increased (decreased) equity and profit or loss by immaterial amounts.

## Fair Value

## (1) Financial instruments measured at fair value for disclosure purposes only

The book value of certain financial assets and liabilities, including cash and cash equivalents, trade and other receivables, current investments, including derivatives, trade and other payables, including derivatives and other long-term liabilities, are equal or approximate to their fair value.

The fair values of the remaining financial liabilities and their book values as presented in the consolidated statements of financial position are as follows:

	December 31, 2017		December 31, 2018	
	Book value	Fair value	Book value	Fair value
	NIS millions		NIS millions	
Debentures including current maturities and accrued interest	(2,954)	(3,288)*	(3,466)	(3,585)*
Long-term loans from financial institutions including current maturities and accrued interest	(540 )	(574 )	(462 )	(479 )

\* The fair value as of December 31, 2018 includes principal and interest in a total sum of approximately NIS 373 million, paid in January 2019, after the end of the reporting period. The fair value as of December 31, 2017 includes principal and interest in a total sum of approximately NIS 418 million, paid in January 2018.

The fair value of marketable debentures is determined by reference to the quoted closing asking price at the reporting date (level 1), with the addition of principal and interest amounts, which were paid during the following month after the end of the reporting period.

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## (2) Fair value hierarchy of financial instruments measured at fair value

The table below analysis financial instruments carried at fair value, by valuation method, to the different levels.

	December 31, 2018			
	Level			
	1	Level 2	Level 3	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Financial assets at fair value through profit or loss				
Current investments in debt securities and shares	398	-	-	398
Derivatives	-	6	-	6
Total assets	398	6	-	404
Financial liabilities at fair value through profit or loss				
Derivatives	-	(1 )	-	(1 )
Total liabilities	-	(1 )	-	(1 )

There have been no transfers during the year between Levels 1 and 2.

	December 31, 2017			
	Level			
	1	Level 2	Level 3	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Financial assets at fair value through profit or loss				
Current investments in debt securities and shares	361	-	-	361
Derivatives	-	3	-	3
Total assets	361	3	-	364
Financial liabilities at fair value through profit or loss				
Derivatives	-	(18 )	-	(18 )
Total liabilities	-	(18 )	-	(18 )

## (3) Details regarding fair value measurement at Level 2

Financial instrument	Valuation method for determining fair value
Forward contracts	Fair value measured on the basis of discounting the difference between the forward price in the contract and the current forward price for the residual period until redemption using market interest rates appropriate for similar instruments, including the adjustment required for the parties' credit risks.
	Fair value is measured based on the Black-Scholes formula.

Foreign  
currency  
options

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## (4) Offset of financial assets and financial liabilities

The following table sets out the carrying amounts of recognized financial instruments that were offset in the consolidated statements of financial position:

	December 31, 2018		Gross amounts of financial assets (liabilities) recognized and offset in the consolidated statements of financial position		Net amounts of financial assets (liabilities) presented in the consolidated statements of financial position	
	Note	Gross amounts of recognized financial assets (liabilities) NIS millions		Gross amounts of recognized financial assets (liabilities) NIS millions		
Financial assets						
Trade receivables	9	160	(125 )		35	
Financial liabilities						
Trade payables and accrued expenses	13	(144 )	125		(19 )	
December 31, 2017						
	December 31, 2017		Gross amounts of financial assets (liabilities) recognized and offset in the consolidated statements of financial position		Net amounts of financial assets (liabilities) presented in the consolidated statements of financial position	
	Note	Gross amounts of recognized financial assets (liabilities) NIS millions		Gross amounts of recognized financial assets (liabilities) NIS millions		
Financial assets						
Trade receivables	9	170	(123 )		47	

Financial liabilities

Trade payables and accrued expenses	13	(149	)	123	(26	)
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Share price risk - sensitivity analysis

The Group's investments in securities include investments in equity instruments. The sensitivity analysis below presents the effect of a change in share prices on the fair value of securities held by the Group, assuming that all other variables remain constant.

A change in share prices would have increased (decreased) profit or loss and equity by the amounts shown below (after tax):

	December 31, 2018 NIS millions	
	Profit or loss	Equity
Increase of 5%	1	1
Increase of 10%	3	3
Decrease of 5%	(1 )	(1 )
Decrease of 10%	(3 )	(3 )

## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 22 - Revenues

## By type of revenue:

	Year ended December 31,		
	2016	2017	2018
	NIS	NIS	NIS
	millions	millions	millions
Revenues from equipment	994	952	904
Revenues from services:			
Cellular services	2,025	1,777	1,581
Land-line communications services	871	1,004	1,068
Other services	137	138	135
Total revenues from services	3,033	2,919	2,784
Total revenues	4,027	3,871	3,688

## Note 23 - Cost of Revenues

## Composition

	Year ended December 31,		
	2016	2017	2018
	NIS	NIS	NIS
	millions	millions	millions
According to source of income:			
Cost of revenues from equipment	674	645	642
Cost of revenues from services	2,028	2,035	2,019
	2,702	2,680	2,661
According to its components:			
Cost of revenues from equipment	674	645	642
Rent and related expenses	321	281	271
Salaries and related expenses	241	224	217
Fees to communications operators	732	767	783
Cost of content and value added services	168	212	223
Depreciation and amortization	396	412	390
Royalties and fees	93	86	84
Other	77	53	51
Total cost of revenues from services	2,028	2,035	2,019
	2,702	2,680	2,661

## Note 24 - Selling and Marketing Expenses

## Composition

	Year ended December 31,		
	2016	2017	2018
	NIS	NIS	NIS
	millions	millions	millions
Salaries and related expenses	257	241	277
Commissions	179	88	85
Advertising and public relations	44	36	38
Depreciation and amortization	20	33	86
Other	74	81	81
	574	479	567

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 25 - General and Administrative Expenses

## Composition

	Year ended December 31,		
	2016	2017	2018
	NIS	NIS	NIS
	millions	millions	millions
Salaries and related expenses	123	124	81
Depreciation and amortization	118	110	108
Rent and maintenance	55	51	46
Data processing and professional services	39	36	34
Allowance for doubtful accounts	33	46	37
Other	52	59	54
	420	426	360

## Note 26 - Other Income (Expenses), net

## Composition

	Year ended December 31,		
	2016	2017	2018
	NIS	NIS	NIS
	millions	millions	millions
Other Income (Expenses), net	(21)	11	(26)

In May 2018, the Group, in collaboration with the employees' representatives, launched a new voluntary retirement plan for employees, following which, the Company recorded an expense in an amount of approximately NIS 26 million in the second quarter of 2018 with respect to employees who joined this plan. (in 2016 the Group has recorded an expense from voluntary retirement plans for employees in an amount of approximately NIS 13 million).

Other Income, net, for 2017 mainly includes a NIS 10 million capital gain from the sale of an indirect subsidiary of the Company. (The total consideration of the sale is approximately NIS 25 million)

## Note 27 - Financing Income and Expenses

## Composition

	Year ended December 31,		
	2016	2017	2018
	NIS	NIS	NIS
	millions	millions	millions
Interest income from installment sale transactions	38	31	27
Net change in fair value of financial assets measured at fair value through profit or loss	6	14	12
Other	2	7	7
Financing income	46	52	46

Linkage expenses to CPI and interest expenses on long-term liabilities	(157)	(147 )	(138 )
Net change in fair value of derivatives	-	(8 )	(7 )
Discount amortization	(26 )	(32 )	(26 )
Other	(13 )	(9 )	(19 )
Financing expenses	(196)	(196 )	(190 )
Net financing expenses recognized in profit or loss	(150)	(144 )	(144 )

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 28 - Income Tax

## A.Details regarding the tax environment of the Group

## Corporate tax rate

Presented hereunder are the tax rates relevant to the Group in the years 2016-2018:

2016 - 25%

2017 - 24%

2018 - 23%

On January 4, 2016 the Israeli Parliament passed the Law for the Amendment of the Income Tax Ordinance (Amendment 216) - 2016, by which, inter alia, the corporate tax rate was reduced by 1.5% to a rate of 25% as from January 1, 2016.

Furthermore, on December 22, 2016 the Israeli Parliament passed the Economic Efficiency Law (Legislative Amendments for Achieving Budget Objectives in the Years 2017 and 2018) - 2016, by which, inter alia, the corporate tax rate was reduced from 25% to 23% in two steps. The first step to a rate of 24% as from January 2017 and the second step to a rate of 23% as from January 2018.

As a result of the aforesaid, the deferred tax balances as at December 31, 2017 and at December 31, 2018 were calculated according to the new tax rate of 23% - the tax rate expected to apply on the date of reversal.

Current taxes for the reported periods are calculated according to the tax rates presented above.

## B.Composition of income tax expense (income)

	Year ended December 31,		
	2016	2017	2018
	NIS	NIS	NIS
	millions	millions	millions
Current tax expense (income)			
Current year	35	27	14
Adjustments for prior years, net	(27)	(1 )	1
	8	26	15
Deferred tax expense (income)			
Creation and reversal of temporary differences	21	14	(21 )
Change in tax rate	(19)	-	-
	2	14	(21 )
Income tax expense (income)	10	40	(6 )





## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 28 - Income Tax (cont'd)

## C. Income tax in respect of other comprehensive income (loss)

	Year ended December 31,			
	2016	2017	2018	
	NIS	NIS	NIS	
	millions	millions	millions	
Before tax	1	1	(2)	)
Tax (benefit) expenses	(1)	-	1	
Net of tax	-	1	(1)	)

## D. Reconciliation between the theoretical tax on the pre-tax profit (loss) and the tax expense (income)

	Year ended December 31,			
	2016	2017	2018	
	NIS	NIS	NIS	
	millions	millions	millions	
Profit (loss) before taxes on income	160	153	(70)	)
Primary tax rate of the Group	25.0 %	24.0 %	23.0 %	
Tax calculated according to the Group's primary tax rate	40	37	(16)	)
Additional tax (tax saving) in respect of:				
Non-deductible expenses	4	5	6	
Taxes in respect of previous years	(27)	(1)	1	)
Effect of change in tax rate	(19)	-	-	
Other differences	12	(1)	3	)
Income tax expenses (tax income)	10	40	(6)	)

## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 28 - Income Tax (cont'd)

## E. Deferred tax assets and liabilities

## (1) Recognized deferred tax assets and liabilities

Deferred taxes are calculated according to the tax rate anticipated to be in effect on the date of reversal as stated above.

The movement in deferred tax assets and liabilities is attributable to the following items:

	Allowance for doubtful debts NIS millions	Property, plant and equipment and intangible assets NIS millions	Carry forward tax deductions and losses NIS millions	Other NIS millions	Total NIS millions
Balance of deferred tax asset (liability) as at January 1, 2018	43	(197 )	-	23	(131 )
Changes recognized in profit or loss	(1 )	1	17	4	21
Changes recognized in equity	3	-	-	7	10
Changes recognized in other comprehensive income	-	-	-	1	1
Balance of deferred tax asset (liability) as at December 31, 2018	45	(196 )	17	35	(99 )
Deferred tax asset	45	5	17	37	104
Offset of balances					(104 )
Deferred tax asset in the consolidated statements of financial position as at December 31, 2018					-
Deferred tax liability	-	(201 )	-	(2 )	(203 )
Offset of balances					104
Deferred tax liability in the consolidated statements of financial position as at December 31, 2018					(99 )

## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 28 - Income Tax (cont'd)

## E. Deferred tax assets and liabilities (cont'd)

## (1) Recognized deferred tax assets and liabilities (cont'd)

	Allowance for doubtful debts NIS millions	Property, plant and equipment and intangible assets NIS millions	Other NIS millions	Total NIS millions
Balance of deferred tax asset (liability) as at January 1, 2017	43	(184 )	24	(117 )
Changes recognized in profit or loss	-	(13 )	(1 )	(14 )
Balance of deferred tax asset (liability) as at December 31, 2017	43	(197 )	23	(131 )
Deferred tax asset	43	5	26	74
Offset of balances				(74 )
Deferred tax asset in the consolidated statements of financial position as at December 31, 2017				-
Deferred tax liability	-	(202 )	(3 )	(205 )
Offset of balances				74
Deferred tax liability in the consolidated statements of financial position as at December 31, 2017				(131 )

## (2) Unrecognized deferred tax liability

As at December 31, 2018 and 2017, a deferred tax liability for temporary differences related to an investment in a subsidiary was not recognized as the decision whether to sell the investment is within the Group and it is satisfied that it will not be sold in the foreseeable future.

## F. Tax assessments

The Company has received final tax assessments up to and including the year ended December 31, 2013 (2013 fiscal year).

013 Netvision Ltd has received final tax assessments up to and including the year ended December 31, 2015 (2015 fiscal year).



## Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 28 - Income Tax (cont'd)

## F. Tax assessments (cont'd)

In January 2019, after the end of the reporting period, the Israeli Tax Authority issued a best judgment assessment for 2014 to the Company, generally due to timing differences. According to the assessment, if the Company's claims are rejected, the Company will be required to pay additional income tax in relation to the year 2014, in an amount of approximately NIS 56 million (including interest and Israeli CPI differences). The Company filed an objection to the tax assessment.

The Company filed an objection to the tax assessment. The Company estimates that such assessment shall not have a material effect on the Company's financial statements.

## Note 29 - Operating Leases

Non-cancelable operating lease rentals are payable as follows:

	December 31, 2017 NIS millions	December 31, 2018 NIS millions
Less than one year	275	283
Between one and five years	573	435
More than five years	70	23
	918	741

During the year ended December 31, 2018, NIS 284 million was recognized as expenses in respect of operating leases in the consolidated statements of income (2017 and 2016, NIS 280 million and NIS 286 million, respectively).

Major operating lease and service agreements:

- a. Office buildings and warehouses - there are lease agreements for periods of up to 14 years.
- b. Switching stations- there are lease agreements for switching station locations for periods of up to 18 years.
- c. Cell sites- there are lease agreements for cell sites for periods of up to 21 years.
- d. Service centers, retail stores and stands - there are lease agreements for service and installation centers and stands for periods of up to 13 years.
- e. Motor vehicles - lease for a period of 3 years.

## Note 30 - Commitments

A. The Group has commitments regarding the license it was granted in 1994, including:

1. Not to pledge any of the assets used to execute the license without the advance consent of the Ministry of Communications.
- 2.

The Company's shareholders' joint equity, combined with the Company's equity, shall not amount to less than US\$ 200 million. Regarding this stipulation, a shareholder holding less than 10% of the rights to the Company's equity is not taken into account.

The Group is in compliance with the above conditions.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 30 - Commitments (cont'd)

As at December 31, 2018, the Group has commitments to purchase equipment for the communications networks, B.end user equipment, systems and software maintenance, and content and related services, in a total amount of approximately NIS 452 million.

Between 2003 and 2019, the Group entered into a number of agreements with TI Sparkle Ireland Telecommunications Ltd. (formerly Mediterranean Nautilus Ltd.) and TI Sparkle (Israel) Ltd. (formerly Mediterranean Nautilus (Israel) Ltd.), (or collectively TI Sparkle), for the purchase of rights of use of certain telecommunications capacities on TI Sparkle's communications cables, as well as maintenance and operation C.services relating to these cables. Over the last few years the Group has increased the capacity purchased for significantly lower prices, as well as reduced maintenance costs. The term of the agreement with respect to capacity purchased from TI Sparkle is in effect until May 2032. The Group has the option to terminate agreements with respect to parts of the capacity in 2022 and 2027. The remainder of the obligation under all existing agreements as of December 31, 2018 is NIS 92 million.

In March and April 2017 the Sharing Agreements came into effect – (1) the 4G network sharing and 2G and 3G hosting services agreement with Xfone (which commenced operating in the cellular market in April 2018), (2) the D.3G and 4G network sharing and 2G hosting services agreement with Golan (originally entered into with Electra and adopted by Golan, after being acquired by Electra) and (3) an agreement combining the 4G network sharing arrangements of the Xfone agreement and the Golan agreement into one three-way agreement.

The Sharing Agreements set the terms under which the sharing networks operate, including:

usage of the parties' relevant frequencies, management and operation by separate entities, or the Joint Corporations, possession of equal parts of the shared network active elements, investment in equal parts in future active elements and IRU of each sharing party to the other sharing parties and IRU by us to the other sharing parties and the Joint Corporations to our passive elements of the shared networks, services provided by us to the Joint Corporations, as a subcontractor and certain arrangements for separation of the parities and adding another sharing party.

The agreements are for a term of ten years, and will be extended for additional periods, unless either party notifies otherwise. The termination of the Golan Agreement prior to the lapse of the first 10 years due to a breach by Golan will entitle us to liquidated damages of NIS 600 million plus VAT. In addition to standard termination causes, Xfone may terminate its agreement by prior written notice if it decides to cease operating in the cellular market in Israel.

The average annual consideration to be received by us under the Golan agreement (starting with lower annual payments and increasing over the term) is expected to be in a range of approximately NIS 210-220 million plus VAT, depending on Golan's number of subscribers and their usage of the shared network and our 2G network.

The consideration for us under the Xfone agreement includes substantially similar arrangements (mutatis mutandis to its sharing and hosting agreement), but during a period of up to five years beginning April 2018, Xfone will be entitled to replace its payments for IRU to the passive network and operating costs with a monthly payment per subscriber, but in any case not less than certain minimum annual amounts (ranging between approximately NIS 20 million in the first year and approximately NIS 110 million in the fifth year).

Under the Golan Agreement (which replaces the former national roaming services agreement) in April 2017, we provided a loan to Golan in the sum of NIS 130 million for a period of 10 years to be repaid in 6 semi-annual equal installments beginning the 8th year of the Term (interest and CPI differentials to be accrued, will be paid as of the 6th year). The loan is guaranteed by a second degree floating charge on Golan's assets and rights (excluding certain exceptions) or an equivalent guaranty.

According to the terms of the Golan agreement, part of the consideration is recognized as revenues and part is recognized as a reduction of operation costs.

The agreement includes a number of performance obligations for revenue recognition purposes: (1) IRU of passive elements; (2) IRU in its part of the existing active elements of the shared 3G and 4G network and 2G hosting services; (3) Transmission services. In addition, Golan shall pay the Company for participation in the operating costs of the 3G and 4G shared network and 2G network and future ongoing investments in the shared networks, according to a mechanism set in the agreement.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 30 - Commitments (cont'd)

E. In October 2016, the Company entered into an agreement with Apple Sales International for the purchase and distribution of iPhone handsets in Israel. Under the terms of the agreement, the Company has committed to purchase a minimum quantity of iPhone products over a period of three years, which are expected to represent a significant portion of the Company total cellular handsets purchase amounts, over that period.

F. In May 2016, the Company entered into several agreements aiming to provide the Company with a comprehensive CRM SAAS solution, on a cloud 'software as a service', or SAAS, basis, which, when completed, will gradually replace all the Company current CRM systems with one CRM solution that will serve both the Company cellular and fixed-line segments. These agreements include the following main agreements:

An agreement with salesforce.com EMEA Limited, or Salesforce, for the provision of Salesforce's CRM SAAS platform, including various products and services and support for the agreement term. The agreement is valid until August 2019 and may be terminated by the Company subject to prior written notice.

The Company also has an option to renew the agreement for two additional periods of 5 years each under certain terms.

Two agreements with Vlocity UK Ltd., or Vlocity, as follows: (i) an agreement for the provision of Vlocity's telecom-CRM SAAS solution, based on Salesforce platform, including support for such services for the agreement term. This agreement is valid until November 2019. and (ii) an agreement for the development and customization for Salesforce's and Vlocity's CRM solution. This agreement will be valid until the project is completed, and may be terminated by the Company subject to prior written notice.

G. In July 2018, the Company entered a new collective employment agreement with its employees' representatives and the Histadrut (an Israeli union labor) for a three year period until the end of 2020, which is similar to the Company's previous collective employment agreement (which expired at the end of 2017) and includes certain nonmaterial additions.

In January 2019, after the end of the reporting period, the Histadrut, the union representing the Company's employees, announced of a labor dispute.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 30 - Commitments (cont'd)

H. In March 2019, after the end of the reporting period, the Company entered into the following definitive agreements, or the Transaction, which in addition to standard and customary conditions, include the following:

**Purchaser Agreements** - The Company and the Israel Infrastructure Fund, or IIF, entered into partnership agreements for the purchase of 70% of IBC's share capital by a jointly and equally owned limited partnership (to be formed), or the Purchaser. The Purchaser Agreements contain an undertaking for an additional investment of up to NIS 200 million by both the Company and IIF, pro rata to their holdings in the Purchaser, over a period of 3 years and certain arrangements regarding a party's failure to make its share of the committed investment and regarding dead lock situations.

**Share Purchase Agreement, or SPA** - The Purchaser, IBC, the Israeli Electric Company, or IEC and the other shareholders and main creditors of IBC entered an agreement for the purchase of 70% of IBC's share capital, through investment of the Purchaser in IBC, for a total amount of NIS 103.5 million (subject to certain consideration adjustment mechanism, with respect to IBC's net working capital at closing), or the "Consideration, to be provided partly as investment and partly as shareholders' loan. The other 30% of IBC's issued and outstanding share capital will be owned by IEC. The Consideration shall be used to settle generally all of IBC's debts (other than a certain amount to IEC). The SPA contains certain precedent conditions to the closing of the transaction, including regulatory approvals, the receipt of updated licenses with reduced deployment obligations, as well as the effectiveness of the other agreements.

**Shareholders Agreement** - The Purchaser and IEC (holding 70% and 30% of IBC's share capital, respectively) entered into a shareholders agreement. The agreement regulates the management of IBC, including certain arrangements regarding funding of IBC and dilution (and anti-dilution in certain circumstances) of non-participating shareholders.

**IRU Agreement** - The Company and IBC entered into an agreement granting to the company an indefeasible right of Use, or IRU to a 10-15% percentage of IBC's fiber optics 'home pass' (i.e. fiber-optic actually reaching / connected to the building), as shall be deployed by IBC in the next 15 years (and may be extended to additional periods with no additional consideration other than annual maintenance payments). The undertaking is subject to certain conditions which should be satisfied at the closing of the SPA and certain amount is available immediately. The IRU consideration is subject to actual IBC's 'home pass' deployment, and is expected to increase each quarter based on the actual addition of 'home passes' deployed during such quarter and shall be paid in 40 quarterly installations (10 years), in addition to annual maintenance payments.

**IEC Services Agreement** - IBC and IEC entered into an agreement updating IBC's existing right of use and services agreement for IBC's fiber-optic network when deployed over IEC's infrastructure. The IEC Services Agreement includes improved pricing and arrangements for IBC's exclusive right to deploy its fiber-optics over the IEC's electricity network and other services provided by IEC to IBC in relation thereof.

The Shareholders Agreement and the IEC Services Agreement shall become effective at, and are subject to, the completion of the SPA. The Purchaser Agreements and the IRU Agreement became effective upon signing.

The execution of the Transaction will be subject to the said conditions precedent, including regulatory approvals. IBC has already filed a request with the Ministry of Communications for an updated license with reduced deployment

obligations. There is no assurance that the Transaction will be approved and executed, nor as to its timing and terms.

In addition, the Company and IIF entered a term sheet for the sale of the company's independent fiber-optic infrastructure in residential areas as shall be at the end of 2019, to IBC, for the sum of NIS180-200 million (subject to the rate of the fiber-optic deployment and the number of actual 'home pass' connected at the end of 2019 and certain adjustments). The consideration for the sale is expected to be partly financed by IBC's shareholders' loans, including by the company. The Fiber-optic sale TS is not part of the Transaction. Once the sale is completed, the IRU Agreement, including the company's obligation to purchase percentage of IBC's fiber optics 'home pass' (as detailed above), shall apply to the infrastructure purchased from the company. The transaction is conditioned on the parties entering a definitive agreement, further agreement with the IEC, closing of the SPA and regulatory approvals. There is no assurance that the parties will reach a definitive agreement, that the sale will be approved and executed, nor as to its timing and terms.

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## Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 31 - Contingent Liabilities

In the ordinary course of business, the Group is involved in various lawsuits against it. The costs that may result from these lawsuits are only accrued for 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, while events that occur in the course of the litigation may require a reassessment of this risk.

The Group's assessment of risk is based both on the advice of its legal counsels and on the Group's estimate of the probable settlements amounts that are expected to be incurred, if such settlements will be agreed by both parties. The provision recorded in the consolidated financial statements in respect of all lawsuits against the Group amounted to NIS 63 million (see also Note 14, regarding Provisions).

Described hereunder are the outstanding lawsuits against the Group, classified into groups with similar characteristics. The amounts presented below are calculated based on the claims amounts as of the date of their submission to the Group.

## A. Consumer claims

In the ordinary course of business, lawsuits have been filed against the Group by its customers. These are mostly purported class actions, particularly concerning allegations of illegal collection of funds, unlawful conduct or breach of license, or a breach of agreements with customers, causing monetary and non-monetary damage to them. As of December 31, 2018, the amounts claimed from the Group by its customers sum up to NIS 16.238 billion (including approved class actions as detailed below). In addition, there are other purported class actions against the Group, in which the amount claimed has not been quantified if the lawsuits are certified as class actions, and in respect of which the Group has exposure in addition to the above mentioned. In addition, there are other purported class action for approximately NIS 453 million, that has been filed against the Group and other defendants together without specifying the amount claimed from the Group, another purported class action against the Group and other defendants together, in which the amount claimed from the Group was estimated by the plaintiffs to be approximately NIS 3 million, and other purported class actions, that have been filed against the Group and other defendants together in which the amount claimed has not been quantified if the lawsuits are certified as class actions and in respect of which the Group has exposure in addition to the above mentioned.

In December 2017, the District Court approved a lawsuit filed against the Company in May 2015, relating to an allegation that the Company unlawfully charged some of its subscribers for call details reports as a class action. In January 2019, after the end of the reporting period, the Supreme Court expanded the approval relating to an allegation for unlawfully charging additional subscribers for call detail report. The total amount claimed was not quantified by the plaintiffs.

In April 2018, a request to certify a lawsuit filed against the Company in December 2014 was approved as class action, relating to an allegation that the Company unlawfully charged subscribers who disconnected from the Company's services during a certain billing month for the full month. The total amount claimed was not quantified by the plaintiff.

In July 2018, a request to certify a lawsuit filed against the Company in June 2015 was approved as a class action, relating to an allegation that the Company unlawfully charged subscribers for collection expenses due to lack of

payment or late payment relating to part of the lawsuit causes of action. The total amount claimed relating to the original lawsuit was estimated by the plaintiffs to be millions of NIS.

Of all the consumer purported class actions, in three purported class actions with aggregate amounts claimed estimated by the plaintiffs of approximately NIS 15.034 billion, and in three purported class actions that has been filed against the Group without specifying the amount claimed from the Group, settlement agreements were filed with the court and the proceedings are still pending.

Of all the consumer purported class actions, there is a purported class action for approximately NIS 15 million, of which at this early stage it is not possible to assess the chances of success.

After the end of the reporting period, three purported class actions against the Group, with aggregate amounts claimed estimated by the plaintiffs of approximately NIS 186 million were concluded.

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 31 - Contingent Liabilities (cont'd)

Described hereunder are the outstanding consumer class actions and purported class actions against the Group broken down by amount claimed if the lawsuit is certified as a class action, as of December 31, 2018:

Claim amount	Number of claims	Total claims amount (NIS millions)
Up to NIS 100 million	15	515
NIS 100-500 million	3	723
Above NIS 1 billion	1	15,000
Unquantified claims	16	-
Against the Group and other defendants together without specifying the amount claimed from the Group	5	453
Against the Group and other defendants together, in which the amount claimed from the Group has been quantified	1	3
Unquantified claims against the Group and other defendants	6	-

Described hereunder are purported class actions against the Group, in which the amount claimed was NIS 1 billion or more:

In March 2015, a purported class action in a total amount estimated by the plaintiffs to be approximately NIS 15 billion, if the lawsuit is certified as a class action, was filed against the Company, by plaintiffs alleging to be 1. subscribers of the Company, in connection with allegations that the Company unlawfully violated the privacy of its subscribers. In February 2017, a settlement agreement was filed with the court and in February 2019, after the end of the reporting period, an updated settlement agreement was filed with the court and proceedings are still pending.

#### B. Employees, subcontractors, suppliers, authorities and others claims

In the ordinary course of business, lawsuits have been filed against the Group by employees, subcontractors, suppliers, authorities and others which deal mostly with claims for breach of provisions of the law governing termination of employment and obligatory payments to employees, claims for breach of agreements, copyright and patent infringement and compulsory payments to authorities.

As of December 31, 2018, the amounts that are claimed from the Group under these claims total approximately NIS 78 million.

#### C. Liens and guarantees

As part of issuance of the Series F and H through L debentures and the loan agreements which the Company entered into, the Company committed not to create liens on its assets, subject to certain exceptions.

The Group has given bank guarantees as follows:

- a. To the Government of Israel (to guarantee performance of the Cellular License) - NIS 80 million.
- b. To the Government of Israel (to guarantee performance of the Licenses of the Group) - NIS 18 million.
- c. To suppliers, government institutions and others - NIS 157 million.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 32 - Regulation and Legislation

Under an interim order issued by the Supreme Court in September 2010, the Company's ability to rely on the exemption from obtaining a building permit for the construction of radio access devices under cellular networks, was reduced to replacing and relocating existing radio access devices in certain conditions. In October 2018, A. regulations setting procedures for the construction, changes and replacement of radio access devices exempt from building permits, were enacted. Although these regulations reflect previous judicial limitations placed upon the Company's ability to make changes and replace radio access devices, they also introduce a new licensing procedure that may further reduce the Company's ability to construct new radio access devices based on such exemption.

A policy document regarding landline wholesale services published by the Ministry of Communications in 2012 provided for the creation of an effective wholesale telecommunications access market in Israel and the gradual annulment of the structural separation in the Bezeq and Hot groups and its replacement with an accounting B. separation and change of the supervision on Bezeq retail tariffs to maximum tariffs rather than the current setting of fixed tariffs, generally depending on the development of a wholesale market and the state of competition in the market, and with relation to television services, if there is a reasonable possibility of providing a basic package of television services through the internet by providers without a national landline infrastructure.

In 2015, the wholesale landline market was formally launched in Israel in regards to internet infrastructure services and use of certain physical infrastructure by operators who do not own such infrastructure. Although the wholesale market was formally applicable to Hot's infrastructure as well, Hot's infrastructure has been effectively excluded from the wholesale market up until 2018, initially as the maximum tariffs for Hot's wholesale infrastructure service were not published by the MOC until June 2017 (and are higher than those set for Bezeq's service) and thereafter, due to disagreements with Hot as to the implementation of the service, which were resolved by the MOC. The Ministry of Communications resolved not to interfere with the tariffs Hot has set for its wholesale telephony service.

In June 2017, the Ministry of Communications published regulations setting Bezeq's resale telephony service to be provided by Bezeq as of July 2017, as a temporary 14 month alternative for wholesale landline telephony service and postponed Bezeq's obligation to offer wholesale telephony service until the lapse of said resale telephony service period. In June 2018, the Ministry of Communications resolved not to prolong said Bezeq's temporary alternative further and to obligate Bezeq to provide wholesale landline telephony services as of August 1, 2018.

Further, in January 2016, the Ministry of Communications announced its intention to annul Bezeq and Hot's structural separation as part of its plan to ensure massive investment in fiber optics infrastructure in Israel. In December 2016 the Ministry of Communications informed Bezeq that it intends to hold a public hearing regarding a possible annulment of the corporate separation and thereafter the structural separation in the Bezeq group. In February 2019, Bezeq filed a petition with the Supreme Court of Justice, against the MOC, requesting the immediate cancellation of the structural separation imposed on Bezeq.

An amendment to the Communications Law applies certain wholesale obligations on all landline operators, including the Company and requiring all landline operators to grant all other landline operators access to their passive infrastructure (except IBC's passive infrastructure), the terms of which (with the exclusion of Bezeq and Hot whose terms are set by the regulator) will be negotiated by the parties.





## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 32 - Regulation and Legislation (cont'd)

In 2017, following the Ministry of Communication's requirement to unify the unified licenses held by each communications group into one unified license, the Company completed a reorganization of its subsidiaries, including Netvision, following which all the Company's fixed-line operation under the unified license are unified under the Company's wholly owned subsidiary Cellcom Fixed Line Communications, Limited Partnership.

In May 2018, the Ministry of Communications amended the Company's licenses to regulate the manner of response of call centers, including measurable parameters for response times. The amendment shall come into force in March 2019 but is subject to further hearing process published in October 2018. In addition, in July 2019, an amendment to the Israeli Consumer Protection Law regulating the manner of response of call centers, will also come into effect. The amendment includes measurable parameters for response times, which are partly incompatible with the said amendment to the Company's licenses.

## Note 33 - Related Parties

## A. Balance sheet

	December 31, 2017 NIS millions	December 31, 2018 NIS millions
Current assets	2	3
Current liabilities	2	1
Long-term liability - debentures (including current maturity)*	-	-

\* Debentures balance held by related parties, which includes debentures held for the benefit of the public, through, among others, provident funds, mutual funds and pension funds, as of December 31, 2018 and 2017, is NIS 8 million par value linked to the CPI and NIS 19 million par value linked to the CPI, respectively.

B. Transactions with related and interested parties executed in the ordinary course of business at regular commercial terms:

	Year ended December 31, 2016 2017 2018 NIS NIS NIS millions millions millions		
Income:			
Revenues	17	13	12
Expenses:			
Cost of revenues and other	16	16	13

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## Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 33 - Related Parties (cont'd)

In the ordinary course of business, from time to time, the Group purchases, leases, sells and cooperates in the sale of goods and services or otherwise engages in transactions with entities that are members of the DIC/IDB group or other interested or related parties.

The Group has examined said transactions and believes them to be on commercial terms comparable to those that the Group could obtain from/ provide to unaffiliated parties.

## C. Key management personnel compensation

In addition to their salaries, the Group also provides non-cash benefits to executive officers (such as a car, medical insurance, etc.), and contributes to a post-employment defined benefit plan on their behalf.

The Group has undertaken to indemnify the Group's directors and officers, as well as certain other employees for certain events listed in the indemnifications letters given to them. The aggregate amount payable to all directors and officers and other employees who may have been or will be given such indemnification letters is limited to the amounts the Group receives from the Group's insurance policy plus 30% of the Group's shareholders' equity as of December 31, 2001 or NIS 486 million, adjusted for changes in the Israeli CPI.

Executive officers also participate in the Group's share option program (see Note 20, regarding Share-Based Payments).

Key management personnel compensation is comprised of:

	Year ended December 31,		
	2016	2017	2018
	NIS	NIS	NIS
	millions	millions	millions
Short-term employee benefits	4	6	4
Share-based payments	1	1	1
	5	7	5

## D. Agreements with DIC

In October 2006, the Company entered into an agreement with DIC pursuant to which DIC provides the Company with advisory services in the areas of management, finance, business and accountancy. In 2015, the agreement was amended so that the annual consideration for DIC management services would be equal to the director's fees (both the annual fee and the meeting attendance fee) paid to the Company's external and independent director (which is in the amount of NIS 134,180 per year and NIS 4,035 per meeting, adjusted for changes in the Israeli CPI for October 2015), for each director that DIC nominates or proposes to the Company's Board of Directors, but no more than five directors. This agreement was not renewed for an additional term after October 2018.

