Cellcom Israel Ltd.
Form 20-F
March 20, 2017

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

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

For the fiscal year ended December 31, 2016

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.

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

ISRAEL

(Jurisdiction of incorporation or organization)

I0 Hagavish Street, Netanya 4250708, Israel

(Address of principal executive offices)

Liat Menahemi Stadler, 972-52-9989595 (phone), 972-98607986 (fax), LIATME@cellcom.co.il, 10 Hagavish Street, Netanya 4250708, Israel

(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
Ordinary Shares, par value NIS 0.01 per share	New York Stock Exchange ("NYSE")

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

None

(Title of Class)

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

None

(Title of Class)

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, 2016, the Registrant had outstanding 100,604,578 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 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 has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the Registrant (1) has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

U.S. GAAP

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

Other

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

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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.

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 3.845 to $1.00, the representative rate of exchange as of December 31, 2016 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 and 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 negati 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 and the notes thereto included elsewhere in this annual report.

The selected data presented below under the captions “Income Statement Data” and “Balance Sheet Data” for, and as of the end of, each of the years in the five-year period ended December 31, 2016, are derived from the consolidated financial statements of Cellcom Israel Ltd. and subsidiaries,. The consolidated financial statements as of December 31, 2015 and 2016, and for each of the years in the three-year period ended December 31, 2016, and the report thereon, are included elsewhere in this annual report. The selected data should be read in conjunction with the consolidated financial statements, the related notes, and the joint independent registered public accounting firms' report and the convenience translation of the consolidated financial statements as of and for the year ended December 31, 2016 into U.S. dollars solely for the convenience of the reader.

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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, 2016, translated using the rate of NIS 3.845 to $1.00, the representative rate of exchange on December 31, 2016 as published by the Bank of Israel.

	Year Ended December 31,					
	2012	2013	2014	2015	2016	2016
	(In NIS millions, except where indicated otherwise)					(In US$ millions)
Income Statement Data:						
Revenues	5,938	4,927	4,570	4,180	4,027	1,047
Cost of revenues	3,463	2,990	2,727	2,763	2,702	703
Selling and marketing expenses	865	717	672	620	574	149
General and administrative expenses	629	570	463	465	420	109
Other (income) expenses, net	(4)	(1)	46	22	21	6
Operating income	985	651	662	310	310	80
Financing expense, net	259	246	198	177	150	39
Income tax	195	117	110	36	10	2
Net income	531	288	354	97	150	39
Basic earnings per share (in NIS)	5.34	2.89	3.51	0.95	1.47	0.38
Diluted earnings per share (in NIS)	5.33	2.86	3.48	0.95	1.47	0.38
Weighted average ordinary shares used in calculation of basic earnings per share (in shares)	99,481,487	99,495,525	99,924,306	100,589,458	100,604,578	100,604,578
Weighted average ordinary shares used in calculation of diluted earnings per share (in	99,609,722	100,319,724	100,706,282	100,589,530	100,698,306	100,698,306

shares)						
Balance Sheet Data:						
Cash	1,414	1,057	1,158	761	1,240	322
Working capital	1,232	1,082	837	625	1,074	279
Total assets	8,787	7,579	7,240	6,278	6,662	1,733
Total equity	500	710	1,092	1,185	1,340	349
Other Data:						
EBITDA(1)	1,753	1,335	1,282	872	858	224
Capital expenditures	537	384	487	396	382	99
Dividends declared per share	1.31	0.85	-	-	-	-
Net cash from operating activities	1,641	1,556	1,557	836	781	203
Net cash used in investing activities	(708)	(344)	(350)	(96)	(364)	(95)
Net cash from (used in) financing activities	(439)	(1,569)	(1,106)	(1,136)	62	16
Cellular Subscribers (in thousands)(2)	3,199	3,092	2,967	2,835	2,801	2,801
Churn rate of cellular subscribers(4)	31.5%	36.8%	44%	42%	42.4%	42.4%
Cellular ARPU (in NIS)(5)	88	78	72	65	63	17
Internet infrastructure - households (end of period) (in thousands)				95	163	163
TV - households (end of period) (in thousands)				63	111	111

(1) EBITDA is a non-IFRS measure and is defined as income before financing income (expenses), net; other income (expenses), net (excluding expense related to employee retirement plans); income tax; depreciation and amortization and share based payments. We present 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, fixed assets. 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. 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, 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.

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The following is a reconciliation of net income to EBITDA:

	Year Ended December 31,					
	2012	2013	2014	2015	2016	2016
	(In NIS millions)					(In US$ millions)
Net income	531	288	354	97	150	39
Financing expense, net	259	246	198	177	150	39
Other expenses (income),net (excluding expense related to employee retirement plans);	(4)	(1)	7	(3)	8	2
Taxes on income	195	117	110	36	10	2
Depreciation and amortization	765	676	610	562	534	139
Share based payments	7	9	3	3	6	2
EBITDA	1,753	1,335	1,282	872	858	223

(2) Cellular subscriber data refers to active subscribers. We use a six-month method of calculating our cellular subscriber base, which means that we deduct subscribers from our subscriber base after six months of no revenue generation and activity on our network by or in relation to the post-paid subscribers, no revenue generating calls or SMS for pre-paid subscribers 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. In the fourth quarter of 2012 we removed approximately 138,000 M2M subscribers from our subscriber base, following the addition of the above revenue generation criterion for M2M subscribers. This change had an immaterial effect on our ARPU for 2012. In the fourth quarter of 2013, we removed approximately 64,000 subscribers from our subscriber base, following a change to our prepaid subscribers counting mechanism. As a result of such change, we add a prepaid subscriber to our subscribers base only upon charging a prepaid card and remove them from our subscribers base after six months of no revenue generating calls or SMS. Following each of these changes, we have not restated prior subscriber data to conform with this change.

(3) Internet infrastructure subscribers and TV subscribers refer to active subscribers.

(4) 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.

(5) 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 services are included even though the number of cellular subscribers in the equation does not include the users of those roaming and hosting services. Inbound roaming services and hosting 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,					
	2012	2013	2014	2015	2016	2016
	(In NIS millions, except number of subscribers and months)					(In US$ millions)
Revenues	5,938	4,927	4,570	4,180	4,027	1,047
less revenues from equipment sales	1,356	942	1,005	1,048	994	258
less other revenues*	1,125	1,034	941	869	881	229
Revenues used in cellular ARPU calculation	3,457	2,951	2,624	2,263	2,152	559
Average number of cellular subscribers	3,291,843	3,135,857	3,034,946	2,898,987	2,832,407	2,832,407
Months during period	12	12	12	12	12	12
Cellular ARPU (in NIS, per month)	88	78	72	65	63	16

* Other revenues include revenues from other communications services such as internet, transmission services, local and international landline services and repair services.

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Exchange Rate Information

The following table shows, for each of the months indicated, the high and low exchange rates between the NIS and the U.S. dollar, expressed as NIS per U.S. dollar and based upon the daily representative rate of exchange as published by the Bank of Israel:

Month	High (NIS)	Low (NIS)
September 2016	3.786	3.746
October 2016	3.856	3.758
November 2016	3.876	3.799
December 2016	3.867	3.787
January 2017	3.860	3.769
February 2017	3.768	3.659

On March 16, 2017 the daily representative rate of exchange between the NIS and U.S. dollar as published by the Bank of Israel was NIS 3.631 to $1.00.

The following table shows, for periods indicated, the average exchange rate between the NIS and the U.S. dollar, expressed as NIS per U.S. dollar, calculated based on the average of the representative rates of exchange on the last day of each month during the relevant period as published by the Bank of Israel:

Year	Average (NIS)
2012	3.844
2013	3.601
2014	3.593
2015	3.887
2016	3.832

The effect of exchange rate fluctuations on our business and operations is discussed in “Item 11 - Quantitative and Qualitative Disclosures about Market Risk.”

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. In recent years, regulation in Israel has materially adversely affected our results.

A substantial part of our operations is subject to the Israeli Communications Law, 1982, the Israeli Wireless Telegraph Ordinance (New Version), 1972, the regulations promulgated thereunder 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 of the Communications Law, Wireless Telegraph Ordinance and regulations and the provisions of our general licenses, as well as our other licenses, 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 has modified and 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 licenses may not be extended when necessary, or, if extended, the extensions may be granted on terms that are not favorable to us.

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

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 all 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), more so 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; do not set competition-inducing tariffs with respect to Hot's wholesale services or set other unfavorable regulation with respect to the landline wholesale market. See also "– We face intense competition in all aspects of our business" below and "Item 4. Information on The Company – B. Business Overview "-Competition";

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- 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. See "Item 4. Information on the Company – B. Business Overview – Competition", "– Government Regulations – Cellular Segment" and thereunder: – Mobile Virtual Network Operators" and "– Additional MNOs" and "Government Regulations – Fixed-line Segment " for additional details;

- do not renew our licenses or the allocation of our frequencies 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;

- 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, including in relation to site and network sharing or provide leniencies to our competitors;

- 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 or provide them to our subscribers, including in respect of existing agreements;

- allow other operators 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;

- impose a stricter policy 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; and

- impose regulation on our OTT TV services, including the requirement to finance original productions or imposing unfavorable 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".

See "Item 4. Information on the Company – B. Business Overview – Government Regulations Cellular Segment – Our Cellular License" and "– Fixed-line Segment - Fixed-Line Licenses".

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.

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We face intense competition in all aspects of our business.

The Israeli telecommunications market is highly competitive in many of its elements, including the cellular and ISP markets. 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. 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 ISP Business" and "– Telephony Business". Should the current level of competition continue, it will continue to materially adversely affect our results of operations. Any of the following developments materializing in our market, may result in increased competition and a further materially reduced profitability for us:

· our network sharing and hosting agreement with Golan Telecom Ltd., or Golan, or Golan's share purchase agreement with Electra Consumer Products Ltd., or Electra, are not completed, or any other development resulting in the loss of the revenues paid to us by Golan and our inability to compensate for such loss, such as Golan's insolvency and increased efforts by the other operators to recruit Golan's subscribers. For additional details, see "Item 4. Information on the Company – B. Business Overview – Network and Infrastructure – Cellular Segment – Network sharing agreements".

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

· an ineffective landline wholesale market, including due to the *de facto* exclusion of Hot's infrastructure, 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 further escalation of the competition by Bezeq and Hot, given their dominance in the landline market, more so if the structural limitations on these groups are alleviated before an effective landline wholesale market is in effect. See "Item 4. Information on The Company –B. Business Overview – Government Regulations – Fixed-line Segment – Landline" for additional details.

· annulment or further relaxation of the structural separation imposed on each of the Bezeq and Hot groups 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. See "Item 4. Information on The Company –B. Business Overview – Government Regulations – Fixed-line Segment – Landline" for additional details.

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- entrance of new competitors to any of the markets we operate in, 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".

- the deployment or procurement of a widespread landline infrastructure by one of our competitors which currently do not own such infrastructure or its entry into cooperation with an operator which owns such infrastructure, if we do not procure or deploy such infrastructure ourselves or enter into cooperation to use such infrastructure. See "Item 4. Information on the Company –B. Business Overview — Competition – Fixed-Line Segment".

- regulatory changes facilitating even further transfer of costumers among operators.

- the continued increased competition in the handsets market may result in decreased handset sales. See "-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" for additional details.

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, 2016, 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 is awaiting the ruling of the Israeli Supreme Court. Under an interim order issued by the Supreme Court in September 2010, we are unable to rely on the exemption under cellular networks, other than to replace or relocate existing radio access devices under certain conditions, until regulations limiting such reliance are enacted or a different decision by the court is made. In 2017, the Ministry of Finance approved and is in the process of deliberations with other regulators on new draft regulations setting procedures for making changes in existing radio access devices including replacement thereof and for the construction of a limited number of new radio access devices exempt from building permits, but requiring certain municipal procedures. We cannot estimate what the final version of the regulations will be and whether they would alleviate or further burden the current procedures for making changes and constructing new radio access devices. If the regulations are enacted and the final regulations include significant limitations on the ability to make changes to and construct radio access devices based on such exemption, it may adversely affect our existing networks and our networks' build out.

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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. Should we fail to obtain building permits for our cell sites or other facilities, including in the event that our reliance upon an exemption from the requirement to obtain building permits for these cell sites and other facilities is found invalid, the Commissioner will not grant or renew our operating permits for those cell sites and other facilities.

Certain proposed amendments to the Non-Ionizing Radiation Law and Regulations and the Planning and Building Law propose setting additional restrictions in relation to the operation of cell sites and other facilities, such as setting larger distance requirements between cell sites locations and residences or certain institutions.

In June 2010, proposed changes to the Israeli National Zoning Plan 36, or the Plan, which regulates cell site construction and operation, were approved by the Israeli National Council for Planning and Building and submitted for the approval of the Government of Israel. The proposed changes, if approved, would place additional restrictions on the construction and operation of cell sites. Several local planning and building authorities are claiming 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 and have refused to provide a building permit in a number of cases. The proposed draft amendment to the Plan covers all new cell sites requiring a building permit, independently of the frequencies in which they operate. 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 any of the proposed changes noted above are adopted, it could adversely affect our existing network and its build-out, delay the deployment of our 4G network, 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, more so after the Israeli Ministry of Health published recommendations to take precautionary measures when using cellular handsets. 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”. In May 2011, the International Agency for Research on Cancer, an agency of the World Health Organization, or WHO, issued a press release classifying radiofrequency electromagnetic fields 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. Although a later publication by the WHO (June 2011) noted that to that date, no adverse health effects have been established as being caused by mobile phone use and while an increased risk of brain tumors is not established, the increasing use of mobile phones and the lack of data for mobile phone use over time periods longer than 15 years warrant further research of mobile phone use and brain cancer risk, particularly given recent popular use by younger people with potentially longer periods of exposure. In September 2014, the Israeli Ministry of Health updated the possibly carcinogenic to humans elements list on its website, according to the International Agency for Research on Cancer's classification. Moreover, 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.

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, that 4G services involve some increase in the level of non-ionizing radiation the public will be exposed to and therefore should have limited permitted usage 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 February 2015, we entered a first collective employment agreement with the Company's employees' representatives and the Histadrut, an Israeli labor union, for a term of 3 years (2015-2017). 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 requires more management attention that would otherwise be available for our ongoing business. In January 2016, the Histradrut announced a labor dispute at the Company with respect to outsourcing and other employment issues. Although to date, we have not suffered any work stoppages or other disruptions to our operation, future disagreements with the employees' representatives, such as during negotiations in relation to the upcoming renewal of the agreement, may trigger such 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. Furthermore, the renewed collective agreement may increase our costs even further and place grater limitations on our operations. 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.

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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 conditions in the markets in which we operate, 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 between a pricing plan and the information processed by our internal information systems occurring 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. Such lawsuits are filed with respect to billing and other practices, such as customer care practices, marketing, including mass media marketing as well as sending commercial messages to customers, data collection and usage practices, including for commercial purposes, offering practices of products and services, including third parties' products and services, and practices related to the provision of such services to our customers, such as disclosure requirements. In addition, with respect to practices governed by our licenses or other regulation, we are also subject to the risk of monetary and other regulatory sanctions. See "We operate in a heavily regulated industry, which can harm our results of operations. In recent years, regulation in Israel has materially adversely affected our results" above. These actions are costly to defend and could result in significant judgments against us. Recent years were characterized by a substantial increase in the number of purported class actions filed and approved in Israel in general, and also against us, the greater involvement of consumer organizations (by filing such suits, opposing settlement agreements and advocating the filing of lawsuits) and the Attorney General (opposing settlement agreements). All of this increases our legal exposure and our legal costs in defending against such suits, which as a result may materially and adversely affect our financial results. This trend is expected to continue. In addition to seven 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. Should these requests to certify lawsuits against us as class actions be approved and succeed, this may have a material adverse effect on our financial results. 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 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 systems, including information systems. Our offering of bundles of cellular and fixed-line services increased the number of complex technological and information systems involved in providing service to our customers and in the billing process of our customers, resulting in some cases in cumbersome procedures, inefficient usage of resources and lack of uniformity. The occurrence of malfunctions in such complex and ever changing and expanding systems is inevitable. In addition, we are in the process of implementing one 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, which may lead to loss of revenues, legal claims and regulatory sanctions. 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, all of which may adversely affect our results of operations.

We have experienced, and continue to experience, various forms of cyber attacks on a frequent basis. The unauthorized entry to or disruption of operation of our information systems, including due to cyber attacks, may result in damage to us and our customers. Such damages could include our inability to provide certain services without disruptions, if at all, our inability to bill for services rendered, loss of data to us and our customers or abuse of customers' data, all of which may expose us to legal claims and liabilities. Further, any successful attacks on our customers' information systems, protected by our data security products, may also expose us to legal claims and liability. We do not have insurance coverage for these types of claims.

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, Discount Investment Corporation Ltd., or DIC (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;

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- 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 committee of our Board of Directors that deals with matters relating to state security, which must be comprised of at least four directors (including an external director) having the requisite security clearance by Israel's General Security Service.

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.

As a result of a rights offering effected by IDB in February 2015 and the subsequent purchase of IDB shares previously indirectly held by Mr. Ben Moshe, one of IDB's controlling shareholders at the time, by corporations controlled by Mr. Elsztain, the other controlling shareholder, in October 2015, the control of IDB and consequently indirectly of us, has changed and required the approval of the Ministry of Communications, including in relation to the Israeli holding requirements included in our communications licenses since Mr. Elsztain is not an Israeli citizen and resident. In January 2017, the Ministry of Communications approved the transfer of control to corporations controlled by Mr. Elsztain, as well as an amendment to our cellular license, reducing the Israeli holdings requirement to 5% of our outstanding share capital and other means of control and an extension period (subject to certain requirements and ending July 2017) in order for us to comply with the updated provision. If we do not meet the Israeli holding requirement when due, we may face sanctions, which, according to the terms of our licenses, could include the suspension or revocation of our licenses.

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.

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.

Although our articles of association contain certain provisions that are aimed at reducing the risk that holdings or transfers of our ordinary shares will contravene our license, we cannot entirely control these and other matters required by our license, the violation of which could be a basis for suspending or revoking our license. Our other licenses contain similar restrictions. See also “Item 4. Information on the Company – B. Business Overview – Government Regulations – Cellular Segment – Our Cellular License”.

We may be adversely affected by the significant technological and other changes in the cellular communications 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 a growing demand for Internet, content and data through advanced third and fourth generation cellular phones, smartphones, modems, tablets and other devices using cellular data that resulted in a rapid and immense growth of data traffic on cellular networks and required cellular operators to upgrade their networks to accord such demand. Transfer of subscribers to unlimited packages of services and national roaming on our network have contributed to the substantially growing demand for data traffic on our network, as well as to voice and text messages. We estimate that data traffic will continue to rapidly grow in the future. 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. In addition, since in order to provide optimal performance, our LTE network requires additional frequencies to those allocated to us under the LTE frequencies tender (as the Ministry of Communications concluded we can evacuate 12 1800MHz allocated to us for our 2G network, to be used by our LTE network), we have allocated an additional 1800MHz to our LTE network in areas where lower usage of our 2G network, together with advanced and modern equipment and software features, allows such allocation, with negligible adverse effect to our 2G network performance. We will further also enjoy additional 10 1800MHZ should our network sharing agreements with Electra and with Marathon 018 Xfone Ltd., or Xfone, become effective. If those frequencies will not be made available to us, our 4G network will have 15MHz at most (similar to Pelephone's network, unless Pelephone enters a network sharing agreement), whereas Partner and Hot's 4G combined network enjoys 20MHz, which may harm our competitive position. The Ministry of Communications is reviewing the possibility of replacing 850 MHz frequencies with 900 MHz frequencies, which, if effected, will require us to make substantial investments in our networks.

We may not be able to maintain current handsets revenues and profitability.

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. Additional changes to this market, including the entry of additional competitors, changes of distribution channels or customers purchasing habits, 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.

If we cannot obtain or maintain favorable arrangements with foreign telecommunications operators, our services may be less attractive or less profitable.

We rely on agreements with cellular providers outside Israel to provide roaming capabilities to our cellular subscribers in many areas outside Israel. 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. Some of our competitors may be able to obtain lower roaming rates than we do because they may have larger call volumes or can use more favorable agreements of their overseas affiliates. If our competitors' providers can deliver a higher quality, more advanced or more cost effective roaming service, then subscribers may migrate to those competitors and our results of operation could be adversely affected, especially if the proposed amendment to our license, allowing other operators to provide roaming services to our subscribers, will be adopted. Favorable roaming arrangements also influence inbound roaming to our network. The entry of additional operators or the abovementioned proposed amendment to our license may increase competition in that respect as well.

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In recent years, roaming tariffs for our subscribers have decreased. If roaming tariffs continue to decrease, including as a result of the increasing competition or the changing regulation, this could adversely affect our profitability and results of operations.

We also rely on agreements with foreign carriers to provide international long distance, or ILD, services, as well as our international voice hubbing (providing ILD services to foreign operators) services. The risks detailed above in relation to roaming services, and possible effects of such risks, apply to the ILD and hubbing services as well. See "Item 4. Information on The Company – B. Business Overview – Fixed-line Segment – International long distance calling services".

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; regulatory change, market terms and our financial results may affect our possibilities to raise debt.

As of December 31, 2016, our total indebtedness was approximately NIS 4,069 million ($1,058 million), with our net debt at approximately NIS 2,547 million ($662 million). For additional details see "Item 5. Operating and Financial Review and Prospects. – B. Liquidity and Capital Resources – General". The indentures governing our debentures 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 2,226 million ($579 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 through K 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.

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Since 2011, we suffered a significant decrease in our operating results, following certain regulatory changes, intensified competition and price erosion (see "Item 4. Information on the Company – B. Business Overview – Competition"). In May 2012 and in June 2013, the rating of our debentures was downgraded due to increased leverage and competitive pressure. This and 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 through K 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. 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 we are a member of IDB's group of borrowers) may limit our ability to obtain additional financing to operate, develop and expand our business or to refinance existing debt.

See also the law for the promotion of competition and the mitigation of concentration under "Risks Relating to Our Ordinary Shares –Legislation in Israel affecting corporate conglomerates, could adversely affect us" below, which may adversely affect our ability to raise debt from Israeli institutional investors.

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 2014, 2015 and 2016, payments denominated in, or linked to, foreign currencies, mainly U.S. dollars, represented approximately 20%, 24% and 14%, respectively, of our total cash outflow (including payments of principal and interest on our debentures). These payments included capital expenditures, some cell site rental fees, payments for roaming services and to equipment suppliers, including handset and set-top boxes and payments to content suppliers (for our OTT TV service). As almost all of our cash receipts are in NIS, any devaluation of the NIS against the foreign currencies in which we make payments, particularly the U.S. dollar, 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 D, 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. See "Item 5. Operating and Financial Review and Prospects – B. Liquidity and Capital Resources – Debt Service" for details.

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.

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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.

In February 2006, we adopted a dividend policy targeting 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 through K 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, 1999, or the Companies Law, or Profits. Moreover, under such indentures and other credit facilities, if our net leverage (defined as the ratio of net debt to EBITDA during a period of 12 consecutive months, excluding certain one-time events) 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 paid in the past. 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 a limited number of suppliers for key equipment and services. We do not own our own 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 network system based on LTE technology and GSM/GPRS/EDGE technology, our UMTS/HSPA core system, part of our radio access network and related products and services, and our landline New Generation Network system, or NGN system; 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; Alcatel Lucent Israel Ltd., or Alcatel Lucent, and Cisco Systems, Inc., or Cisco provide our Carrier Ethernet network and SDH equipment for our transmission 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 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 ISP, ILD, landline telephony (using Voice over Broadband, or VOB, technology), broadband infrastructure (using the landline wholesale market) and OTT TV services. Those providers include Mediterranean Nautilus Ltd. and Mediterranean Nautilus (Israel) Ltd., or collectively Med Nautilus, which connects the Israeli internet network to the "entry points" of the global internet network, as well as Israeli telephony, via an underwater communications cable, and Bezeq and Hot, which provide broadband infrastructure in Israel. Since the launch of the landline wholesale market, we are dependent on Bezeq for the provision of our broadband infrastructure services as well. 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. Bezeq has suffered labor disruptions, stoppages and slowdowns and has breached certain regulatory obligations in the equal provision of wholesale services to its retail customers or refused to provide them at all, 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. Altech Multimedia (Pty) Ltd., or Altech, provides our set-top boxes and 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.

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 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 our OTT TV solution, which we launched in December 2014, and the potential investment or deployment of a wide-spread landline infrastructure, which we are assessing. 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, especially in businesses that require long term and fixed cost such as for the purchase of content for our OTT TV services, 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 operating difficulties 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, as triggered in December 2014 by Hot after the launch of our OTT TV services and Bezeq's refusal to market our ISP services (in violation of its license) as of the inception of the fixed-line wholesale market (which allowed us to compete with Bezeq in the internet infrastructure market).

We are a member of the IDB group of companies, a large and highly regulated Israeli business group, which may limit our ability to expand our business, to acquire other businesses or raise debt. The effects on us of IDB's financial condition are unclear.

We are an indirect subsidiary of IDB Development Corporation Ltd., or IDB, a large and highly regulated Israeli business group. As of 2013, IDB's financial statements include a note regarding the existence of significant doubts as to its ability to continue as a going concern due in part to its liquidity condition. IDB's and DIC's financial condition could have an adverse effect on our debentures' rating or on the terms of any new debt raised. In addition, pursuant to the "Guidelines for Sound Bank Administration" issued by the Israeli Supervisor of Banks, the amount that an Israeli bank may lend to one group of borrowers and to each of its six largest borrowers is limited. Since we are a member of IDB's group of borrowers, these guidelines may limit the ability of Israeli banks to lend money to us.

Under the Law for the Promotion of Competition and the Mitigation of Concentration, or the Concentration Law, competitive and control concentration factors, both of a certain market and generally, are to be taken into consideration prior to allocation of rights and granting of licenses or regulatory approvals, especially in public essential infrastructure assets (including in the communications field), by the relevant governmental authorities, to entities considered to be 'concentrated entities'. Being a subsidiary of IDB, we are included in the list of concentrated entities published annually to which such requirements apply. This may adversely affect the renewal of our licenses and allocation of additional frequencies to us, which would have an adverse effect on our business. See also "Risks Relating to Our Ordinary Shares – Legislation in Israel affecting corporate conglomerates, could adversely affect us" below.

Due to the limited size and high level of regulation of the Israeli market, and the communications market in particular, our being a member of the IDB group of companies may limit our ability to expand our business in the future, form joint ventures and strategic alliances and conduct other strategic transactions with other participants in the Israeli communications market.

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

As of December 31, 2016, DIC held, directly and indirectly, approximately 42.26% of our outstanding share capital and the voting rights in respect of an additional approximately 3.39% of our share capital, pursuant to shareholders agreements among DIC and certain of our minority shareholders. In addition to DIC's shareholdings and such additional voting rights, it has the right to appoint the 10% of our directors that we are required by our license and articles of association to have appointed by Israeli citizens and residents among our founding shareholders. Accordingly, subject to legal limitations, DIC has control (as the term "control" is defined in 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.

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Legislation in Israel affecting corporate conglomerates, could adversely affect us.

The Concentration Law, enacted by the Israeli parliament in December 2013, includes the following: (1) imposes limitations on the holdings by a significant corporation that is not in the financial sector in a significant corporation in the financial sector or the holdings of both kinds of corporations under common control and on the possibility of serving as a director in both a significant non-financial corporation and a significant financial corporation; (2) imposes a two layer limitation on the total number of reporting corporations (layers) in pyramidal structure (for existing pyramidal structures of three layers - after a transition period of six years and of four layers – after a transition period of four years); (3) requires that as of September 2014 and during the said transition period in companies that are third layer and up in a pyramidal structure - the majority of the board of directors be independent, as defined in the Israeli Companies Law, and that the number of external directors be half the number of the company's directors less one (rounded upward) but not less than two; (4) authorizes the Israeli Minister of Finance or bodies authorized by it to set limitations regarding the aggregate credit that may be provided by financial institutions to a corporation or a business group (defined as a controlling shareholder and the corporations under its control); and (5) sets additional procedures including involving the committee of mitigation of concentration designated to take into consideration competitive and control concentration factors prior to any allocation of rights and granting of licenses or regulatory approvals, especially in public essential infrastructure assets (including in the communications field), by the relevant governmental authorities. We are a third layer company in the pyramidal structure of the IDB group and are included in the list of concentrated entities published annually to whom such requirements apply. Accordingly, in September 2014 we changed the composition of our board of directors to accord with the requirements of the Concentration Law, and IDB and DIC have until December 2019 to cause us to cease being a third layer company. IDB and DIC have announced that they are reviewing possible ways to achieve this goal without having to forfeit control of us. There can be no assurance of how or when this would occur, if at all. In addition, the new procedures set in the law in relation to allocation of rights in public assets, could have an adverse effect on our ability to renew our cellular license or receive additional frequencies. The law may also adversely affect our ability to raise debt or other aspects of our business.

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 and some of our suppliers are located in Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, Hamas (an Islamist militia and political group in the Gaza Strip) and Hezbollah (an Islamist militia and political group in Lebanon). Any hostilities involving Israel or the interruption or curtailment of trade within Israel or between Israel and its trading partners could adversely affect our operations and could make it more difficult for us to raise capital. 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.

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More generally, any armed conflicts, terrorist activities or political instability in the region would likely negatively affect business conditions and could harm our results of operations, including following termination of such conflicts, due to a decrease in the number of tourists visiting Israel. Such adverse effects may also occur due to the increasing criticism of Israel in the international community. Since the end of 2010 several countries in the region have been experiencing increased political instability which has enabled the development of extremist groups, which could threaten Israeli interests. In addition, Iran has threatened to attack Israel and is suspected to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in areas that neighbor Israel, such as Hamas in Gaza and Hezbollah in Lebanon. This situation may potentially escalate in the future to violent events which may affect Israel and us.

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.

The Communications Law grants the Prime Minister of Israel the authority, for reasons of state security or public welfare, to order a telecommunications license holder to provide services to security forces, to perform telecommunications activities or to establish a telecommunications facility as may be required for the security forces to carry out their duties. Further, the Israeli Equipment Registration and IDF Mobilization Law, 1987, also permits the registration of engineering equipment and facilities and the taking thereof for the use of the Israel Defense Forces. This law further sets the payment for use and compensation for damages caused to the operator as a result of such taking. Our general license 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, and requires us to cooperate with such actions. 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. See also “Item 4. Information on the Company – B. Business Overview – Government Regulations – Cellular Segment – Our Cellular License” and “– Fixed-line Segment – Our Fixed-line Licenses”.

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

The Israeli 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. For example, a merger may not be completed unless at least 50 days have passed from the date that a merger proposal was filed by each merging company with the Israel Registrar of Companies and at least 30 days from the date that the shareholders of both merging companies approved the merger. In addition, a majority of each class of securities of the target company is required to approve a merger. 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. 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 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, DIC, holds approximately 42.26% of our outstanding ordinary shares, as of December 31, 2016. The market price of our ordinary shares could decline as a result of future sales by DIC or other existing shareholders or the perception that these sales could occur. DIC sold approximately 1.7% of our outstanding shares outside the United States in 2013. 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, under our 2006 option plan and 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, 2016 we had 2,764,334 shares reserved for issuance upon the exercise of options. See "Item 6. Directors, Senior Management and Employment – E. Share Ownership –Share Incentive Plans".

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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.

DIC, a subsidiary of IDB, currently directly and indirectly holds approximately 42.26% of our share capital and the voting rights in respect of an additional approximately 3.39% 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.

On August 31, 2011, we completed the acquisition of 100% of the share capital of Netvision, a major Israeli ISP and ILD services provider, for a total consideration of approximately NIS 1.57 billion ($404 million).

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.

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 three unified general licenses for the provision of fixed-line services, granted by the MOC in 2015 and valid until 2025/2026.

In January 2017 we annulled the 2015 agreement for the purchase of Golan, one of the other four MNO's operating in Israel, after the regulators' refusal to approve it and continuous litigation with Golan due to Golan's repeated breaches of our agreements, including an attempt to renege on its obligation to pay us NIS 600 million plus VAT for past national roaming differences by December 2015 and Golan's violation of its obligation to pay us the agreed consideration for national roaming services. A successful mediation process held pursuant to our liquidation request against Golan, resulted in a mediation agreement between the Company and Golan, followed by Golan entering a share purchase agreement with Electra which simultaneously entered a 3G and 4G network sharing and 2G hosting services agreement with us; the aforementioned annulment of our 2015 purchase agreement of Golan; dismissal of legal actions filed by us and Golan against each other; and an agreement of a reduced monthly payment for national roaming services for a certain period. The mediation agreement further includes arrangements in case the share purchase agreement with Electra is not closed within a certain period, including a continuation of the mediation process and reduced monthly payment for national roaming services to be provided by us for a certain period and the right to resume legal actions, including with relation to the past national roaming payment difference. We cannot estimate what the chances of completion of such agreements are, or the impact of failure to complete such agreements on our ability to collect amounts owed by Golan or to generate future revenues from Golan. A substantial reduction of the future revenues from Golan will have a material adverse effect on our revenues and results of operations.

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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.

Principal Capital Expenditures

Our accrual capital expenditure in 2014, 2015 and 2016 amounted to NIS 487 million, NIS 396 million and NIS 382 million, respectively. Accrual capital expenditure is defined as investment in fixed assets and intangible assets, such as spectrum licenses, rights of use of communications lines, cellular networks' enhancement and expansion and development of new products, set-top boxes for our TV services and routers for our landline services.

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, end user fixed-line equipment and supplemental services.

In the year ended December 31, 2016, we generated revenues of NIS 4,027 million ($1,047 million), EBITDA of NIS 858 million ($223 million), and operating income of NIS 310 million ($81 million). See note 1 to the table in “Item 3. Key Information – A. Selected Financial Data” for a definition of EBITDA. See "Item 5. Operating and Financial Review and Prospects. – A. Operating Results – Overview –General".

The following table presents our number of subscribers in our main fields of operation and revenues for each of the last five years:

	Year Ended December 31,				
	2012	2013	2014	2015	2016
Cellular subscribers (end of period) (in thousands)(1)	3,199	3,092	2,967	2,835	2,801
	-	-	-	95	163

Internet infrastructure customers (households)(end of period) (in thousands) (2)					
TV customers (households) (end of period) (in thousands) **(2)**	-	-	-	63	111
Revenues (in NIS millions)	5,938	4,927	4,570	4,180	4,027

(1) Subscriber data refers to active cellular subscribers. We use a six-month method of calculating our cellular subscriber base, which means that we deduct subscribers from our cellular subscriber base after six months of no revenue generation and activity on our network by or in relation to the post-paid subscriber, no revenue generating calls or SMS for pre-paid subscriber 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. In the fourth quarter of 2012, we removed approximately 138,000 M2M subscribers from our subscriber base, following the addition of the above revenue generation criterion for M2M subscribers. This change had an immaterial effect on our ARPU for 2012. In the fourth quarter of 2013 we removed approximately 64,000 subscribers from our subscribers base, following a change to our prepaid subscribers counting mechanism. As a result of such change, we add a prepaid subscriber to our subscribers base only upon charging a prepaid card and remove them from our subscribers base after six months of no revenue generating calls or SMS. Following each of these changes, we have not restated prior subscriber data to conform to such changes.

(2) Internet infrastructure and TV were launched in February 2015 and December 2014, respectively. Internet infrastructure subscribers and TV subscribers refer to active subscribers.

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For our network sharing and hosting agreements entered in 2016 and 2017, see "– Network and Infrastructure – Cellular Segment – Network sharing agreements."

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, 2016. As of December 31, 2016, we provided cellular communications services to approximately 2.801 million subscribers in Israel with an estimated market share of 27.5%. 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, such as ILD services. We offer two methods of payment: pre-paid and post-paid. Pre-paid services are offered to subscribers who pay for our services prior to obtaining them, usually by purchasing our “Talkman” pre-paid cards or “virtual” Talkman cards. 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. Price erosion and the marketing of unlimited 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.

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 "unlimited 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.

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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, 2016, we had commercial roaming relationships with 551 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, 2016, we had 3G roaming arrangements with 368 of these operators in 114 countries (some 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 SMS and MMS, cloud backup and content services such as "Cellcom Volume" our new upgraded music application and "Cellcom tv" application. SMS is included in our "unlimited packages". 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 insure continuous service, work force management and vehicles management applications. We are constantly considering and evaluating the possibility of introducing additional products and services to our customers. Those include IOT (internet of things) solutions such as "smart city" end-to-end solution trials.

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 Apple, LG, Samsung and Sony. The vast majority of our handset sales in 2016 have been by Apple and Samsung. 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 modems and tablets to promote our data services. In addition, we sell added value products to our customers, such as smart watches.

Fixed line Segment

Our main fixed line services include our internet infrastructure (based on the landline wholesale market) and ISP services, OTT TV services, ILD services and landline telephony services. We also offer landline transmission and data services to selected business customers and telecommunications operators, using our approximately 1,800 kilometers of inland 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 solutions based on products and services offered by us and by third party vendors.

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Internet infrastructure and ISP

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. 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" above.

As of December 31, 2016, we provide ISP services to approximately 638,000 households and we estimate our market share to be 25%, and we provide Internet infrastructure services, based on the wholesale landline market, to approximately 163,000 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 ISP 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, such as IOT solutions.

OTT TV services

As of December 2014, we also offer OTT-TV services, branded 'Cellcom tv' 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, and Video on Demand library subscription (SVoD) that can be also accessed by smartphones, tablets, Smart TV and Apple TV (TV anywhere), access to internet video content from selected internet sites, music streaming service and additional advanced features such as personal video recorder, VoD playlist channels, for a highly competitive price. Our VoD catalogue and linear channels offer international and local content from top content suppliers. As of December 31, 2016, we provide OTT TV services to approximately 111,000 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.

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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.

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 make substantial capital expenditures on our network system.

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 112 Mbps on the downlink path and up to 37 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 2017 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 "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 2017 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.

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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. At the same time we intend 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 cellular communications industry ".

We provide wire-line 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 our license (as well as the licenses of the other 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 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 bands of 10 MHz in the 850 MHz frequency band previously used by our TDMA network and currently by our UMTS/HSPA base stations, 2 bands of 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 bands of 10 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.

Execution of our network sharing and hosting agreements will provide us with additional 2X10 MHz in the 1800 MHz frequency band and 2X10 MHz in the 2100 MHz frequency band. See "– Network sharing agreements" for additional details.

The Ministry of Communications is reviewing the possibility of replacing 850 MHz frequencies with 900 MHz frequencies, which, if effected, will require us to make substantial investments in our networks.

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 July 2016, we entered a 4G network sharing and 2G and 3G hosting services agreement with Xfone, or the Xfone Agreement, which was awarded 4G frequencies in the 2015 frequencies tender and has not entered the cellular market yet. In January 2017, we entered a 3G and 4G network sharing and 2G hosting services agreement with Electra (which will apply to Golan when owned by Electra), or the Golan Agreement, and Electra simultaneously entered an agreement with Golan and Golan's shareholders to purchase Golan's share capital, or the Share Purchase Agreement by Electra or SPAE.

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The main provisions of the Xfone Agreement and the Golan Agreement include the following:

- Both agreements are preconditioned by the receipt of any required regulatory approval, including from the Antitrust Commissioner and the Ministry of Communications. The Golan Agreement is also conditioned upon the closing of the SPAE (which is also subject to regulatory approvals).

- Network sharing – the parties will cooperate in the development of a shared network (as applicable), which will use both parties' relevant frequencies, to be operated by a separate, newly created entity, or NewCo, that will be equally owned by the parties. Each of us and the sharing party/parties will hold the active elements of the shared network in equal parts and will grant each other and NewCo an indefeasible right of use, or IRU, in their active elements of the shared network. To that end, the sharing party / parties will purchase and hold equal shares of the active elements of the shared network owned by us prior to a certain date. Future ongoing investments in such active elements will be equally borne by the parties. Each party will purchase and operate its own core network. We will further provide the sharing parties and NewCo an IRU to our passive elements of the shared networks. We will provide services to NewCo as a subcontractor.

- Hosting services – We will provide Xfone hosting services in relation to our 2G and 3G networks and to Golan hosting services in relation to our 2G network.

  - Term – the agreements are for a term of ten years (the Xfone Agreement - commencing from the earlier of the commercial launch of cellular services by Xfone or 12 months following the receipt of regulatory approvals for the agreement ("the Xfone Agreement Effective Date")), 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.

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o Consideration –

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. Such consideration includes the following components:

§ its share of the active elements of the existing 3G and 4G network owned by us and minimum future investment by Golan in active elements of the shared network;

§ IRU to the passive network; and

§ operating costs of the shared network and the 2G network (both active and passive), to include a fixed component to be borne equally by the parties, subject to certain discount arrangements dependent on the number of Golan's subscribers, and a variable component to be borne by the parties according to the parties' relative usage of data by their respective subscribers.

The consideration for us under the Xfone Agreement includes substantially similar arrangements (*mutatis mutandis* to its sharing and hosting agreement), but Xfone will be entitled to a discount according to which the said payments for the IRU to the passive elements and its share of the operating costs will be replaced during a period of up to 5 years from the Xfone Agreement Effective Date with a monthly payment per subscriber to us of NIS 25 in the first year, NIS 27.5 in the second year and NIS 30 thereafter, plus VAT, but in any case not less than certain minimum annual amounts (ranging between NIS 20 million in the first year and NIS 110 million in the fifth year).

The agreements include standard stipulations as well as certain arrangements for separation of the parities and adding another sharing party. 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 Golan Agreement includes the following arrangements as well:

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- § Loan – Upon closing of the SPAE, we will lend Golan the sum of NIS 130 million for a period of 10 years to be repaid in 6 semi-annual equal installments beginning in the 8th year of the term (interest and CPI differentials to be accrued and will be paid as of in the 6th year). The loan will be guaranteed by a second degree floating charge on Golan's assets and rights (excluding certain exceptions) or an equivalent guaranty.

- § Interim Period – The Golan Agreement includes arrangements in relation to a possible interim period commencing upon the closing of the SPAE, if closed prior to the receipt of regulatory approvals of the agreement, and until the closing of the agreement. Those include the continued exclusive purchase of national roaming services by Golan from us, for a consideration equal to that stipulated under the agreement as well as an agreed compensation in the sum of NIS 600 million plus VAT in the event such purchase is stopped other than following closing of the Agreement.

- § Resolution of the previously reported differences regarding past national roaming payments.

In October 2016, the Israeli Antitrust Commissioner approved the Xfone Agreement, subject to the annulment of a certain provision.

In February and March 2017, we agreed on certain amendments to these agreements including certain immaterial discounts out of the agreements' consideration. We, Xfone and Electra have further entered another agreement, combining the 4G network sharing arrangements of the Xfone agreements and the Electra agreement into one three-way agreement.

In March 2017, the Antitrust Commissioner and the Ministry of Communications approved the Golan Agreement and SPAE.

We cannot estimate the likelihood or timing of Xfone entering the cellular market.

We cannot estimate the likelihood of approval of the Xfone Agreement by the Ministry of Communicatoins and completion of all such agreements, or the impact of failure to complete the Electra/Golan agreements on our ability to collect amounts owed by Golan or to generate future revenues from Golan. A substantial reduction of the future revenues from Golan would have a material adverse effect on our revenues and results of operations.

The 2014 co-operation agreement regarding maintenance services for passive elements of cell sites with Pelephone will not be executed.

Fixed-line Segment

Fixed-line infrastructure

We launched our SDH transmission network in 1999 and it covers substantially all of the populated areas in Israel. We launched our Carrier Ethernet network in 2010 and it covers substantially all of the populated areas in Israel. In 2015 we launched an MBH network intended to support all our cellular traffic. In 2017 we intend to migrate the majority of our cellular sites to this new network.

Our transmission network enables us to provide our 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 and landline network in substantially all of the populated territory of Israel while reducing our need to lease capacity from Bezeq, the incumbent landline operator in Israel.

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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 1,800 kilometers. The fiber-optic network is monitored by a fault-management system that performs real-time monitoring in order to enable us to provide our subscribers with high quality service. In order to efficiently complete our transmission network's coverage to substantially the entire country, 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, 2016, we had approximately 2,720 microwave links to both our cell sites and our landline and transmission subscribers.

In 2016, 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.

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

Suppliers

In April 2014, we entered 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 will also govern the purchase and services provided under our previous agreement with NSN, in relation to our GSM/GPRS and EDGE networks, UMTS core system and a UMTS/HSPA radio access network and related products and services. We have an option to purchase maintenance services on an annual basis until March 2030.

We entered into an agreement with LM Ericsson in September 2005 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, to provide services to our networks, allowing us, at minimal cost, to internally develop sophisticated services with a short time-to-market that are customized to local market requirements. Our IN platform supports all relevant IN protocols, which allows us to provide (subject to applicable roaming agreements) advanced roaming services, including Virtual Home Environment, abbreviated dialing, unified access to voice mail, VPN, local number format from subscribers' phone book and call screening.

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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 Mediterranean Nautilus Ltd. and Mediterranean Nautilus (Israel) Ltd., or collectively Med Nautilus, between 2003 and 2016. Med Nautilus is the owner of the communications infrastructure which connects the Israeli internet network to the "entry points" of the global internet network via an underwater communications cable (out of three existing cables, one of them is owned by one of our competitors, Bezeq International). Pursuant to our agreements with Med Nautilus, we purchased rights of use of certain telecommunications capacities on Med Nautilus' communications cables, 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 Med Nautilus is in effect until May 2032. We have the option to terminate agreements with respect to parts of the capacity in 2022 and 2027. The terms of these agreements may be subject to regulatory intervention – see "–Government Regulation – Fixed-line Segment" below.

We have also entered into agreements with Bezeq and Hot, the primary internet infrastructure providers in the Israeli market. We are dependent upon these suppliers since without their infrastructure we would be unable to provide our ISP services to our customers. 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. Our internet infrastructure service is dependent on Bezeq and in case we purchase such services from Hot, it will be dependent on Hot as well. The terms of the service 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 also agreed to purchase from Alcatel Lucent at least 51% of the equipment and services that we purchase for such network until the lapse of 7 years from final acceptance (until February 2017). 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 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).

We entered into an agreement with Nortel Networks Israel (Sales and Marketing) Ltd., or Nortel, in June 2004, 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, Geneband 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 ISP 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. Our traffic requires interconnections with these operators and is dependent on their availability and quality.

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. Our traffic requires interconnections with these operators and is dependent on their availability and quality.

In 2011, we entered an agreement with LM Ericsson, for the purchase of our OTT TV services system and ancillary products and services. We have an option to purchase maintenance services on an annual basis until 2018. Our OTT TV service also uses the Israeli DTT infrastructure. The DTT infrastructure may be used freely by our customers.

In June 2015, we entered an agreement with Altech, for the purchase and distribution of set-top boxes and ancillary products and services for our OTT TV services.

In 2013, we entered an agreement with VU, 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 minimum amounts for such content and services. The Agreement is valid until the end of 2018 and may be terminated by us at the end of 2017, subject to certain conditions; 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 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.

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

In 2010 - 2015, we entered into several agreements with Amdocs (Israel) Limited, or Amdocs, for the provision of operation, maintenance, management and development services for our billing and customer care systems as well as for the development of a new version of our billing system as well as an agreement to replace our current CRM systems. In February 2016, those agreements were consensually terminated by mutual agreement and our billing and CRM systems are supported mostly internally and by Intec. We also use a customer care system provided by PeopleSoft and supported mostly internally, an inventory and suppliers management system by Priority/Eshbel, a financial system by Coda and an infrastructure integrations system by Microsoft BizTalk.

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 Salesfoce'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 us in April 2018. 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 may be terminated by us in April 2018; 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 "Cellcopedia".

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 valid until December 2017 and either party may terminate it earlier, by advanced written notice to the other party.

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Sales and Customer Care and Marketing

Sales and customer care

We combine our sales and customer care efforts in order to maximize sales opportunities alongside accessible and quality customer service. As part of our strategy to fully penetrate every part of the Israeli market, we try to make the purchase of our services as easy and as accessible as possible, while making our sales lineup more cost efficient. Our customer service unit is our main channel for preserving the long-term relationship with our subscribers and we invest large resources in the quality of our service to our customers. We focus on customer retention through the provision of quality service and customer care. In order to achieve this goal, we systematically monitor and analyze our subscribers' preferences, characteristics and trends by developing and analyzing sophisticated databases. 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 ARPU, 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. 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.

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, and closely monitor the service provided by them in order to assure its quality. 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 new 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, 2016, we independently operated approximately 28 service and sales centers, with approximately 150 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 provide a walk-in contact channel and offer the entire spectrum of products and services that we provide to our subscribers and potential subscribers (the majority of which are provided in our dealers' sale and service points as well), including handset sales, accessories sales (by Dynamica), upgrades and other services, such as bill payment, pricing plan changes and subscriptions to new services. 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. The majority of our walk-in centers offer handset repair service for the more minor malfunctions, whereas for the more major malfunctions and where on-site repair service is not available, our walk-in centers serve as a contact point in which our subscribers deposit their handsets for repair and receive the repaired handset after two business days in the same center or at a location of their choice by a courier, with the repair services conducted in a central lab.

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In 2016, we reduced the space of several additional points of sale, and we may continue to do so in 2017.

We also distribute our products and services indirectly through a chain of dozens of dealers (including our own wholly owned dealer, Dynamica) who operate at approximately 150 points of sale throughout Israel. Our dealers are compensated for each sale based on qualitative and quantitative measures. We closely monitor the quality of service provided to our subscribers by our dealers. In our efforts to penetrate certain sectors of our potential subscriber base, we select dealers with proven expertise in marketing to such sectors.

Telephonic sales/Call centers. Telephonic sales efforts target existing and potential subscribers who are interested in buying or upgrading handsets and services. Our sales representatives (both in-house and outsourced) offer our customers a variety of products and services, both in proactive and reactive interactions. In order to provide quick and efficient responses to the different needs of our various subscribers, our call-center services are divided into several sub-centers: general services; technical services; billing; sales; international roaming; and data and internet. We are constantly reviewing the effectiveness of our service and as of 2014 we also operate a multi-function call center providing all our services. The call center services are provided in four languages: Hebrew, Arabic, English and Russian. We currently operate call centers in nine locations throughout Israel, four of which are outsourced. In 2016, 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 offering simple price plans 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, focusing on sales of products and services, customer retention and tailor-made solutions for the specific needs of such customers. 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. We offer our business customers handsets repair services by a dispatch service, during which time, the customer is provided with a substitute handset, free of charge. 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 through our 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 and our smartphone application, automatic and live chat and live sms chat, facebook chat and mobile phone application, where they can receive general and specific information, including pricing plans, account balance, information regarding our various services and products and trouble shooting and handset-operation. We invest efforts in directing our customers toward self-service channels. We have established a dedicated internet site for the marketing and sales our OTT TV service.

Customer service for our OTT TV and internet infrastructure market services are provided also through technicians providing services at the customers' homes.

All of our sales and service channels are monitored and analyzed regularly in order to assure the quality of our services and to identify areas where we can improve.

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 work closely with Accessibility Israel, a leading Israeli non-profit organization advancing accessibility for persons with disabilities in Israel, and 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 services bundles for families and for the office for small and mid-sized businesses. We believe the provision of bundles and triple 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 and laptop. Alongside our focus on packages for a fixed sum, we have substantially reduced the number of calling plans available to our customers, thus reducing our back office operation.

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 models, to increase customer satisfaction, loyalty and revenues.

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We regularly advertise in all forms of media, including in promotional campaigns. We also use "one to one" promotional campaigns such as advertisements in our subscribers' monthly bill and in incoming IVR. We believe our marketing and branding campaigns, including our "Cellcom tv" advertisement campaign conducted since the launch of such services, has been very successful and acclaimed among the Israeli public and even contributed to the strength of the "Cellcom" brand.

Cellcom was ranked by Globes as the leading and strongest brand of Israel’s cellular market in 2016 for the sixth year in a row, and 'Cellcom tv' was chosen as the 2015 winning launch, both by Israel's marketing association and in a poll taken among Israel's leading marketing VPs. 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 television over the internet services, internet infrastructure services through the landline wholesale services and IOT;
- focusing on the offering of bundles of services, as it strengthens customer retention and on enlarging customer purchases from us;
- entering network sharing and hosting agreements with Golan (to go into effect when owned by Electra) and Xfone, which will facilitate a more efficient cost structure in relation to our networks and operations thereof and investments therein;

- investing in our network to ensure our ability to offer quality and advanced cellular and fixed line services, including in our 4G network, 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.

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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-012 Smile 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 that some of the services in the Bezeq bundle would be available for sale separately under the same terms as in the bundle, and the requirement that Bezeq allows its competitors to participate in a similar bundle (if it includes ISP, 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 ISP services, with respect to the ISP service component of the bundle.

In addition to certain relaxation of the structural separation imposed on the Bezeq group as of 2010, allowing it to offer bundles of services with its subsidiaries, in 2015, Bezeq merged with Yes, Bezeq's subsidiary providing multichannel pay-TV, under certain conditions (detailed under "-Fixed line Segment – Television services" below). Although the Hot group is also subject to structural separation limitations between its multi-channel television, ISP, cellular and landline services, it was allowed to offer a bundle of landline telephony, multichannel television and internet infrastructure services and under certain conditions ISP 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 already announced the commencement of a full merger process with Yes, including full integration of Yes into Bezeq. We believe the annulment of corporate and structural separation for Bezeq and Hot will adversely affect our competitive standing, especially if it is effected before a complete and effective wholesale landline market is in place.

Any changes to the structural separation limitations in the Bezeq and Hot groups and the supervision over Bezeq's tariffs, or anti-competitive behavior if not prevented by the regulators could adversely affect our ability to compete with Bezeq and Hot in general and may have a material adverse effect on our results of operation.

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 119%, representing approximately 10.2 million cellular subscribers at December 31, 2016, and the average annual churn rate in Israel in 2016 is estimated to be 36%, 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 eight other cellular communications operators: four MNOs (Partner, Pelephone, Hot Mobile and Golan) and four MVNOs (Rami Levy Hashikma Communications Marketing Ltd., or Rami Levy, Home Cellular Ltd. (whose operations we have purchased, pending requisite approvals), or Home Cellular, Azi Communications Ltd., or Azi, and Cellact Communications Ltd., or Cellact). Xfone won frequencies in the 2015 4G frequencies tender but hasn't entered the market yet. For details of our network sharing and hosting agreements with Golan (to go into effect when owned by Electra) and Xfone see "– Network and Infrastructure – Cellular Segment – Network sharing agreements" above.

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Our estimated market share based on number of subscribers was approximately 27.5% as of December 31, 2016. The market shares at such time of Partner, Pelephone, Hot Mobile and Golan were estimated to be approximately 26%, 23%, 13.8% and 7.8%, respectively, and the MVNOs' collective market share was estimated to be 1.9%. 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 operation in May 2012. Rami Levy, Home Cellular, Azi and Cellact, all MVNOs, commenced operations in December 2011 - December 2013.

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 Telelcom, 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 and controlled by the Israeli businessman Shaul Alovich.

Hot Mobile (previously named Mirs Communications Ltd.) had its license upgraded from push-to-talk to a cellular license in February 2001. In mid-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 Xavier Niel, founder and controlling shareholder of the French telecom company Iliad - Free, Patrick and Gerard Pariente, founders and former owners of Naf Naf, a European fashion brand, Michael Golan, the CEO of Golan and former CEO of the French telecom company Iliad – Free, and David Golan. Golan began to operate in mid-2012. In January 2017, Golan and its shareholders entered a share purchase agreement with Electra for the purchase of Golan and Golan entered a network sharing and hosting agreement with us (to go into effect when Golan is owned by Electra). Both agreements are subject to regulatory approvals as described under "-Network and Infrastructure – Cellular Segment – Network sharing agreements" above.

Rami Levy is a subsidiary of a major Israeli discount supermarket chain. Home Cellular is a subsidiary of a leading 'do it yourself' stores chain. Azi is owned by Telzar, an ILD operator. Cellact is owned by Cellact Ltd., a content provider.

The competition in the cellular communications market intensified following the entry of additional cellular operators to the market, specifically the launch of two new UMTS operations by Hot Mobile and Golan in mid 2012, without having to first invest in building their own network, with significantly lower tariffs than market level at that time for private customers. This has led to a material increase in churn rate and accelerated and continuous price erosion for both private and business customers and a material decrease in revenues and profitability for us.

Handsets

In the handsets market, we compete with numerous vendors, chain stores and importers' stores. Regulatory decisions in recent years alleviating the regulatory requirements on the import to and sale of handsets in Israel, coupled with regulatory decisions preventing cellular operators from linking handsets sale and cellular services, led to the entry of additional competitors into the market, significantly increased competition and decreased sales for us. See "Item 4. Information on The Company – Government Regulations – Cellular Segment – Tariff Supervision" for additional details. That, coupled with the growing change in the business market where corporations no longer purchase cellular services for their employees from a designated operator but rather allow each employee to purchase his or her own device and obtain cellular services from their operator of choice, known as the "bring your own device" phenomenon, may further increase the competition in this market.

Fixed-line Segment

The only groups having their own landline infrastructure in Israel are Bezeq and Hot. In June 2016, Partner announced that it intends to deploy a nation-wide landline infrastructure and we are assessing the possibility of investing in IBC (a company owned by the Israeli Electric Company, or IEC, and an international group led by Via Europa) or deploying our own wide-spread landline infrastructure. A landline wholesale market was formally launched in Israel in 2015. See "-Government Regulations – Fixed-line Segment – Wholesale Landline Market" below. An effective wholesale landline market, specifically one including both Bezeq's and Hot's infrastructure and providing both telephony and infrastructure services, will enhance our ability to compete and extend our service offering. However, the intended annulment or substantial alleviation of corporate or structural separation and Bezeq's tariffs supervision, 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. 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 ISP Business

The two main internet infrastructure providers for the private sector in Israel and the only groups having their own landline infrastructure and offering internet infrastructure services to both ISPs and end-users are Bezeq and Hot. Bezeq is 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. In 2014, a third competitor - IBC commenced deployment of its infrastructure and the provision of broadband services in selected areas, reportedly through agreements entered with some of the smaller ISPs. IBC's licenses allows the provision of broadband infrastructure services on the IEC's optic fibers infrastructure to other licenses holders as well as directly to large business customers. In 2016, IBC's shareholders announced their intention to raise capital by inserting additional investors. We are reviewing the possibility of investing in IBC.

As of September 30, 2016, internet infrastructure services are provided by Bezeq and Hot to approximately 1.19 million and 700,000 households in Israel, respectively, with an immaterial quantity by IBC. As of the first half of 2015, internet infrastructure services are provided by other operators, including us, through the landline wholesale market, using Bezeq's infrastructure. Based on Bezeq and Hot reports, at the end of September 2016, the Internet infrastructure services household penetration rate was approximately 93%. We bundle this service with our ISP service and also as part of our triple play offering. As of December 31, 2016, we had approximately 163,000 households subscribed to our internet infrastructure services.

In January 2016, the Ministry of Communications published a hearing proposing maximum tariffs for Hot's wholesale internet infrastructure services. Effective inclusion of Hot's infrastructure in the wholesale market may increase the amount of potential subscribers to our triple play and bundle offerings. For the details regarding a wholesale landline market in Israel see "– Government Regulations – Fixed-line Segment – Wholesale Landline Market" below".

Internet connectivity access (ISP) is currently provided by three major ISPs: us, Bezeq International, Smile Telecom (a subsidiary of Partner), and some other smaller players including Hotnet (a subsidiary of Hot) and Xfone Communications Ltd. As of December 31, 2016, we provide ISP services to approximately 638,000 households and we estimate our market share to be 25% and the market shares of Bezeq International and Smile Telecom to be 40% and 23%, respectively.

The Israeli ISP market is highly competitive and saturated and is characterized by relatively low entry barriers. Competition among the various players concentrates mainly on the ability to offer high speeds of internet connection and on pricing. Although the provision of ISP services requires obtaining a license from the Ministry of Communications, the Ministry's policy is liberal in granting ISP licenses (and more recently unified licenses, which allow the provision of ISP services to any holder of such license, subject to the inclusion of an ISP appendix). As a result, as of the date of this report, there are a few dozen holders of ISP licenses (or unified license allowing the provision of ISP services) in Israel, though most of them do not hold significant market shares. Due to substantial penetration costs and the other ongoing costs of operating ISP service, profitability in the ISP market usually requires creation of a broad customer base and the ability to sell added value products and high speed packages to the customers.

The entry of Hot (through its subsidiary Hotnet) into the ISP market at tariffs significantly lower than market prices in 2012, the subsequent entry of cellular operators into that market in 2013, 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 ISP 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 ISP using the wholesale market increased the competition in this field, resulting in loss of some of our ISP customers. Bezeq's continued breach of its obligation to market our ISP services when proposing an internet infrastructure and ISP bundle, has also resulted in a substantial loss of ISP customers. 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.

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Global internet connectivity is provided by three underwater cables. The main provider, which also provides us with global internet connectivity, is Med Nautilus, with another one owned by the Bezeq group. The deployment of the second and third underwater cables in 2011 and 2012 led to a substantial decrease in the pricing of the global internet connectivity services provided to Israeli ISPs.

In addition, should the IBC infrastructure be available (which currently cannot be assured), this would improve our competitiveness in the ISP and internet infrastructure markets as this is likely to reduce our dependency on Bezeq and Hot as internet infrastructure providers.

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".

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 816,000 and 618,000 households, respectively, as of September 30, 2016. The multichannel pay-TV market is also highly penetrated with levels above those of most developed economies. We successfully entered this market in December 2014, using an hybrid OTT-DTT television service, with approximately 111,000 households subscribed to our Cellcom tv services as of December 31, 2016. DTT broadcasting may be used by additional players as well, to be bundled with additional IPTV or Over the Top (OTT) channels, as we do. Partner announced it will be entering the TV market in the first half of 2017, and in 2016, Netflix and Amazon Prime, American internet based VOD content providers, opened their services to viewers in Israel, and are providing a complementary service to the existing competitors' content.

In March 2014, the Israeli Antitrust Commissioner, aiming to facilitate the entry of new competitors to the TV market by reducing entry barriers, published the following requirements as a precondition for the approval of any merger in the Bezeq group: (1) Bezeq to generally not bill ISPs for TV related internet infrastructure services, annul and not engage in any non-original production exclusivity arrangements; and (2) Bezeq / Yes to allow new TV service providers to purchase certain original production of Bezeq for two years from the approval of the merger. The Bezeq –Yes legal merger was completed in 2015.

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 its wholly-owned subsidiary Smile Telecom). 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 2016, our market share in the ILD market is estimated to be approximately 20%, with Bezeq International, Smile Telecom and Hot holding 35%, 24% and 12% market shares, respectively.

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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. The price of an international call is also influenced by the call completion tariff paid to the operator in the call's destination country and increased competition in the destination country leads to a decrease in tariffs for calls to those destinations and thus an increase in the quantity of minutes made to those destinations.

Regulatory changes in the telephony market such as the inclusion of ILD services in unlimited bundles offered by cellular and landline operators, have increased competition further. In addition, in recent years the use of alternative telecommunications 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 at a more moderate pace. This trend together with the offering of ILD services for no additional cost in bundles of cellular and landline telephony services, has resulted in a continual decline in revenues from traditional ILD services. The adoption of proposed changes to ILD regulation, which includes the provision of ILD services by landline operators and cellular operators themselves and not through a separate company, as required today, would increase the competition in the ILD market and may adversely affect our results of operations. See "– Government Regulation – Fixed-line Segment – International long distance calling services" below.

Landline telephony

The Israeli landline telephony market has been dominated for many years by Bezeq, the incumbent landline monopoly, which held as of March 31, 2016 (according to the Ministry of Communications report) approximately 2/3 of the landline telephony market (and an even larger market share in the business landline telephony sector(. Hot, the incumbent TV monopoly, and second entrant to this market, was allowed to bundle its landline service together with its internet infrastructure and its multi-channel television service. Other players include us, Partner-Smile Telecom and Bezeq International.

We offer landline telephony to selected business customers and landline telephony using VOB technology to private customers. Our penetration into the landline telephony business is an important element in our ability to offer comprehensive service packages to our subscribers. 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. As of the date of this report, no wholesale landline telephony services are provided. In December 2015 the Ministry of Communications published a hearing proposing an interim alternative by which operators without infrastructure would be allowed to resell Bezeq's telephony (for tariffs substantially higher than those set for the wholesale service), which still awaits the MOC's resolution. We believe the resale alternative will not result in competition in this field. In January 2016, the Ministry of Communications announced it will not interfere with the tariffs Hot proposes for its wholesale telephony service, but has not yet published maximum tariffs for Hot's wholesale internet infrastructure (and Hot filed a petition against the MOC in February 2017, claiming the MOC is required to hold another hearing prior to setting such maximum tariffs) or other decisions in regards to the technological implementation of the wholesale landline market on Hot's infrastructure. For details see "– Government Regulation – Fixed-line Segment – Wholesale landline market".

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A wholesale landline telephony services market and the IBC's infrastructure, if and when made effectively available, will enhance our ability to compete and allow us (as well as our competitors) to provide a wider selection of services at competitive prices, specifically in relation to residential landline services, which is currently immaterial. See also “Item 3. Key Information – D. Risk Factors – Risks Related to our Business – We face intense competition in all aspects of our business” and "– Government Regulations – 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 2016 the competition in these fields of operation intensified following HOT's and Partner's offerings, and the usage of bandwidth of transmission increased.

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 100 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. The Ministry of Communications has broad supervisory powers in connection with the operations of license holders and is authorized, among other things, to impose financial penalties for violations of the Communications Law, the regulations and our licenses.

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:

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- 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 DIC (or a transferee or transferees approved by the Ministry of Communications), in its capacity as our founding shareholder, holds, directly or indirectly, less than 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); if our founding shareholders who are Israeli citizens and residents hold, directly or indirectly, less than 5% of our means of control (DIC, as founding shareholder, has undertaken to comply with this condition as of July 2017); if at least 10% of our directors are not appointed by Israeli citizens and residents from among our founding shareholders or if less than a majority of our directors are Israeli citizens and residents; if any of our managers or directors is convicted of a crime of moral turpitude and continues to serve; if we commit an act or omission that adversely affects or limits competition in the cellular communications market; or if we and our 10% or greater shareholders fail to maintain combined shareholders’ equity of at least $200 million;

- 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 to transfer any of our means of control if as a result of such transfer, control over our company will be transferred from one party to another, 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;

- 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, for any of the foregoing to serve as an office holder of one of our competitors, subject to certain exceptions requiring the prior approval of the Ministry of Communications;

- we, our office holders and our interested parties, may not be parties to any arrangement whatsoever with Bezeq or another cellular operator that is intended or is likely to restrict or harm competition in the field of cellular services, cellular handsets or other cellular services. For the purpose of the license, an “interested party” is defined as a 5% or greater holder of any means of control;

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- 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. For example, our Board of Directors is required to appoint a committee to deal with matters concerning state security whose members must have the requisite security clearance by Israel's General Security Services. 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;

- 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, in order to enable subscribers of all operators to communicate with one another, and are also required to provide national roaming services to new UMTS operators;

- we may not give preference in providing infrastructure services to a license holder that is an affiliated company over other license holders, whether in payment for services, conditions or availability of services or in any other manner, other than in specific circumstances and subject to the approval of the Ministry of Communications;

- there are certain general types of payments that we may collect from our subscribers, certain procedure for 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, establishing call centers, maintaining a certain service level (both coverage and performance) of our network, protecting the privacy of subscribers; use a specific format for our agreement with our customers; obtain an explicit request from our subscribers to purchase services, whether by us or by third parties, as a precondition to providing and charging for such services, including specific requirements as to format and a default blockage of the customer's ability to purchase certain services; maintain a specific form of evidence of customers' request to purchase our services as a precondition to charging our customers for those services; and provide certain notifications to customers regarding the services ordered and the procedures for handling subscribers' objections as to billing and repayment of overcharged sums;

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- we may not transfer, pledge or encumber the license or any part thereof without the prior approval of the Ministry of Communications, and face restrictions on the sale, lease or pledge of any assets used for implementing the license;

- 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 a business continuity plan and a disaster recovery plan; and

- network sharing, if approved, is to be carried out in accordance with specific instructions in our license;

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. The Ministry of Communications published criteria to be used for determining the sum of the imposed sanctions, including the impact on the competition, the duration of the violation, the number of subscribers affected, the benefit to the operator from the violation and prior violations. Following the publication of the guidelines, the MOC has substantially increased its supervision activities and imposed monetary sanctions, including on us (in immaterial sums). 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 August 2014, the Ministry of Communications published a hearing regarding roaming services provided to subscribers. The hearing proposes, in order to increase competition and reduce roaming payments by subscribers, among others, to allow other Israeli telecommunication operators, including other cellular operators, mobile virtual network operators, international calls operators and landline operators to offer roaming services to a cellular subscriber of another cellular operator, while abroad, using the subscriber's usual cellular number as well as change the way payments for roaming services are calculated. See additional details under "– Tariff Supervision" below. The effects of the changes proposed vary significantly depending on the alternative adopted. The adoption of some alternatives may have a material adverse effect on our results of operations.

In August 2014, the Ministry of Communications proposed to amend the Israeli Communications Law and set fixed compensation in case of failure to meet response times the Minister of communications proposes to set for telecommunications operators' call centers, as well as a fixed compensation in case a subscriber was wrongfully overcharged (more severe than the existing provision to that effect in the Israeli Consumer Protection Law). We estimate that the proposed changes, if adopted as proposed, would have a material adverse effect on our results of operations.

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In January 2017 our cellular license was amended to include a reduced Israeli holding requirement of 5% of our outstanding share capital and other means of control, effective as of July 2017. Until then, we are not required to have Israeli holdings, subject to certain requirements. The amendment further included the reduction of directors appointed by Israeli citizens and residents from among our founding shareholders to 10% of our directors. For additional details, see “Item 3. Key Information – D. Risk Factors – Risks Related to our Business – There are certain restrictions in our licenses relating to the ownership of our shares. " and "Item 7. Major Shareholders and Related Party Transactions – A. Major Shareholders".

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 December 31, 2017. We expect we will be able to renew this license without undue burden. The provisions of the cellular license described above, including as to its extension, generally apply to this license, subject to certain modifications.

Tariff supervision

Under the Israeli Communications Regulations (Telecommunications and Broadcasting) (Payment for Interconnecting), 2000, interconnect tariffs among landline operators, international call operators and cellular operators are subject to regulation. In September 2010, the regulations were amended to dramatically reduce maximum interconnect tariffs payable to cellular operators, leading to a material decrease in our revenues.

We are prohibited, under the Communications Law, from making any linkage between a cellular services transaction and a handset purchase transaction, including by way of offering airtime rebates or refunds for handsets. This has resulted in decreased sales of handsets by us and increased churn. In November 2013, the MOC instructed the discontinuance of any specific rebates and refunds to customers transferring from other cellular operators.

The Communication Law prevents the collection of early termination fees in plans with a commitment to a predefined period, or early termination fees, in the cellular market as of 2012 (excluding from customers with more than a certain amount of cellular lines or over a certain amount of monthly invoice for bundles or other services) as well as prohibits the collection of the handset's remaining installments in one payment pursuant to early termination. This has led to materially increased churn rate and subscriber acquisition and retention costs and subsequently to accelerated price erosion.

Under the Communications Law, if agreement as to the terms of a hosting service (including the consideration), whether for national roaming of an MNO or hosting of an MVNO have not been reached , the Ministry of Communications with the Minister of Finance may intervene in the terms of the agreement, including by setting the price of the service, in certain circumstances. The Ministry of Communications may further review the reasonability of MVNO hosting agreements, including existing agreements which the MVNO request to update if the existing agreement hinders its ability to compete and the parties fail to reach an agreement as to its update, to be carried out in light of the best offer made by the cellular operator to a business customer. 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" and " - Additional MNOs" below).

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As of January 2013, we are obligated to pay our customers predetermined damages for each discrepancy from the customer's pricing plan, remedied after the customer complained, under the Consumer Protection Law. The damages are in an insignificant amount, but may aggregate to substantial amounts if paid to numerous customers on multiple occasions.

The Communication law authorizes the Minister of Communications to give instructions and to set interconnect tariffs and usage of another operator's network rates and supervised services prices, based not only on previous method of cost (according to a calculation method determined by the Minister of Communications) plus reasonable profit, but also on the basis of one of the following: (1) payment for services provided by a licensee; (2) payment for a comparable service; or (3) comparison to 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.

In August 2014, the Ministry of Communications published a hearing regarding roaming services provided to subscribers. The hearing proposes, in order to increase competition and reduce roaming payments by subscribers, among others, to change the way payments for roaming services are calculated, such as by requiring a 1 second unit or 1 KB unit (as applicable) for billing of roaming services while abroad and not charging for certain intervals of the call. The adoption of such proposed changes may have a material adverse effect on our results of operations.

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. The operation of MVNOs in the Israeli cellular market has contributed to the increased competition.

For the Minister of Communications' authority to intervene in the terms, including tariffs, for hosting an MVNO, see "–Tariff Supervision" above. Unfavorable terms and consideration for the service may result in material adverse effect on our results of operations.

To date the Ministry of Communications has granted eleven MVNO licenses and five MVNOs have entered hosting agreements with cellular operators, without the Ministry of Communication's intervention. Four of them are still active. It is unknown if and when the others will commence operations.

Additional MNOs

Hot Mobile (in September 2011) and Golan (In January 2012) were awarded new UMTS frequencies, following a spectrum tender held by the Ministry of Communications. Under the UMTS tender terms, both Golan's and Hot Mobile's commitment to pay license fees was reduced to NIS 10 million, after reaching 7% market share each, in the private sector. Hot Mobile and Golan were awarded certain additional benefits and leniencies, such as a prolonged timetable for network coverage completion and the right to use national roaming through our, Pelephone or Partner's ' networks. Investing in a 4G Network will, under certain conditions, replace Golan and Hot Mobile's obligation to deploy a UMTS network. For additional details see "– Network Sharing" above.

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Under the Communications Law, existing operators (other than Hot Mobile) are required to provide new UMTS operators and Hot Mobile national roaming services, for a period of seven to ten years (subject to certain conditions). For regulatory intervention in the terms of the national roaming service, including tariffs, in case of inability to reach an agreement, see "– Tariff Supervision" above.

In October 2011, we entered a national roaming agreement with Golan, under which we provide Golan national roaming services (which will be replaced by our network sharing and hosting agreement with Golan (when owned by Electra), when completed. See "– Network and Infrastructure – Cellular Segment – Network sharing agreements"), and Hot Mobile entered a national roaming agreement with Pelephone and later with Partner (which was later replaced by a network sharing agreement by Hot Mobile and Partner). As a result, the Ministry of Communications did not determine the terms for the service.

In May 2012, Golan and Hot Mobile launched their UMTS services, which materially increased competition in the market, increased churn and accelerated price erosion, and have materially adversely affected our results of operations.

In January 2015, the Ministry of Communications completed an 1800MHz frequencies tender, for 4G technologies (such as LTE, LTE Advanced). All existing MNOs and Xfone won bands in the tender. Under the tender terms, Xfone, Golan and Hot Mobile are eligible for up to a 50% discount, 10% for each 1% addition to their market share, obtained over the next 5 years. We were awarded 3MHz for NIS 6.5 million per 1MHz. Pelephone was awarded 15MHz and each of Partner, Golan, Hot Mobile and Xfone was awarded 5MHZ, for NIS 6.4 – 6.9 million per 1MHz.

Network Sharing

In May and July 2014, the Ministry of Communications set certain requirements for the approval of network sharing by the Ministry of Communications, including the following principles: (1) sharing of passive elements of cell sites and active sharing of antennas among all cellular operators are encouraged; (2) active sharing of radio networks using shared equipment and frequencies will be allowed only between an operator with a partial 3G network deployment and an operator with a full 3G network deployment, whereas such sharing will not be allowed for two operators with full 3G network deployment; (3) sharing of transmission from cell sites among operators sharing frequencies is generally allowed; (4) investing in a 4G network will be considered as meeting an operator's undertaking to deploy a 3G network under certain conditions; (5) approval of active sharing of radio networks using shared equipment and frequencies shall be for a limited period, only if there are at least three independent cellular networks in Israel, and is conditioned upon certain conditions, including: (i) the obligation to allow other operators to join on terms similar to the terms granted to the sharing operator with the smallest market share; (ii) the obligation to host a Mobile Virtual Network Operator 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

Ministry of Communications 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.

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For details regarding our network sharing and hosting agreement with Xfone and Golan (after Golan shall be owned by Electra) pending regulatory approvals see "– Network and Infrastructure – Cellular Segment – Network sharing agreements". Hot's and Partner's network sharing agreement was approved and the two began a joint operation through a joint subsidiary.

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. The construction of radio access devices, which are cell sites of smaller dimensions, is further regulated 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

National Zoning Plan 36, or 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. Many local authorities have argued that a building permit issued in reliance on the Plan requires the payment of amelioration charge. In 2013 this position was adopted in principle by an appeal zoning committee. However, in 2014 a district court rejected such claim in relation to another national zoning plan, and the decision was appealed and awaits the Supreme Court's decision. Should the matter be decided against us in appeal zoning committees or by a court of law, the costs of constructing a site will substantially increase.

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Proposed changes to the Plan, adding additional restrictions and requirements on the construction and operation of cell sites, were approved by the National Council for Planning and Building in 2010 and submitted for the approval of the Government of Israel. If the proposed changes are approved by the Israeli Government, they 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. Violations of the Planning and Building Law are criminal in nature. The Planning and Building Law contains enforcement provisions to ensure the removal of unlawful sites. There have been instances in which we received demolition orders or in which we and certain of our directors, officers and employees faced criminal charges in connection with cell sites constructed and/or used without the relevant permits or not in accordance with the permits. In most of these cases, we were successful in preventing or delaying the demolition of these sites, through arrangements with the local municipalities or planning and building authorities for obtaining the permit, or in other cases, by relocating to alternate sites. As of December 31, 2016, we were subject to four 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 in the process of 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 opinion on the matter (given in May 2008) 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.

Notwithstanding the Attorney General's opinion, in May 2008 the District Court of Tel-Aviv-Jaffa, in its capacity as court of appeals, ruled that our and other cellular operators’ devices do not meet the exemption’s requirements and therefore cannot be relied upon by us and other cellular operators. We and other cellular operators appealed against this ruling to the Supreme Court and the State notified the Supreme Court it concurs with our and another cellular operator’s appeals against the District Court ruling. The Supreme Court decided to hear our appeal together with two appeals filed in 2008 and 2009, including by the Union of Local Authorities in Israel and certain local planning and building authorities, requesting to argue against the position of the State.

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However, in September 2009, following publication of an inter-ministry committee established to examine the appropriateness of future application of the exemption according to the Attorney General opinion, the Attorney General concluded that the application of the exemption does not balance properly the different interests involved and therefore cannot continue and at its 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. Hot Mobile and Golan are allowed to construct radio access devices in reliance on the exemption, under certain limitations. Certain relaxation to the prohibition, allowing the replacement of radio access devices under certain conditions, was approved by the Court with the Attorney General's approval, in March 2016. Further, in 2017 the state notified the Supreme Court that the Ministry of Finance approved and is in the process of deliberations with other regulators on draft regulations setting procedures for making changes in existing radio access devices including replacement thereof and for the construction of a limited number of new radio access devices exempt from building permits, but requiring certain municipal procedures. We cannot estimate what will be the final version of the regulations will be and whether they would alleviate or further burden the current procedures for making changes and constructing new radio access devices. If the regulations are enacted and final regulations include significant limitations on the ability to make changes to and construct radio access devices based on such exemption, it may adversely affect our existing networks and our networks' build-out. We are awaiting the Court's decision regarding the appeals.

Additionally, in November 2008 and again in October 2014, the District Court, in its capacity as court of appeals, ruled that the exemption does not apply to radio access devices, if the rooftop on which those devices are located is at the same level as a place of residence or other building that is regularly frequented by people. Other appeals relating to the exemption, including as to the requirement to obtain an extraordinary usage permit in certain circumstances, are still under consideration, as well as other claims asserting that those cell sites and other facilities do not meet other legal requirements continue.

An annulment of, or 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, 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. Since October 2007, the Commissioner of Environmental Radiation at the Ministry of Environmental Protection took the position that he will not grant and/or renew operating permits to radio access devices, where the local planning and building committee’s engineer objected to the Company's reliance upon this exemption for radio access devices. We believe that in taking this position, the Commissioner is acting beyond his powers.

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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. 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. Since 2002, following the approval of the Plan, building permits for the Company's cell sites (where required) have been issued in reliance on the Plan. The proposed draft amendment to the Plan covers all new cell sites requiring a building permit, independently of the frequencies in which they operate. Most of our cell sites and many cell sites operated by other operators, also operate in frequencies not specifically detailed in the Plan. The frequencies allocated in the 2011 UMTS tender to Hot Mobile and Golan as well as the frequencies awarded under the January 2015 4G frequencies tender, are also not 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, it would have a negative impact on our ability to deploy additional cell sites (until such time as the Plan is amended to include all cellular 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 (including those already installed) requires a building permit, we will perform cost-benefit analyses to determine whether to apply for permits for existing repeaters or to remove them and whether to apply for permits for new repeaters or femto-cells.

In addition, we construct and operate microwave sites as part of our transmission network. The various types of microwave sites receive permits from the Ministry of Environmental Protection in respect of their radiation level. Based on advice received from our legal advisors, we believe that building permits are not required for the installation of these 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.

In May 2012, the positions of the Ministries of Communications, Health and Environmental Protection in relation to the various aspects of the provision of 4G services in Israel were published. The Ministries held the position that 4G services would involve some increase in the level of non-ionizing radiation the public will be exposed to and that in order to minimize such increase 4G deployment should, among others, be based on current cell sites, additional outdoor and indoor small cell sites and, whenever possible, use wireline infrastructure so that data traffic shall be carried mostly through wirelines and not cellular infrastructure. The Ministry of Environmental Protection stated that full deployment of 4G infrastructure, under the guidelines set by the ministries shall decrease the level of exposure from handsets and create a more balanced level of exposure from cell sites, and in any case much lower than the maximum exposure levels recommended by the international health organization and required under the environmental permits for cell sites in Israel. In August 2014, the Ministry of Communications allowed the provision of 4G services and in January 2015, 4G frequencies were awarded to the cellular operators. The abovementioned recommendations were not included in the approval or tender documents. See "– Construction and operating permits from the commissioner of environmental radiation" below for additional details.

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 under Section 197 of the Planning and Building Law, as a condition for issuing a building permit for a cell site. Section 197 establishes that a property owner whose property value has been depreciated as a result of the approval of a building plan that applies to his property or neighboring properties may be entitled to compensation from the local building and planning committee. 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 National Zoning Plan 36 for a cell site 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 410 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, and as of December 31, 2016, we are a party to one depreciation claims for immaterial amounts. 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, should we determine that the risks associated with providing such indemnification letters outweigh the benefits derived from constructing such cell sites, which could impair the quality of our service in the affected areas.

Construction and operating permits from the commissioner of environmental radiation

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Under the Non-Ionizing Radiation Law, it is prohibited to construct and operate cell sites without a permit from the Ministry of Environmental Protection. The Commissioner of Environmental Radiation is authorized to issue two types of permits: construction permits, for cell site construction; and operating permits, for cell site operation.

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. Some repeaters require specific permits and we receive such permits, and others require general permits from the Commissioner in respect of their radiation level, and we ensure that each repeater functions within the parameters of its applicable general permit.

Pursuant to the Non-Ionizing Radiation Law, the construction and operation of cell sites and other facilities requires the prior approval of the Commissioner. The validity of a construction permit will be for a period not exceeding three months, unless otherwise extended by the Commissioner, and the validity of an operating permit will be for a period of five years and we are required to submit to the Commissioner annual reports regarding radiation surveys conducted on our cell sites and other facilities by third parties that were authorized to conduct such surveys by the Commissioner. An applicant must first receive a construction permit from the Commissioner and only then may the applicant receive a building permit from the planning and building committee. In order to receive an operating permit from the Commissioner, certain conditions must be met, such as presenting a building permit or an exemption and means taken (including technological means) to limit exposure levels from each cell site or facility (relevant also for the receipt of a construction permit). Cellular operators are required to provide the Commissioner with online, ongoing data regarding the radiation level on each of the cell sites and other facilities operated by each cellular operator, satisfied by a monitoring system supplied by the Commissioner and installed at the operator's premises. 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, documentation and reporting requirements, and provisions for supervision of cell site and other facility operation. The Non-Ionizing Radiation Law 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.

Several bills have been submitted in the past aiming to impose additional restrictions on the grant of permits under the Non-Ionizing Radiation Law and the Planning and Building Law. Any amendment to these laws 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.

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Handsets

The Israeli Consumer Protection Regulations (Information Regarding Non-Ionizing Radiation from Cellular Telephones), 2002, regulate the maximum permitted level of non-ionizing radiation from handset that emit non-ionizing radiation, according to the European standard, for testing GSM devices, and the American standard, for testing TDMA and CDMA devices. 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.

We obtain type-approval from the Ministry of Communications for part of the handset models we import and for other models we inform the MOC and receive the MOC's approval for their import. 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 are required to provide a warranty for certain end user equipment purchased from us, for certain malfunctions during the first year, and are required to provide repair services for two years and in certain cases, for three years. We are also required to annul equipment sale in certain circumstances, at the request of the customer.

Royalties

Under the Communications Law, the Israeli Communications Regulations (Royalties), 2001, and the terms of our general license, we are required to pay the State of Israel royalties equal to a certain percentage of our revenues generated from telecommunications services, less payments transferred to other license holders for interconnect fees or roaming services and losses from bad debt. No royalties were due for sale of handsets. Since 2013, that percentage was 0%.

Frequency fees

Frequency allocations for our cellular services are governed by the Wireless Telegraph Ordinance. We pay frequency fees to the State of Israel in accordance with the Israeli Wireless Telegraph Regulations (Licenses, Certificates and Fees), 1987.

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Fixed-line Segment

Our Fixed-line Licenses

Our Unified licenses

The establishment and operation of fixed-line communications networks, and allocation of spectrum if relevant, requires a license pursuant to the Communications Law and the Wireless Telegraph Ordinance (New Version), 1972.

In July 2015 our wholly-owned subsidiaries were granted three non-exclusive unified general licenses, allowing the provision of landline telephone, ILD and ISP services as well as a "network end point" services (replacing our former special general licenses for the provision of landline communications services, the general license for the provision of international telecommunication services, special licenses for the provision of ISP services and "network end point", i.e. installation and maintenance of telecommunication equipment at a customer's or the licensee's premises). The licenses expire in /20252026 but may be extended by the Ministry of Communications for successive periods of 10 years. We have deposited a bank guarantee in the amount of NIS 2 million with the Ministry of Communications upon receiving each of the licenses. 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).

The unified license allows its holder to provide any of the aforementioned services as well as MVNO services, subject to the inclusion of a relevant appendix in the unified license and it is intended to alleviate the requirements on license holders that are not required to have a nationwide infrastructure, in order to decrease entry barriers for additional competitors to enter those markets. Internet infrastructure services are provided under the unified license as well.

Our unified licenses are to be unified into one unified license. The unification process of our unified licenses into one license and its timing is yet to be determined in coordination between the Ministry of communications and the operator and may have various legal, financial, tax and accounting implications on our operations to the extent it would require the transfer of assets, goodwill, rights and obligations among the companies in our group or require an operational unification. The provision of several services by one entity may also circumvent the limitations on discrimination between operators.

ISP License

Internet Rimon, our subsidiary, holds a special license for the provision of ISP services. The license is valid through November 2017. The provisions of our cellular license, including as to its extension, generally apply to the ISP license, subject to certain modifications.

Services in Judea and Samaria

The Israeli Civil Administration in Judea and Samaria granted us non-exclusive licenses for the provision of ISP, ILD, landline and 'network end point' services to the Israeli-populated areas in Judea and Samaria. These license are effective until 2025/2026. The provisions of the cellular license described above, including as to its extension, generally apply to these licenses, subject to certain modifications.

Data and transmission services

In 2000, we were granted a non-exclusive special license for the provision of local data communications services and high-speed transmission services only to one of our wholly owned subsidiaries, which is effective until December 2017. Data and transmission services are being provided to our customers through our wholly-owned subsidiary Cellcom Fixed Line. The provisions of our general and general specific licenses described above, including as to their extension, generally apply to this license, subject to certain modifications.

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

In May 2012, the Israeli Minister of Communications published a policy document regarding landline wholesale services, which mainly provided for: (1) the creation of an effective wholesale telecommunications access market in Israel, as Bezeq and Hot will allow other operators that do not own an infrastructure, to use their infrastructure in order to provide services to end users; (2) 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, generally depending on the development of a wholesale market and the state of competition in the market, and with relation to television broadcasting 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 November 2014, the Minister of Communications amended Bezeq's and Hot's Communications' licenses so as to include certain wholesale landline services, such as internet infrastructure services and wholesale landline telephony services, and the terms for the provision of such services (within 3-6 months from the date of that decision) as well as promulgated regulations setting the maximum tariffs of the wholesale landline services to be provided by Bezeq. In November 2014, the Ministry of Communications further published a hearing 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.

In January 2015, the Ministry of Communications further amended Bezeq and Hot's licenses to include additional landline services, such as the use of certain of their physical infrastructure by operators who do not own such infrastructure, and the terms for their provision, as of August 2015.

In February 2015, the wholesale landline market was formally launched in Israel (through non-automated operation) in regards to internet infrastructure services and in May 2015 the automated stage of the wholesale landline market was effected in regards to internet infrastructure services. Landline telephony service, which was to be provided as of May 2015, has not been provided yet and in December 2015, the Ministry of Communications published a hearing for an alternative temporary one year resale telephony service, at substantially higher tariffs than those set for the telephony wholesale service. We believe that a resale telephony service is not a viable alternative and that its adoption will harm the competition in the landline market and have therefore objected to its adoption. Further, Although the wholesale market was formally applicable to Hot's infrastructure as well, Hot's infrastructure has been effectively excluded from the wholesale market and in January 2016, the Ministry of Communications published a hearing proposing to set maximum tariffs for Hot's wholesale internet infrastructure services and noting it will not interfere with the tariffs Hot has set for its wholesale telephony service but since then has not published maximum tariffs for Hot's wholesale internet infrastructure (and Hot filed a petition against the MOC in February 2017, claiming the MOC is required to hold another hearing prior to setting such maximum tariffs), nor has the MOC published other decisions in regards to the technological implementation of the wholesale landline market on Hot's infrastructure yet. Effective inclusion of Hot's infrastructure in the wholesale market may increase the potential subscribers to our triple play and bundle offerings.

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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 Israeli Arrangements Law for2017-2018 amended the Communications Law applying 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 whose terms are set by the regulator) will be negotiated by the parties. However, until October 2017, such requirement will not apply to a unified license landline operator's infrastructure (including us and Partner), nor will IBC, Hot or Bezeq be able to use each other's infrastructure. For changes to the Israeli Communication law, extending the Minister of Communications' authority to give instructions and set interconnect tariffs, usage of another operator's network rates and supervised services prices, and give instructions in relation to structural separation, see "–Government Regulation – Cellular Segment - Tariff supervision" above.

OTT TV

Television services over the Internet are currently not regulated in Israel. In July 2015, a committee nominated by the Ministry of Communications in order to examine, among other things, the regulatory principles and rules that should apply to both television broadcasting over the internet and the incumbents' TV service over cables and via satellite, submitted its recommendations.

In June 2016, a second advisory committee for the regulation of broadcasting nominated by the Ministry of Communications in October 2015, published its final recommendations, including: (1) classification of the audio visual providers in the market (defined as a provider that mainly directs its content to the Israeli public through any electronic means (technological neutrality)) into three categories and determination of the regulation applied to each class as follows: (i) a "small audio visual provider" (i.e. holds more than 10% market share) shall be subject to narrow regulation involving a mandatory license that shall include certain limitations ,such as, in relation to content, cross ownership and a choice of financing between subscription fees or advertisements; (ii) a "small and stable audio visual provider" (i.e. holds more than 10% market share for 3 consecutive years) shall be subject to the said narrow regulation in addition to a wide regulation which shall include mandatory investments in original Israeli content financing; (iii) a "material provider" (i.e. holds more than 20% market share) shall be subject to the said narrow and wide regulation and (iv) an audio visual provider who holds less than 10% market share shall be allowed to adopt a self-regulation; (2) setting a "must sell" obligation in regards to certain sport channels and sport leagues and Israeli original content productions (the latter after 3 years from initial broadcasting) to audio visual providers which hold a license and are subject to at least the narrow regulation to purchase; (3) changes to the basic narrow package HOT and YES must offer; and (4) regulation of advertising and commercial content.

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In March 2017, the Ministry of Communications adopted most of the above recommendations of the second committee and some remain under advisement. The implementation of such recommendations is subject to the adoption thereof by legislation. If the legislation adopted require 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.

In December 2016, the Israeli Arrangements Law for 2017-2018 amended the applicable law's provisions regarding the operation of the DTT infrastructure (currently operated by a statutory television authority), requiring the state to hold a tender for the operation of the DTT infrastructure, in which Bezeq, Hot and the existing commercial channels will not be permitted to participate, and setting a mandatory internet based broadcasting of DTT channels in the future.

See also "– Competition – Fixed-line Segment – Television services" above.

International long distance calling services

In October 2013, the Ministry of Communications published a hearing regarding a change to the ILD services regulation, which proposes, among other things: to annul the current limitation preventing landline and cellular operators from providing ILD services themselves (rather than through a separate corporation), which if adopted and applied to the Bezeq and Hot groups as well, would result in the annulment of the structural limitations currently imposed on them, in relation to the ILD services; that holders of a special license for the provision of ILD services will not be obligated to provide service to anyone so requesting nor to all the countries in the world; and to annul the restrictions on the cooperation between cellular and ILD operators in relation to prepaid calling cards. In February 2015, a second hearing proposing certain alternatives to the abovementioned proposed changes, to be applied to the Bezeq and Hot groups during an interim period ending upon annulment of structural separation, was published. The adoption of such changes would increase the competition in the ILD market even further and may adversely affect our results of operations.

The Communications Law prevents us from collecting early termination fees in the ILD and the landline telephony markets (excluding from customers with over a certain amount of monthly invoice for bundles or other services) since 2011. This has led to an increase in competition, churn rates and rate of gross recruitment of subscribers and price erosion.

Emergency situations

We may be subject to certain restrictions and instructions regarding our activities or provision of services during national emergencies or for reasons of national security or public welfare, which may increase our liability, including taking control of our cellular or landline networks. Further, the Prime Minister and the Ministry of Communications may determine that our services are deemed essential services, in which case we may be subject to further additional limitations on our business operations.

Reporting requirements

We are subject to extensive reporting requirements. We are required to report to the Ministry of Communications the transfer of means of control from certain thresholds and changes of office holders, as well as to provide reports relating to our ongoing operation and services. We are required to submit to the Ministry of Communications detailed annual reports with information concerning subscribers, revenues by service, the number of new subscribers and churn, network performance, annual financial statements and prior notice of tariff increases. In addition, under our license we may be required by the Ministry of Communications to file additional reports, such as reports on complaints, pricing, specific costs and revenues, network problems and the development of the network. We are required to provide the Commissioner of Environmental Radiation under the Non-Ionizing Radiation Law and regulations with periodic and online, ongoing data of all cell sites operated by us.

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. Since the commencement of operations by the Israeli Securities Law Administrative Enforcement Committee, significant monetary sanctions, ranging up to several million NIS in individual cases, have been imposed 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 2016, 25% of our employees participated in volunteering activities in the community. In the 2016, after 12 years of contribution through our 28 "Cellcom Volume" youth centers initiative, we decided to shift our contribution to an association supporting ALS patients and family members. In that framework, we partnered with the association in various voluntary activities, including our employees' participation in a fundraising race for ALS patients and donation of approximately NIS 0.2 million 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. Accordingly, while providing quality products and services to our subscribers, 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 improve our performance, strive to achieve an efficient deployment of infrastructure subject to the applicable standards, and cooperate with the local authorities. We constantly monitor our environmental performance and aim to reduce our ecological footprint, through activities such as recycling of electronic components and packages, reduction of paper usage by managed printing, reduction of pollutants' emissions and energy usage as well as activities aimed at allowing our subscribers to better protect the environment, such as collecting used batteries, sending subscribers their monthly bill for our services and other correspondence from us via e-mail and as of 2014, also by SMS, in lieu of regular mail, transfer to usage of environment friendly raw materials and separation between different types of waste in our repair services and since 2014 are purchasing electricity produced by a private natural gas based power station.

C. ORGANIZATIONAL STRUCTURE

The IDB Group

Our largest shareholder, DIC, is a majority-owned subsidiary of IDB, one of Israel's largest business groups. IDB's debentures are traded on the Tel Aviv Stock Exchange and DIC is a public Israeli company traded on the Tel Aviv Stock Exchange. See "Item 3. Key Information – D. Risk Factors – We are a member of the IDB group of companies, a large and highly regulated Israeli business groups, which may limit our ability to expand our business, to acquire other businesses or raise debt. The effects on us of IDB's financial condition are unclear" for details regarding IDB's financial situation and the footnote to the table under "Item 7.A – Major Shareholders" for information on the holdings in IDB.

We and 013 Netvision, our wholly-owned indirect company, are incorporated in Israel. 013 Netvision is our only significant subsidiary.

D. PROPERTY, PLANT AND EQUIPMENT

Headquarters

In August 2003, we entered into a long-term 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 sublease 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 October 2010, we entered into a long-term agreement for the enlargement of our techno-logistic center, including our new central laboratory, in Netanya, Israel, and the lease thereof. 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 January 2015, we sublease approximately 1,100 square meters of the leased property, for a period of five years and following our decision to transfer the central laboratory to our headquarters, in 2016 we sublease additional approximately 5,000 square meters of the leased property, for a period of 6 years. The sub-lessees have an option to renew the leases for an additional period subject to certain conditions.

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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. Until December 2011, this space was used as a headquarters for Netvision. The Haifa lease covers approximately 8,900 square meters, is in effect until December 2019, may be terminated by us in December 2018 subject to prior notice, 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 2017 and is renewable for five 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 Ashdod Energy Ltd. (subsequently assigned to 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 as amended in July 2012, 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, 2016, we leased 78 service centers, points of sale and other facilities (including those operated by our wholly-owned dealer), which are used for marketing, sales and customer service. Lease agreements for our retail stores and service centers 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 varies and ranges, in most cases, from two to five years, with an option to extend the lease for successive similar periods. The lease agreements also differ from each other in aspects such as payment terms 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.

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

Authorization Agreement with Land Regulatory Authorities

In June 2013, we renewed an authorization agreement with the ILA (which manages the lands of the Development Authority and the Jewish National Fund) that authorizes us to use lands managed by the ILA for the establishment and operation of cell sites. The authorization agreement is effective until 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. In connection with the authorization agreement 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 the event of changes in the designation of the land on which a cell site was erected, in the event that we violate a fundamental condition of the authorization agreement, in the event that the holders of rights in the properties on which we erected cell sites breach the agreements between them and the ILA and in the event that the land on which a cell site was erected is required for public use.

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, which differ in certain respects from U.S. Generally Accepted

Accounting Principles, or U.S. GAAP. Following our adoption of IFRS, as issued by the IASB, we are no longer required to reconcile our financial statements prepared in accordance with IFRS to 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.

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A. OPERATING RESULTS

Overview

General

We are the largest provider of cellular communications services in Israel with approximately 2.801 million cellular subscribers as of December 31, 2016, with an estimated market share of 27.5%, as well as a major ISP and ILD services supplier. In 2015 we also entered the TV market and the internet infrastructure market (through the recently launched landline wholesale market).

We earn revenues and generate our primary sources of cash by offering a broad range of communications services, including cellular, Internet services (ISP and infrastructure) , international calling services (ILD), landline services and OTT TV services.

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 landline market - sales of television services and sales of internet infrastructure services, 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 segment 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, 2016 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.

Our fixed-line segment's services include landline telephony services, internet infrastructure (since May 2015, through the landline wholesale market) and connectivity services, television services (since December 2014), international calling services (ILD) and end user fixed-line equipment. We have an advanced fiber-optic transmission infrastructure of approximately 1,800 kilometers. Together with our complementary microwave-based infrastructure, our fiber-optic infrastructure connects the majority of our cell sites with the remainder connected using supplemental transmission capacity leased from Bezeq, the incumbent landline operator, and Hot. Having our own transmission network enables us to save substantial operating cash lease costs that would be associated with complete reliance on Bezeq's infrastructure, although these savings are partially offset by maintenance costs and microwave spectrum fees. We sell our various services on a stand-alone basis or bundled with certain other services offered by us which as of May 2015 also included triple play bundles of internet infrastructure and ISP, landline telephony and TV services. Entering a new and penetrated market requires substantial investment and additional expenses.

Our management evaluates our performance through focusing on our key performance indicators, which include among others: average revenue per user of cellular and landline subscribers, or ARPU, EBITDA (as defined in "Results of Operations"), EBITDA as percentage of revenues, operating income, net income cash flow, number of cellular, landline ISP, internet infrastructure and OTT TV subscribers or households (both standalone and as a part of a bundle or triple play package), subscriber churn rate, handset sales and profitability and Net Promoter Score, or NPS, (indicating our subscribers' satisfaction with our services). 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. 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 play) and enhancing our competitive capabilities; retaining our existing subscribers; offering new services that are synergetic to our core businesses; growing wireline service revenues; and attracting new subscribers. We intend to continue our efforts to optimize our costs by implementing further efficiency measures, reducing our expenses, including through the network sharing and hosting agreements we entered with Golan and Xfone, and adjusting our operations to the changing market conditions, but cannot guarantee the success of these measures.

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In July 2016, we entered a 4G network sharing and 2G and 3G hosting agreement with Xfone, which was awarded 4G frequencies in the 2015 frequencies tender and has not entered the cellular market yet. Such agreement has been approved by the Israeli Antitrust Commissioner and awaits the approval of the Minister of Communications. We cannot estimate the chances and if so, the timing, of Xfone entering the cellular market. In January 2017 we annulled the 2015 agreement for the purchase of Golan, one of the other four MNO's operating in Israel, after the regulators' refusal to approve it and ongoing litigation with Golan resulting from repeated breaches of their agreements with us. A successful mediation process held following the filing of our petition to liquidate Golan resulted in Golan entering a share purchase agreement with Electra, which simultaneously entered a 3G and 4G network sharing and 2G hosting services agreement with us and the aforementioned annulment of our 2015 purchase agreement of Golan. We cannot estimate the likelihood of the Ministry of Communications' approval of the Xfone network sharing agreement (the Golan network sharing agreement and Electra-Golan share purchase agreement have been already approved by the Antitrust Commissioner and the Ministry of Communications) and completion of such agreements, or the impact of failure to complete such agreements on our ability to collect amounts owed by Golan or to generate future revenues from Golan. A substantial reduction of the future revenues from Golan will have a material adverse effect on our revenues and results of operations.

For details of our network sharing and hosting agreements with Golan and Xfone, see "Item 4. Information on the Company –B. Business Overview – Network and Infrastructure – Cellular Segment – Network sharing agreements". For details of our mediation agreement with Golan, see" Item 4. Information on the Company – A. History and Developments– Our History."

In February 2015, we entered a collective employment agreement with the Company's employees' representatives and the Histadrut for a term of three years (2015-2017). In January 2016, the Histradrut announced a labor dispute at the Company with respect to outsourcing and other employment issues.

The Israeli telecommunications market is currently dominated by four communications groups: Bezeq, Hot, Partner-012 Smile and Cellcom, with the first two having a full landline infrastructure. While an effective wholesale landline market (launched in 2015) enhances our ability to compete and extend our service offering, the annulment of structural/corporate separation imposed on the Bezeq and Hot groups, and Bezeq's tariffs supervision or other favorable regulatory changes relating to the Bezeq and Hot groups, may have a material adverse effect on our competitive capabilities and results of operation.

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The communications market and specifically the cellular industry are primarily regulated by the Ministry of Communications. Regulatory changes have had material adverse effects on our results of operations in recent years. See “Item 4. Information on the Company – B. Business Overview – Government Regulations.” While our pricing is not generally regulated, certain of our rates and pricing mechanisms are subject to regulation. See "Item 4. Information on the Company – B. Business Overview – Government Regulations – Cellular Segment – Tariff Supervision."

Since 2012, our results of operations have been materially adversely affected by regulatory changes, which have also facilitated the entry of additional competitors and dramatically increased competition. Competition may increase further if current trends continue, if our network sharing and hosting agreement with Golan or Golan's share purchase agreement with Electra are not approved by the regulators, if the landline wholesale market, launched in 2015, is ineffective, if the structural separation imposed on the Bezeq and Hot groups is annulled or further relaxed, or if new competitors enter the communications markets. During that period, 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 may be enacted 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 2016, approximately14 % 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 our debentures (excluding Series E, G, I and K) 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.”

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Further, we have incurred significant debt by issuing debentures and receiving loans, the aggregate outstanding principal amount of which as of December 31, 2016 was NIS 4,069 million. See “ – Liquidity and Capital Resources – Debt Service” and "-Other Credit Facilities”.

In February 2006, our Board of Directors adopted a policy to distribute each year at least 75% of our annual net income. In March 2007, our Board resolved to distribute dividends within the boundaries of the February 2006 dividend policy and until resolved otherwise, on a quarterly basis. In respect of 2014, 2015 and 2016, 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 K 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".

Revenues

We derive our revenues in the cellular segment primarily from the sale of cellular network services (such as airtime and data surfing), including hosting services to other operators, handsets and other services, including content and value added services, repair services, and roaming 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. Revenues from airtime are derived from cellular subscribers (our or the hosted operator's subscribers) 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 connectivity and related services (ISP) and internet infrastructure services (through the landline wholesale market, since February 2015), OTT TV services (since December 2014), transmission services, 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. See “– Application of Critical Accounting Policies and Use of Estimates Long-lived assets - depreciation.”

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Selling and marketing expenses

Selling and marketing expenses consist primarily of sales force salaries and commissions, advertising, public relations and promotional expenses. We compensate our sales force through salaries and incentives. 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 plan (in 2014, 2015 and 2016) and capital gains or losses from sale of property, plant and equipment.

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 other expenses, 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, premium 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 26.5% for the 2014 and 2015 tax years, 25% for the 2016 tax year and will be subject to a corporate tax rate of 24% for the 2017 and 23% for the tax years of 2018 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.

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Results of Operations - Comparison of 2014, 2015 and 2016

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

	Year Ended December 31,			Change*	
	2014	2015	2016	2015 vs. 2014	2016 vs. 2015
Cellular subscribers at end of period(1) (in thousands)	2,967	2,835	2,801	(4.4 %)	(1.2 %)
Internet infrastructure - households (end of period) (in thousands) (2)	-	95	163	-	71.6%
TV - households (end of period) (in thousands) (2)	-	63	111	-	76.2%
Churn rate of cellular subscribers(1)(3)	44 %	42 %	42 %	2 pp	-
Average monthly revenue per cellular subscriber (ARPU) (1)(4) (in NIS)	72	65	63	(9.7 %)	(3.1 %)
Operating income (in NIS millions)	662	310	310	(53.2%)	-
Net income (in NIS millions)	354	97	150	(72.6%)	54.6%
EBITDA(5) (in NIS millions)	1,282	872	858	(32.0%)	(1.6 %)
Operating income margin(6)	14.5 %	7.4 %	7.7 %	(7.1 pp)	0.3 pp
EBITDA margin(7)	28.1 %	20.9 %	21.3 %	(7.2 pp)	0.4 pp

* pp denotes percentage points and this measure of change is calculated by subtracting the 2014 measure from the 2015 measure and the 2016 measure from the 2015 measure, respectively.

(1) Cellular subscriber data refers to active subscribers. We use a six-month method of calculating our cellular subscriber base, which means that we deduct subscribers from our subscriber base after six months of no revenue generation and activity on our network by or in relation to the post-paid subscriber, no revenue generating calls or SMS for pre-paid subscriber 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.

(2) TV and Internet Infrastructure subscribers (households) refer to active subscribers.

(3) 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.

(4) 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 services are included even though the number of subscribers in the equation does not include the users of those roaming and hosting services. Inbound roaming services and hosting 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.

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

	Year Ended December 31,		
	2014	2015	2016
	(In NIS millions, except number of subscribers and months)		
Revenues	4,570	4,180	4,027
less revenues from equipment sales	1,005	1,048	994
less other revenues*	941	869	881
Revenues used in ARPU calculation (in NIS millions)	2,624	2,263	2,152
Average number of subscribers	3,034,946		