

PARTNER COMMUNICATIONS CO LTD

Form 20-F

March 10, 2014

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

As filed with the Securities and Exchange Commission on March 10, 2014

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

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2013

OR

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

For the transition period from _____ to _____

OR

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

Date of event requiring this shell company report _____

Commission file number 1-14968

PARTNER COMMUNICATIONS COMPANY LTD.

(Exact Name of Registrant as Specified in its Charter)

ISRAEL

(Jurisdiction of Incorporation or Organization)

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

ISRAEL

(Address of Principal Executive Offices)

Roly Klinger

ExecutiveOffices@orange.co.il

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

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

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

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

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

NONE

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

NONE

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

ORDINARY SHARES OF NIS 0.01 EACH 155,687,002

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

YES NO

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

YES NO

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

YES NO

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

YES NO

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

U.S. GAAP

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

Other

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

ITEM 17

ITEM 18

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

YES

NO

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INTRODUCTION

As used herein, references to “we,” “our,” “us,” the “Group,” “Partner” or the “Company” are references to Partner Communications Company Ltd. and its wholly-owned subsidiaries, Partner Future Communications 2000 Ltd., Partner Land-Line Communications Solutions LLP, Partner Business Communications Solutions LLP (of which Partner Future Communications 2000 Ltd. serves as the general partner and the Company serves as the limited partner), and, as of March 3, 2011 (the date of acquisition), 012 Smile Telecom Ltd., except as the context otherwise requires. In addition, references to our “financial statements” are to our consolidated financial statements, unless the context requires otherwise.

The Company provides telecommunications services in the following two segments: (1) cellular telecommunications services (“Cellular Services”) and (2) fixed-line communication services (“Fixed-Line Services”), which include: (a) Internet services (“ISP”) that provide access to the internet as well as home WiFi networks, including Value Added Services (“VAS”) such as anti virus and anti spam filtering; and fixed-line voice communication services provided through Voice Over Broadband (“VOB”); (b) Transmission services and Primary Rate Interface (“PRI”); (c) International Long Distance services (“ILD”); outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services. The cellular segment and the fixed-line segment also include operations of equipment selling: mainly handsets, phones, modems, data cards, domestic routers and related equipment. Unless the context indicates otherwise, expressions such as “our business,” “Partner’s business” and “the Company’s business” or “industry” refer to both Cellular and Fixed-Line Services.

In this document, references to “\$,” “US\$,” “US dollars,” “USD” and “dollars” are to United States dollars, and references to “NIS” and “shekels” are to New Israeli Shekels. We maintain our financial books and records in shekels. This annual report contains translations of NIS amounts into US dollars at specified rates solely for the convenience of the reader. No representation is made that the amounts referred to in this annual report as convenience translations could have been or could be converted from NIS into US dollars at these rates, at any particular rate or at all. The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the exchange rate on December 31, 2013, of NIS 3.471= US\$1.00 as published by the Bank of Israel, unless otherwise specified. See “Item 3A. Key Information – Selected Financial Data – Exchange Rate Data”.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

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

FORWARD-LOOKING STATEMENTS

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

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

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

3A. Selected Financial Data

Our consolidated financial statements for the years ended December 31, 2009, 2010, 2011, 2012 and 2013, have been prepared in accordance with the International Financial Reporting Standards (“IFRS”) published by the International Accounting Standards Board (“IASB”).

The tables below at and for the years ended December 31, 2009, 2010, 2011, 2012 and 2013, set forth selected consolidated financial data under IFRS. The selected financial information is derived from our consolidated financial statements, which have been audited by Kesselman & Kesselman, our independent registered public accounting firm in Israel and a member of PricewaterhouseCoopers International Limited. The audited consolidated financial statements at December 31, 2012 and 2013 and for the years ended December 31, 2011, 2012 and 2013, appear at the end of this report.

	Year ended December 31,					2013
	2009	2010	2011	2012	2013	2013
	New Israeli Shekels in millions					US\$ in
	(except per share data)					millions (1)
Consolidated Statement of Income Data						
Revenues	6,079	6,674	6,998	5,572	4,519	1,302
Cost of revenues	3,770	4,093	4,978	4,031	3,510	1,011
Gross profit	2,309	2,581	2,020	1,541	1,009	291
Selling and marketing expenses	387	479	711	551	462	133
General and administrative expenses	290	306	291	236	217	63
Impairment of goodwill			87			
Other income, net	69	64	105	111	79	23
Operating profit	1,701	1,860	1,036	865	409	118
Finance income	22	22	33	21	29	8
Finance expenses	198	203	327	255	240	69
Finance costs, net	176	181	294	234	211	61

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Profit before income tax	1,525	1,679	742	631	198	57
Income tax expenses	384	436	299	153	63	18
Profit for the year	1,141	1,243	443	478	135	39
Earnings per ordinary share and per ADS						
Basic:	7.42	8.03	2.85	3.07	0.87	0.25
Diluted	7.37	7.95	2.84	3.07	0.86	0.25
Weighted average number of shares outstanding (in thousands)						
Basic:	153,809	154,866	155,542	155,646	155,687	155,687
Diluted:	154,817	156,296	155,779	155,773	156,199	156,199

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	2009	2010	Year ended December 31, 2011 2012		2013	2013
			New Israeli Shekels in millions (except per share data)			US\$ in millions (1)
Other Financial Data						
Capital expenditures (2)	522	435	468	558	413	119
Adjusted EBITDA (3)	2,304	2,570	2,178	1,602	1,114	321
Dividend per share (4)	6.86	7.85	2.25	1.03	—	—
Capital reduction	—	9.04	—	—	—	—
Statement of Cash Flow Data						
Net cash provided by operating activities	1,753	1,958	1,570	1,705	1,539	443
Net cash used in investing activities	(732)	(486)	(1,085)	(471)	(498)	(143)
Net cash used in financing activities	(876)	(1,480)	(274)	(1,218)	(1,108)	(319)
Balance Sheet Data (at year end)						
Current assets	1,807	1,830	2,308	2,120	1,703	490
Non current assets	3,816	3,797	4,779	4,297	3,784	1,090
Advance payment in respect of the acquisition of 012 smile	—	30	—	—	—	—
Property and equipment	2,064	2,058	2,051	1,990	1,791	516
License and other intangible assets	1,260	1,077	1,290	1,217	1,167	336
Goodwill	—	—	407	407	407	117
Deferred income tax asset	14	—	30	36	12	4
Total assets	5,623	5,627	7,087	6,417	5,487	1,580
Current liabilities (5)	1,915	1,826	1,889	1,525	1,374	395

Long-term liabilities (5)	1,746	3,175	4,773	4,151	3,239	933
Total liabilities	3,661	5,001	6,662	5,676	4,613	1,328
Shareholders' equity	1,962	626	425	741	874	252
Total liabilities and shareholders' equity	5,623	5,627	7,087	6,417	5,487	1,580

- (1) The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the exchange rate on December 31, 2013, of NIS 3.471 = US\$1.00 as published by the Bank of Israel, unless otherwise specified. See “Item 3A. Key Information – Selected Financial Data – Exchange Rate Data”.
- (2) Capital Expenditures represent additions to property and equipment and computer software.
- (3) Adjusted EBITDA as reviewed by the Chief Operating Decision Maker (“CODM”) represents earnings before interest (finance costs, net), taxes, depreciation, amortization (including amortization of intangible assets, deferred expenses-right of use, and share based compensation expenses) and impairment charges, as a measure of operating profit. Adjusted EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. Adjusted EBITDA may not be indicative of the Company’s historic operating results nor is it meant to be predictive of potential future results. We use the term “Adjusted EBITDA” to highlight the fact that amortization includes amortization of deferred expenses – right of use and employee share-based compensation expenses; it is fully comparable to EBITDA information which has been previously provided for prior periods.
- (4) The dividend per share was calculated in respect of the period for which it was announced. For the year ended December 31, 2013, no dividend has been declared by the Company. During 2012, the Company declared a dividend in the amount of approximately NIS 160 million (US\$ 43 million), or NIS 1.03 per share. The aggregate total dividend for 2011 was NIS 350 million or NIS 2.25 per share.
- (5) See Notes 15 and 16 to the consolidated financial statements for information regarding long-term liabilities and current maturities of long-term bank loans and notes payable.

The tables below at and for the years ended December 31, 2009, 2010, 2011, 2012 and 2013, set forth a reconciliation between operating cash flow and Adjusted EBITDA.

	Year ended December 31,					US \$ in millions (1)
	2009	2010	2011	2012	2013	
	New Israeli Shekels in millions					
Reconciliation Between Operating Cash flow and Adjusted EBITDA						
Net cash provided by operating activities	1,753	1,958	1,570	1,705	1,539	443
Liability for employee rights upon retirement	(1)	(8)	26	12	14	4
Accrued interest, exchange and linkage differences on long-term liabilities	(167)	(160)	(289)	(222)	(213)	(62)
Increase (Decrease) in accounts receivable and assets:						
Trade	229	214	190	(467)	(566)	(163)
Other (*)	16	34	2	16	2	1
Inventories	33	(57)	58	(65)	(5)	(1)
Decrease (Increase) in accounts payable and accruals:						
Trade	(43)	40	37	106	114	33
Parent group-trade	17	(38)	(70)	72		
Other (*)	(43)	(15)	54	65	17	5
Decrease (Increase) in asset retirement obligation	1	(1)	(1)	(1)	(1)	***
Income tax paid	339	426	311	153	9	3
Finance costs, net (**)	170	177	290	228	204	58
Adjusted EBITDA (2)	2,304	2,570	2,178	1,602	1,114	321

- (1) The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the exchange rate on December 31, 2013, of NIS 3.471 = US\$1.00 as published by the Bank of Israel, unless otherwise specified. See “Item 3A. Key Information – Selected Financial Data – Exchange Rate Data”.
- (2) Adjusted EBITDA as reviewed by the Chief Operating Decision Maker (“CODM”) represents earnings before interest (finance costs, net), taxes, depreciation, amortization (including amortization of intangible assets, deferred expenses-right of use, and share- based compensation expenses) and impairment charges, as a measure of segment profit. Adjusted EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. Adjusted EBITDA may not be indicative of the Company’s historic operating results nor is it meant to be predictive of potential future results. We use the term “Adjusted EBITDA” to highlight the fact that amortization includes amortization of deferred expenses – right of use and employee share-based compensation expenses; it is fully comparable to EBITDA information which has been

previously provided for prior periods.

(*) Excluding provision for tax expenses.

(**) Finance costs, net excluding any charge for the amortization of borrowing costs that were capitalized before the launch of the cellular network.

(***) Representing an amount less than 1 million.

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	At December 31,		
	2011	2012	2013
Cellular Industry Data			
Estimated population of Israel (in millions) (1)	7.8	8.0	8.1
Estimated Israeli cellular telephone subscribers (in millions) (2)	10.0	10.2	10.1
Estimated Israeli cellular telephone penetration (3)	128%	125%	125%

	Year ended December 31,				
	2009	2010	2011	2012	2013
Partner Data					
Cellular subscribers (000's) (at period end) (4)	3,042	3,160	3,176	2,976	2,956
Pre-paid cellular subscribers (000's) (at period end) (4)	811	870	894	874	823
Post-paid cellular subscribers (000's) (at period end) (4)	2,231	2,290	2,282	2,102	2,133
Share of total Israeli cellular subscribers (at period end) (5)	32	% 32	% 32	% 29	% 29
Average monthly usage per cellular subscriber ("MOU") (mins.) (6)	364	366	397	450	522
Average monthly revenue per cellular subscriber including roaming ("ARPU") (NIS) (7)	151	148	111	97	83
Churn rate for cellular subscribers (8)	18	% 21	% 29	% 38	% 39
Number of fixed-lines (000's) (9,10) (at period end)		69	292	288	299
ISP subscribers (000's)(10) (at period end)		60	632	587	583
Estimated cellular coverage of Israeli population (at period end) (11)	98	% 99	% 99	% 99	% 99
Number of employees (full time equivalent) (at period end) (12)	5,670	6,068	7,891	5,396	4,045

(1) The population estimates are as published by the Central Bureau of Statistics in Israel as of December 31, 2013.

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

- (3) Total number of estimated Israeli cellular telephone subscribers expressed as a percentage of the estimated population of Israel. The total number of estimated cellular telephone subscribers includes dormant subscribers as well as other subscribers who are not included in the Israeli population figures, such as Palestinians, visitors, and foreign workers.
- (4) In accordance with general practice in the cellular telephone industry, we use the term “subscriber”, unless the context otherwise requires, to indicate a telephone or a data or video device, rather than either a bill-paying network customer, who may have a number of telephones connected to the network, or a cellular telephone user who may share a single telephone with a number of other users. “Subscriber” includes our pre-paid customers. A pre-paid subscriber is recognized as such only following the actual use of his pre-paid SIM card and, as of January 2011, only once they have generated revenues in the amount of at least one shekel (excluding VAT).

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

- (5) Total number of Partner subscribers expressed as a percentage of the estimated total number of Israeli cellular subscribers.
- (6) We have calculated our average monthly usage per cellular subscriber by (i) dividing, for each month in such period, the total number of minutes of usage, excluding in roaming usage, during such month by the average of the number of our subscribers, and (ii) dividing the sum of such results by the number of months in the relevant period. MOU data includes total incoming minutes to subscribers of those MVNO operators which Partner hosts on its network. In view of the continued increase in the proportion of cellular subscribers with bundled packages that include large or unlimited quantities of minutes, the Company believes that reporting MOU is no longer beneficial to understanding the results of operation, and therefore the Company will not be reporting MOU figures in the future.
- (7) We have calculated our average monthly revenue per cellular subscriber by (i) dividing, for each month in the relevant year, the total cellular segment service revenues during the month by the average number of our cellular subscribers during that month, and (ii) dividing the sum of all such results by the number of months in the relevant period.
- (8) We define the “churn rate” as the total number of cellular subscribers who disconnect from our network, either involuntarily or voluntarily, in a given period expressed as a percentage of the average of the number of our subscribers at the beginning and end of such period. Our churn rate includes subscribers who have not generated revenue for us for a period of the last six consecutive months ending at a reporting date. This includes cellular subscribers who have generated minute revenues only from incoming calls directed to their voice mail. Involuntary churn includes disconnections due to non-payment of bills or suspected fraudulent use, and voluntary churn includes disconnections due to subscribers terminating their use of our services.

- (9) Fixed-lines include Primary Rate Interface (“PRI”) lines, whereby each PRI is considered to include 30 lines according to the number of channels, Session Initiation Protocol (“SIP”) trunks and Voice over Broadband (“VoB”) lines.
- (10) Due to market developments in 2013, and in particular the increasing prevalence of bundled offerings in the market, we believe that the numbers of fixed-line and ISP subscribers no longer provide any meaningful insight in the results of operation, and we therefore will not be reporting them in the future.
- (11) We measure cellular coverage using computerized models of our network, radio propagation characteristics and topographic information to predict signal levels at two meters above ground level in areas where we operate a network site. According to these coverage results, we estimate the population serviced by our network and divide this by the estimated total population of Israel. Population estimates are published by the Central Bureau of Statistics in Israel.
- (12) A full-time employee is contracted to work a standard 186 hours per month. Part-time employees are converted to full-time equivalents by dividing their contracted hours per month by the full-time standard. The result is added to the number of full-time employees to determine the number of employees on a full-time equivalent basis.

Exchange Rate Data

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

	Year ended December 31,				
	2009	2010	2011	2012	2013
Average (1)	3.927	3.732	3.579	3.844	3.609
High	4.256	3.894	3.821	4.084	3.791
Low	3.690	3.549	3.363	3.700	3.471
End of period	3.775	3.549	3.821	3.733	3.471

(1) Calculated based on the average of the exchange rates on the last day of each month during the relevant period.

	September 2013	October 2013	November 2013	December 2013	January 2014	February 2014	March 2014 (through March 6)
High	3.632	3.567	3.569	3.53	3.507	3.496	3.492
Low	3.504	3.518	3.519	3.471	3.483	3.549	3.475

On December 31, 2013, the exchange rate was NIS 3.471 per US\$1.00 as published by the Bank of Israel. Changes in the exchange rate between the shekel and the US dollar could materially affect our financial results.

3B. Capitalization and Indebtedness

Not applicable.

3C. Reasons for the Offer and Use of Proceeds

Not applicable.

3D. Risk Factors

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

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

We operate in a highly regulated telecommunications market in which the regulator imposes substantial limitations on our flexibility in managing our business and seeks to increase industry competition, while limiting our ability to compete by, among other measures, giving preference to new competitors and limiting our ability to expand our business and develop our network. These measures may increase our costs, decrease our revenues and adversely affect our business and results of operations. We are exposed to government regulatory intervention regarding a broad range of issues, such as roaming charges, interconnect tariffs and other billing and customer service matters; the terms and conditions of our subscriber agreements; obligations under our operating licenses; the construction and maintenance of antennas and other network infrastructure; the provision of infrastructure access to existing or new providers of telecommunications services; frequency allocation; limitations or other constraints on the services and products that we may sell; promotion of competition and reduction of concentration of control regulation; and anti-trust regulation. We are also affected by changes in enforcement measures in connection with violations of applicable laws.

3D.1a Regulatory initiatives may continue to impact the cellular market, intensify competition and adversely affect our business and results of operations.

Over the last few years, the Ministry of Communications has taken active steps to increase competition in the cellular telecommunications market. Such steps have included:

- Granting licenses and frequencies to two facility-based competitors (HOT Mobile Ltd. ("HOT Mobile") and Golan Telecom). In April 2011, UMTS frequencies were awarded to Mirs Communications Ltd ("MIRS") (subsequently renamed "HOT Mobile") and Golan Telecom Ltd. ("Golan Telecom"), which entered the market in May 2012. HOT Mobile and Golan Telecom were awarded various benefits and leniencies, such as low minimum license fees and a reduction mechanism of the license fee offered to the winner (to the minimum fee set) based on the market share gained by the winner in the private sector over 5 years after being awarded the license. In order to achieve the market share, these two competitors, have launched aggressive tariff plans which include unlimited use packages;
- Facilitating entry of MVNOs into the market. Since 2010, the Ministry of Communications has adopted regulations to enable Mobile Virtual Network Operators ("MVNOs") to offer telecommunications services, and it has granted licenses to 11 MVNOs, 5 of which had entered the market as of December 31, 2013; and
- Facilitating migration of customers between cellular companies. On January 1, 2013, an amendment to the Communications Law (Telecommunications and Broadcasting), 1982 (the "Telecommunications Law") became effective which prohibits cellular companies from linking cellular service transactions and handset-related transactions. This amendment was added to previous amendments promulgated by the Ministry of Communications to facilitate the migration of subscribers among cellular companies and thus enhance competition, including the cancellation of exit fees before the end of a customer's commitment period, cancellation of commitment periods and a prohibition on selling SIM-locked handsets.

As a result of such measures, the level of competition in the cellular market has increased, leading to a material increase in churn rate and significant price erosion. If this trend continues, it may continue to materially adversely affect our revenues. See "Item 3D.2c Competition resulting from the full service offers by telecommunications groups, and additional entrants into the mobile telecommunications market, as well as other actual and potential changes in the competitive environment and communications technologies, may continue to cause a decrease in tariffs, an increase in subscriber acquisition and retention costs, and may continue to reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations."

3D.1b If insufficient or improperly implemented, regulatory initiatives that are intended to allow telecommunication providers, such as Partner, that do not have their own fixed-line infrastructure to include the infrastructure component as part of their bundled service offerings may negatively affect our business and results of operations.

The Ministry of Communications seeks to increase competition in the fixed-line telecommunications market by regulating wholesale market prices. Such regulation is intended to allow telecommunication providers that do not have their own fixed-line infrastructure ("New Entrants"), such as Partner, to include the infrastructure component as part of their bundled service offerings. However, if regulation of the fixed-line wholesale market is insufficient and/or improperly implemented, it may negatively affect our business and results of operations, inter alia, in relation to the following:

- Wholesale market tariffs and margin protection. For us to compete effectively in the fixed-line market, the regulated wholesale tariffs would need to be set by the Ministry of Communications at a level which allows us to earn a reasonable profit from our business.

Bezeq-The Israel Telecommunication Corp., Ltd. ("Bezeq") and HOT Telecom LLP ("HOT Telecom"), are the only fixed-line operators in Israel that own and operate their own fixed-line infrastructure. Because their infrastructure costs are lower than the proposed wholesale prices to be paid by New Entrants, Bezeq and HOT Telecom will benefit from a pricing advantage over the New Entrants when offering fixed-line services in the retail market. To enable the New Entrants to compete effectively against Bezeq and HOT Telecom in the retail market while maintaining sufficient margins, the Ministry of Communications would need to establish a mechanism which prevents Bezeq and HOT Telecom from exploiting their cost advantage;

- Technical and Operational implementation. For New Entrants to offer services of adequate quality and respond in a competitive manner to retail market demand in the fixed-line market, the Ministry of Communications must ensure that the relevant wholesale services provided by Bezeq and HOT Telecom are of sufficient technical and operational standards.

If the Ministry of Communications fails to effectively implement the measures described above, or if the operational implementation of these measures fails due to the need for financial resources, our ability to compete effectively in the fixed-line market and/or the future television market would be significantly limited.

Furthermore, in accordance with the policy of the Ministry of Communications, within nine months after the Ministry sets wholesale tariffs and service portfolios, the Ministry of Communications may allow Bezeq to offer, inter alia, bundled fixed-line and mobile telecommunications services. If the Ministry of Communications then also permits price reductions for bundled components (which is currently prohibited under structural separation provisions applicable to Bezeq) before an effective wholesale market has been implemented, Bezeq may be able to take advantage of their nationwide presence and cross-subsidization to market and sell more competitive and attractive offers than we will be able to offer, including cellular services. Bundled offerings have become more frequent in Israel and are expected to accelerate price erosion in each of the services included.

In addition, if the wholesale tariffs are set by the Ministry of Communications in a manner and/or at a level which would not allow us to offer competitive access to television networks, we would not be able to compete effectively with the bundled offerings by Bezeq and HOT Telecom which include such access.

For further discussion of important risks related to competition, see also "Item 3D.2c Competition resulting from the full service offers by telecommunications groups, and additional entrants into the mobile telecommunications market, as well as other actual and potential changes in the competitive environment and communications technologies, may

continue to cause a decrease in tariffs, an increase in subscriber acquisition and retention costs, and may continue to reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations.”

3D.1c Other regulatory developments may have a negative impact on the Company's business and results of operation.

Other regulatory developments that may have a negative impact on the Company's business and results of operation include:

- Proposed premium services regulation. In July 2013, the Ministry of Communications published a hearing that is intended to regulate how premium services are provided. All premium services will be provided through only three local prefixes, two of which shall be blocked as a default. The Ministry of Communications would ban the current practice according to which some premium calls are routed abroad and charged accordingly. The revenues of the Company may be adversely affected by the results of this hearing.
- Unified license hearing. In August 2013, the Ministry of Communications published a hearing regarding the obligation of all existing telecommunications licensees except Bezeq and HOT Telecom to be regulated by a unified general license. The Ministry proposed that existing licensees be required to conform to the unified license which would cover international Long Distance ("ILD") services, special fixed-line services, ISP and network termination point ("NTP") services. Existing licensees would have to conform to the terms of the unified license within a set period of time to be determined and afterwards to merge all relevant activities into a single corporate entity. Since the provisions of the draft unified license vary from those of the relevant existing licenses (and in many cases are more stringent), such an obligation may impose additional constraints on the Company's business and operations in the relevant segments, have accounting implications and have an adverse effect on our financial results.
- Proposed new regulations for the ILD market. In October 2013, the Ministry of Communications published a hearing regarding proposed new regulations for the ILD market. The Ministry proposed allowing all general telecommunications licensees (including MVNOs) to provide international call services to international destinations included in their subscribers' tariff plans as well as to international destinations for which the tariff is lower or equal to the tariff for a domestic call on the licensee's network. The Ministry of Communications also proposed that general licensees would no longer be allowed to charge interconnect fees for outgoing international calls. The revenues of the Company would be adversely affected if these proposed new regulations are adopted.
- Requiring the maintenance of network neutrality. A new draft bill is aimed at requiring ISP and fixed-line broadband providers to maintain "network neutrality". This bill may significantly limit our ability to manage traffic on our fixed line and ISP services and as a result would increase our expenses and reduce our profits.
- Potential increased costs for our fixed-line services. The Ministry of Communications is considering providing new company protections for Tamares Telecom Ltd. ("Tamares"), a company which laid an underwater cable in early 2012. Such protections are intended to support Tamares's entry into the international transmission market by setting minimum tariffs which Tamares's main competitor, Mediterranean Nautilus Israel Ltd. ("Med Nautilus"), may charge its customers, which include Partner. Such measures may oblige us to purchase international fixed-line service capacity at higher prices than we currently pay. Because Bezeq International Ltd. ("Bezeq International") has its own underwater cable and may supply itself with its own international transmission services at a lower cost, our ability to compete on price with Bezeq for services in the international fixed-line telecommunications market may be reduced.
- Applicability of Charge Cards Law to Cellular Payments. During the fourth quarter of 2012, the Attorney General opined before two separate tribunals that when subscribers of cellular operators subscribe to services that are paid through the cellular operator to third party providers, this payment mechanism should be considered a credit card charge and the cellular operator as acting as the "card issuer" under the Israeli Charge Cards Law, 1986. The operation of credit card payment systems is subject to various laws and regulations governing their set-up,

operations and responsibilities vis-à-vis the card holders and the providers of the services or goods purchased using the card. If we were required to ensure compliance with such laws and regulations, we would incur increased operating costs and face additional legal risks, which could negatively impact our results of operations.

For the reasons given above and further below, regulation of our industry has had in the past, and may in the future have, a material adverse effect on our business and results of operations. In addition, new laws, regulations or government policies, or changes in current regulations, may be adopted or implemented in a manner which damages our business and operating results. Announcements by the government of changes or other developments in applicable regulations may have a negative impact on the market value of our shares. For information regarding the principal regulations and regulatory developments affecting our business, see “Item 4B.13 Regulation”. Furthermore, defending ourselves against regulatory violations alleged by state authorities or consumers has required, and may in the future require, substantial financial and management resources. We may not always be successful in our defense, and should we be found in violation of these regulations, we and our management may be subject to civil or criminal penalties, including the loss of our operating license as well as administrative sanctions. For information regarding on-going litigation and proceedings, see “Item 8A.1 Legal And Administrative Proceedings”.

3D.1d Recent and potential future regulation and negotiation of roaming tariffs, both within Israel and elsewhere, may increase our roaming expenses, decrease our roaming revenues and prevent us from raising our tariffs. If our competitors, including new entrants into the telecommunications market, can deliver a more cost effective roaming service or more effective roaming solutions than we do, our subscribers may migrate to those competitors and our results of operations could be adversely affected.

Regulation and negotiation of roaming charges. The Ministry of Communications has declared its intention to evaluate roaming charges. In 2008, the government instructed the Ministry of Communications, together with other ministries, to negotiate a reduction of inbound and outbound roaming tariffs with the European Union (“EU”) and/or members of the EU or countries frequently visited by Israelis, and to consider other tools for reducing roaming charges. As a result, in the last few years the Ministry of Communications has requested Partner and its competitors to provide information regarding our roaming services and tariffs. If roaming tariffs are reduced as a result of the review by the Ministry of Communications or as a result of the proposed negotiations or otherwise, if additional EU member operators raise their tariffs, or if we are not able to raise our tariffs or otherwise compensate for possibly higher roaming expenses, our profitability and results of operations could be materially adversely affected.

Competition in roaming. Some of our competitors may be able to obtain lower roaming rates than us either because they have larger call volumes or through their affiliations with other international cellular operators. Some competing service providers use alternative technologies for roaming that bypass the existing method of providing roaming services. In addition, the entry into the market of MVNOs and two infrastructure based cellular operators has increased competition in the roaming market, since some of the entrants offer roaming solutions that allow them to set lower roaming charges. In addition, the requirement to sell unlocked handsets facilitates the ability of subscribers to use local SIM cards in their handsets when traveling abroad, which may compete with our roaming services and negatively affect our revenues and profits from roaming. Further competition in roaming services (both inbound and outbound) has arisen and may arise in the future from pure internet-based services such as Skype, Viber and WhatsApp, as well as other operator products which use VoIP applications.

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

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

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

For the reasons described in further detail below, we have had difficulties obtaining some of the building permits required for the erection and operation of our network sites. As of December 31, 2013, less than 10% of our network sites were operating without local building permits or exemptions which, in our opinion, are applicable. In addition, some of our network sites are not built in full compliance with the applicable building permits.

Network site operation without required permits or that deviates from the permit has in some cases resulted in the filing of criminal charges and civil proceedings against us and our officers and directors, and monetary penalties against the Company, as well as demolition orders. See “Item 8A.1 Legal And Administrative Proceedings”. In the future, we may face additional demolition orders, monetary penalties (including compensation for loss of property value) and criminal charges. The prosecutor’s office has set up a national unit to enforce planning and building laws. The unit has stiffened the punishments regarding violations of planning and building laws, particularly against commercial companies and its directors. If we continue to experience difficulties in obtaining approvals for the erection and operation of network sites and other network infrastructure, this could have an adverse effect on the extent, coverage and capacity of our network, thus impacting the quality of our cellular voice and data services, and on our ability to continue to market our products and services effectively. In addition, as we seek to improve the range and quality of our services, we need to further expand our network, and difficulties in obtaining required permits may delay, increase the costs or prevent us from achieving these goals in full. Our inability to resolve these issues could prevent us from maintaining the quality requirements contained in our license.

Uncertainties under National Building Plan 36. Since June 2002, following the approval of the National Building Plan 36 (the “Plan”), which regulates network site construction and operation, building permits for our network sites (where required) have been issued in reliance on the Plan. Several local planning and building authorities have questioned the ability of Israeli cellular operators to receive building permits, in reliance on the Plan, for network sites operating in frequencies not specifically detailed in the frequency charts attached to the Plan. In a number of cases, these authorities have refused to grant building permits for 3G network sites, claiming that 3G frequencies are not included in the Plan. There has been no judicial ruling at this stage. A class action that was filed against us as well as other cellular operators a number of years ago with a request for the revocation of the building permits given to the 3G network sites was dismissed during 2012.

The Plan is in the process of being changed. See “Item 4B.13g Network Site Permits”.

Uncertainties regarding the validity of exemptions for wireless access devices. We have set up several hundred small communications devices, called wireless access devices, pursuant to a provision in the Telecommunications Law which exempts such devices from the need to obtain a building permit. A claim was raised that the exemption does not apply to cellular communications devices and the matter reached first instance courts a number of times, resulting in conflicting decisions. This claim is included in an application to certify a class action filed against the three principal

Israeli cellular operators. In May 2008, a district court ruling adopted the position that the exemption does not apply to wireless access devices. We, as well as our competitors, filed a request to appeal this ruling to the Supreme Court. In May 2008, the Attorney General filed an opinion regarding this matter stating that the exemption does apply to wireless radio access devices under certain conditions. Two petitions were filed with the High Court of Justice in opposition to the Attorney General's opinion. The matter is still pending before the Supreme Court and the High Court of Justice. See "Item 4B.13g Network Site Permits".

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

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

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

The Ministry of Environmental Protection's Request for the Installment of Monitoring Devices. In May 2010, the Ministry of Environmental Protection notified the Company of a new condition for all of the Company's network site operation permits, according to which the Company must install in its systems software (provided by the Ministry of Environmental Protection) that continuously monitors and reports the level of power created in real time from the operation of its network sites. The Ministry of Environmental Protection refused to provide the Company with any technical data regarding the monitoring software and therefore the Company cannot anticipate the manner of operation of the software nor its reliability. The Company complied with the Ministry of Environmental Protection's condition. Since the installment of the software, the Company has received several alerts reporting exceeded transmission power at some of the Company's cell sites. All purported alerts were examined by the Company's engineers and were found to be baseless. In addition, the Ministry of Environmental Protection has sent to all the cellular network operators notice of an administrative and criminal enforcement procedure that will be implemented by the Ministry as part of the monitoring devices. Partner, as well as the other cellular network operators, has advised the Ministry that based on their experience so far from the alerts that have been received and examined by their engineers, it seems that the devices are not credible and therefore administrative and criminal proceedings should not be based on their findings. The Ministry of Environmental Protection has not yet responded.

The Company is of the opinion that all of the antennas that it operates comply with the conditions of the safety permits that the Company was granted by the Ministry of Environmental Protection. However, implementation of the monitoring software increases the exposure of the Company and its senior officers to civil and criminal proceedings in the event that any antennas are found to not meet the conditions of the permits granted to the Company and the maximum permitted power. In addition, if our antennas are found to not meet the conditions of the permits granted to the Company and the maximum permitted power, the Ministry of Environmental Protection may revoke existing permits, which would require us to dismantle existing network sites. As a result, our network capacity and coverage would be negatively impacted, which could have an adverse effect on our revenue and results of operations.

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

Under the Planning and Building Law, local planning committees may be held liable for the depreciation of the value of nearby properties as a result of approving a building plan. Under the Non-Ionizing Radiation Law, 2006 ("the Non-Ionizing Radiation Law") the National Council for Planning and Building requires indemnification undertakings from cellular companies as a precondition for obtaining a building permit for new or existing network sites. The National Council has decided that until the Plan is amended to reflect a different indemnification amount, cellular companies will be required to undertake to indemnify the committees in full against all losses resulting from claims against a committee for reductions in property values as a result of granting a permit to the network site. On June 1, 2010, the National Council for Planning and Building approved the National Building Plan No. 36/A/1 version that incorporates all of the amendments to the Plan (the "Amended Plan"). The Amended Plan sets forth the indemnification amounts as a percentage of the value of the depreciated property claims in accordance with the manner in which the licenses were granted. See "Item 4B.13g Network Site Permits". The Amended Plan is subject to governmental approval, in accordance with the Planning and Building Law. It is unknown when the government intends to approve the Amended Plan.

As of December 31, 2013, we have provided local authorities with 510 indemnification undertakings. These indemnifications expose us to risks which are difficult to quantify or mitigate and which may have a material adverse effect on our financial conditions and results of operations, if we are required to make substantial payments in connection therewith. In addition, the requirement to provide indemnification in connection with new building permits may impede our ability to obtain building permits for existing network sites or to expand our network with the erection of new network sites. The indemnification requirement may also cause us to change the location of our network sites to less suitable locations or to dismantle existing network sites, which may have an adverse effect on the quality and capacity of our network coverage.

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

3D.1g We may not be allocated sufficient spectrum band or any spectrum at all needed in order to provide fourth generation (4G) services, and we may be required to terminate the use of certain spectrum or to share with another operator some of the spectrum we are currently using on an exclusive basis. These requirements may adversely affect our network quality and capacity as well as our ability to provide our customers with advanced technology services, which may adversely affect our ability to compete and our results of operations.

Uncertainties regarding Long Term Evolution ("LTE") spectrum allocation. The Ministry of Communications has announced its intention to allocate LTE frequencies in the 1800 and 2600 spectrum. If allocations take place via a tender or other means and spectrum is allocated to our competitors and not to us, or if the spectrum allocated to us is insufficient to provide quality 4G services, our ability to migrate to next generation technologies would be harmed, which would place us at a disadvantage compared to our competitors. As a result, our business and results of operations may be negatively impacted. See "Item 4B.13d - v LTE Spectrum Allocation".

Possible rearrangement of allocated spectrum. There have been demands from different third parties to rearrange the current spectrum allocation in Israel and the Palestinian Administered Areas. We received in 2009 notification from the Civil Administration in Judea and Samaria of its intention to change the allocation of some of the spectrum

previously allocated to us for our use in the West Bank, and that following the change, we may be allocated other spectrum in the West Bank and additional spectrum for our use in Israel. If we were prevented from using a portion of our existing spectrum, or if alternative equivalent spectrum are not allocated to us, or the allocation is of an inferior quality, or if we were required to share some of our spectrum, our ability to effectively manage our licensed spectrum for the use of GSM, UMTS and Long-Term Evolution (“LTE”) or any other future technology could be reduced. As a result, our UMTS network capacity and our LTE and any other new technology rollout plans may be negatively affected, which could have a material adverse effect on our operations, profitability and capital expenses. Until we receive further details regarding this allocation of spectrum, we are unable to evaluate the impact that the intended change in spectrum allocation, if it occurs, will have on our business or our results of operations.

3D.1h We can only operate our business for as long as we have licenses from the Ministry of Communications. A legislative amendment has increased the extent of monitoring and enforcement measures of the Ministry of Communications.

We conduct our operations pursuant to licenses granted to us by the Ministry of Communications, which may be extended for additional periods upon our request to the Ministry of Communications and confirmation from the Ministry that we have met certain performance requirements. We cannot be certain that our licenses will not be revoked, will be extended when necessary, or, if extended, on what terms an extension may be granted. See “Item 4B.13e Our Mobile Telephone License”.

Furthermore, although we believe that we are currently in compliance with all material requirements of our licenses, disagreements have arisen and may arise in the future between the Ministry of Communications and us regarding the interpretation and application of the technical standards used to measure these requirements, including the requirements regarding population coverage and minimum quality standards and other license provisions. We have provided significant bank guarantees to the Ministry of Communications to guarantee our performance under our licenses. If we are found to be in material breach of our licenses, the guarantees may be forfeited and our licenses may be revoked. In addition, the Ministry of Communications is authorized to levy significant fines on us for breaches of our licenses, which could have a material adverse effect on our financial condition or results of operations. In August 2012, an amendment to the Telecommunications Law was enacted which sets a mechanism that allows the Ministry of Communications to impose significant financial sanctions on a licensee based on two parameters: the annual income of the violator (NIS 1.6 million plus 0.225% of the annual income of the licensee) and the degree of severity of the violation. The potentially significant financial sanctions are expected to lead to materially increased monitoring and enforcement measures by the Ministry of Communications towards the licensees.

3D.1i Our mobile telephone license imposes certain obligations on our shareholders and restrictions on who can own our shares. Ensuring compliance with these obligations and restrictions may be outside our control, but if the obligations or restrictions are not respected by our shareholders, we could lose our license.

As with other companies engaged in the telecommunications business in Israel, our license requires that a minimum economic and voting interest in, and other defined means of control of, our company be held by Israeli citizens and residents or entities under their control. If this requirement is not complied with, we could be found to be in breach of our license, even though ensuring compliance with this restriction may be beyond our control. See “Item 4B.13e Our Mobile Telephone License”.

Our general mobile telephone license requires that our founding shareholders or their approved substitutes hold at least 26% of the means of control in the company and 5% of which shall be held by Israeli citizens and residents who were approved as such by the Minister of Communications. The license also requires that these Israeli shareholders appoint at least 10% of our Board of Directors. In 2006, our Israeli founding shareholders sold substantially all of their shares in the Company to Israeli institutional investors, who are approved substitutes. Since then, there were additional share sales to Israeli institutional investors that were approved as substitutes by the Minister of Communications. In addition, according to our license, no transfer or acquisition of 10% or more of any of such means of control, or the acquisition of control of our company, may be made without the consent of the Minister of Communications. Nevertheless, under certain licenses granted, directly or indirectly, to Partner, approval of, or notice to, the Minister of Communications may be required for holding of 5% or more of Partner’s means of control. Our license also restricts cross-ownership and cross-control among competing mobile telephone operators, including the ownership of 5% or more of the means of control of both our company and a competing operator, without the consent of the Minister of Communications, which may limit certain persons from acquiring our shares. Shareholdings in breach of these restrictions relating to transfers or acquisitions of means of control or control of Partner could result in the following consequences: the shares will be converted into “dormant” shares as defined in the Israeli Companies

Law, 1999 ("Israeli Companies Law"), with no rights other than the right to receive dividends or other distributions to shareholders, and to participate in rights offerings until such time as the consent of the Minister of Communications has been obtained and our license may be revoked. In addition, under certain licenses of the Company's affiliates, approval of, or notice to, the Minister of Communications may be required for holding of less than 5% of means of control. Because of this lack of consistency, Partner may be in breach of its licenses in this regard.

3D.1j New legislation in Israel to promote competition and reduce concentration of control over businesses may adversely affect the expansion of our business, require changes in our shareholder base, affect our share price and limit our ability to obtain bank credit.

The Promotion of Competition and the Reduction of Centralization Law (the "Centralization Law") was enacted in Israel on December 11, 2013. The Centralization Law imposes new constraints on the allocation and extension by government regulatory authorities and ministers (the "State") of various rights, including in the telecommunications field. The Centralization Law seeks to regulate the allocation of rights to promote competition and avoid the centralization of control. The Centralization Law applies to Partner as a result of rights granted to it under its operating licenses, or which it may seek in the future, and could therefore require that specified procedures be followed before the State may approve further rights allocations or extensions. These procedures could, if deemed necessary to promote competition and avoid centralized control, be more restrictive than those currently applied to us, and as a result may impede or prevent allocations to us of telecommunications or other rights, which could limit our ability to expand our business. The Centralization Law may also limit transfers of interests in Partner which exceed certain thresholds of Partner's outstanding capital.

In addition, the Centralization Law imposes restrictions on corporate structures where, among other situations, one public company controls multiple layers of subsidiary public companies (called "pyramids"), and it seeks to limit such structures to no more than two layers of public companies. For existing pyramids, the Centralization Law requires that the number of layers of public companies be reduced to three layers within four years (by December 2017) and to two layers within six years (by December 2019). Partner currently may be deemed to be a layer corporation of a pyramid structure, such that the Centralization Law may require changes in our shareholder base within four or six years. Such changes may impact management of the Company and may have an adverse effect on our share price, depending on if and how our shares may be transferred to comply with the Centralization Law.

From June 2014 until the last applicable date for required reductions in layers (December 2017 or 2019), the Centralization law imposes stricter corporate governance constraints on the Board structure of certain layer corporations. The Israeli Securities Authority may impose a financial sanction ("Izum Caspi") on a layer corporation for certain breaches of these additional interim corporate governance constraints. However, under an initial draft of regulations recently proposed under the Centralization Law, some classes of corporations, including Partner, may be exempted from these interim requirements.

The Centralization Law also authorizes the Minister of Finance and the Governor of the Bank of Israel to set restrictions on granting credits to an entity ("ta'agid") or, in the aggregate, to a business group (i.e., a controlling party and corporations under its control) by financial institutions. It is not currently clear if and to what extent such restrictions may be adopted and applied to us, and thus whether they will add further constraints on our ability to obtain credit from financial institutions in the future.

The Centralization Law is new, and critical elements will need to be provided by future regulations and other formal publications, including clearly identifying persons and entities to which different constraints apply. As a result, the precise ramifications of the Centralization Law for Partner cannot be fully ascertained at this time.

For further information on the Centralization Law, see "Item 4B.13d - vi The Promotion of Competition and the Reduction of Centralization Law".

3D.2 RISKS RELATING TO OUR BUSINESS OPERATIONS

3D.2a As a result of substantial and continuing changes in our regulatory and business environment, our operating results have decreased significantly in the past two years. Our operating results may continue to decline in 2014 and beyond, which may adversely affect our financial condition.

Our revenues in 2013 were NIS 4,519 million (US\$ 1,302 million), a decrease of 19% from NIS 5,572 million in 2012 and a decrease of 35% from NIS 6,998 million in 2011. Our profit in 2013 was NIS 135 million (US\$ 39 million), a decrease of 72% from NIS 478 million in 2012 and a decrease of 70% from NIS 443 million in 2011 (including the effect of the 2011 asset impairment). Earnings per share have declined from NIS 2.85 for 2011 (including the effect of the 2011 asset impairment) and NIS 3.07 for 2012, to NIS 0.87 for 2013.

The principal factors leading to this continued decline in operating results over the past few years have been the regulatory developments intended to enhance competition in the Israeli cellular market. These developments have caused (i) price erosion due to competition from new entrants into the Israeli telecommunications market, (ii) a decline in roaming revenues, (iii) a decrease in our cellular subscriber base and (iv) a decrease in handset and equipment sales.

Depending on past and future regulatory and market developments, these factors may continue to negatively impact our business through 2014 and beyond, which may adversely affect our financial condition and liquidity by, among other things:

- increasing the likelihood of a downgrade in the rating of our Notes by the rating company;
- increasing our vulnerability to adverse economic, industry or business conditions or increases in the consumer price index ("CPI"), particularly because a portion of our borrowings is linked to the CPI;
- limiting our flexibility in planning for, or reacting to, changes in our industry and business as well as in the economy generally;
- requiring us to dedicate a substantial portion of our cash flow from operations to service our debt, thereby reducing the funds available for financing ongoing operating expenses and future business development;
 - increasing the risk of a substantial impairment in the value of our telecommunications assets; and
- limiting our ability to obtain the additional financing we may need to operate, develop and expand our business on acceptable terms or at all.

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

3D.2b The network sharing agreement recently entered into by Partner may not provide the anticipated benefits and may lead to unexpected costs.

In November 2013, we entered into a 15-year network sharing agreement with HOT Mobile pursuant to which, subject to the approval of the Israeli regulatory authorities, the parties would create a joint venture which would operate and develop a radio access network to be shared by both companies. However, the benefits from a pooled infrastructure may be less than anticipated, and the Company may experience unexpected costs for technical, legal or other matters which may arise in connection with its efforts to implement the agreement. It also may not be possible to establish the joint venture as the parties intend or at all. The sources of these uncertainties include the possibilities that:

- either of the parties to the agreement experiences credit or payment difficulties and cannot contribute effectively to the financing of the joint venture;
 - the elimination of network sites results in lower operational savings than expected;
- Israeli authorities do not approve the network sharing agreement or require changes which would render the agreement unattractive from the Company's perspective or would negatively affect the commercial interest of the agreement;
 - the joint venture experiences management deadlock; or
- the parties' existing agreements with other Israeli telecommunications companies limit the parties' ability to realize their objectives.

See "Item 4B.9 Our Network".

On December 10, 2013, Cellcom Israel Ltd. ("Cellcom") announced that it had entered into an agreement with Pelephone Communications Ltd. ("Pelephone") and Golan Telecom, for the construction and operation of a shared 4G radio network, an agreement between Cellcom and Pelephone for the sharing of passive elements of cell sites for existing networks, and an indefeasible right of use agreement between Cellcom and Golan regarding Cellcom's 2G and 3G radio networks. The agreements are subject to the approval of the Ministry of Communications and the Israeli Antitrust Commissioner. If these agreements receive regulatory approval and our network sharing agreement with HOT Mobile is not approved, this would place us at a disadvantage compared to our competitors. As a result, our business and results of operations may be negatively impacted.

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

Additional entrants into the mobile telecommunications market. Following the Ministry of Communications' tender for the allocation of UMTS frequencies to two additional operators, the frequencies were ultimately awarded to MIRS (subsequently renamed HOT Mobile) and Golan Telecom, which entered the market in May 2012. The two additional entrants were awarded various benefits and leniencies, such as low minimum license fees and a reduction mechanism of the license fee offered to the winner (to the minimum fee set) based on the market share gained by the winner in the private sector over 5 years after being awarded the license. In order to achieve the market share, these entrants have launched aggressive tariff plans which include unlimited use packages. Consequently, the prepaid packages have lost their advantages as a cost controlling tool, and as a result there has been migration from the pre-paid market to the post-paid market. Following the entry of the additional operators, the competition has increased which has and may continue to adversely affect our churn rate and revenues.

The entrance of MVNO operators has further increased competition in the market, since many MVNOs are retailers with a wide customer base and distribution network that allows them to offer attractive package prices to their customers. See "4B.10a Competitors in the Cellular Services market".

Competitive advantages of the two fixed-line infrastructure groups. The Bezeq Group and the HOT Group are the only groups that own nationwide fixed-line telecommunications infrastructures.

Bezeq Group – Bezeq, Israel's largest telecommunications provider and the primary fixed-line operator, provides fixed-line telephony services, cellular telecommunications services, primary rate interface ("PRI"), broadband internet access infrastructure services, ISP services, transmission and data communications services, ILD services and multi-channel television services. The Bezeq Group is under structural separation rules which apply to management, employees, assets, marketing and finance and data systems. Starting in 2010, the Ministry of Communications has allowed the Bezeq Group to market bundled telecommunications services to the private sector, subject to certain conditions and limitations, including provisions which prevent Bezeq from discounting the price of bundled services from their unbundled prices and including its fixed-line telephony service within bundles. See "Item 4B.2 Broadband and Internet services."

HOT Group – The HOT Group provides cellular telecommunications services, multi-channel television services, fixed-line telephony services, PRI, broadband internet access, infrastructure services, transmission and data communications services, ISP services and ILD services. During 2012, the HOT Group began providing ISP services to the private market. MIRS's cellular license was amended to include UMTS frequencies allocated subsequent to

winning a Ministry of Communications' tender offer for frequencies in the 2100 Mhz spectrum. In May 2012, MIRS launched cellular services based on the new frequencies and officially changed the company name to HOT Mobile. See "Item 3D.1a Regulatory initiatives may continue to impact the cellular market, intensify competition and adversely affect our business and results of operations." The HOT Group may offer a bundle of services only including fixed-line telephony, broadband infrastructure and multi-channel television ("Triple"). The bundle of services currently offered by the HOT Group does not include cellular services (other than a bundle of cellular services with ISP services offered by its subsidiaries HOT Mobile and Hot-Net Internet Services Ltd. ("HOT-NET")). The Ministry of Communications allowed HOT Telecom, HOT Telecommunication Systems and HOT Mobile to sell and market each other's services and exchange information regarding such marketing activities.

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

Bezeq – Yes merger. Bezeq has applied to the Anti-Trust Authority for approval of a merger between it and its subsidiary, DBS Satellite Services (1998) Ltd. (Yes) which provides multi-channel television services. Such merger, if approved, may increase Bezeq's incentives to prevent or limit Partner and other competitors' ability to provide over-the-top (OTT) multi-channel television services, if Partner or the other competitors should choose to enter the television market.

Israel Broadband Company (IBC). The Ministries of Finance, National Infrastructures and Communications and the Israeli Electric Company, the Israeli national electric company, published in October 2011 an election process to elect a controlling shareholder, investor and co-founder of a new telecommunications company to establish a new nationwide Fiber to the Home ("FTTH") internet broadband access infrastructure (two such infrastructures already exist in Israel, owned by Bezeq and HOT Telecom, respectively). On August 27, 2013, the Minister of Communications granted Israel Broadband Company (2013) Ltd. ("IBC"), a general license for the provision of fixed-line telecom services (infrastructure). See " 4B.13d - xi Election Procedure of the Electricity Company". Although IBC is in principle permitted to provide its services only to other telecommunications licensees on a wholesale basis, according to media reports IBC intends to introduce a new business model which may enable it to reach the retail market through the services of ISPs. According to media reports, IBC plans to launch a web portal in which it would offer ISP services to end users. ISPs which reach agreements with IBC would be listed on such a web portal. The variety of suppliers, immediate choice, and ability to quickly switch suppliers may commoditize the ISP segment and negatively impact our revenues and profits.

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

Sale of handsets. Competition in the cellular handset market has increased as a result of recent regulatory reforms. Among other changes, cellular companies are prohibited from linking cellular service transactions and handset-related transactions. Regulatory actions have also been taken to remove import barriers on handsets, including exemptions from the requirement for a commercial license and a type approval for imported cellular handsets that meet acceptable European and American standards. As a result of these reforms, we face increased competition in the handset market from other handset dealers.

Competition in Roaming Services. We are also subject to competition from other businesses offering roaming services which use alternative technologies and offer rates which are lower than ours.

LTE licenses. LTE is an evolved mobile technology that allows a wide bandwidth for data services. If 4G licenses are granted to new operators or to any of our competitors and not to us, or if the spectrum allocated to us is insufficient to provide quality LTE services, we may suffer a competitive disadvantage which could adversely affect our business, since it would impair our ability to migrate to LTE and compete in the mobile broadband market. See " 3D.1g We may not be allocated sufficient spectrum band or any spectrum at all needed in order to provide fourth generation (4G) services, and we may be required to terminate the use of certain spectrum or to share with another operator some of the spectrum we are currently using on an exclusive basis. These requirements may adversely affect our network quality and capacity as well as our ability to provide our customers with advanced technology services, which may adversely affect our ability to compete and our results of operations."

3D.2d In the event our employees are unionized, management's flexibility to adapt operations to market conditions may be reduced, and our operating expenses may be increased, which could adversely impact our results.

Over the last year, there has been a trend toward the unionization of employees in Israel, including in the telecommunications market. The overall trend together with union efforts to encourage support among our employees, and our efforts to align operating costs with reduced revenues, create organizational stress which may lead to the unionization of our employees. One of our competitors has recently signed a collective bargaining agreement with the representative organization, and another is negotiating such an agreement (after one of the Israeli employee unions established its representation of the employees in each of the companies). Israeli employee unions have been trying to establish their representation of our employees in order to sign a collective bargaining agreement; however, at present, no union has been named as representative, and it is not possible to know whether our employees will choose unionization.

If an employee union is recognized as representative of our employees and the Company signs a collective bargaining agreement, management's flexibility to efficiently run our business and adjust operations to market conditions, and in particular to reduce employee headcount, may be reduced. In addition, the unionization of our employees may increase operating expenses and adversely affect our results of operations.

3D.2e Significant price decreases may in the future cause us to recognize substantial impairment in the value of our telecommunications assets.

As a result of price decreases in the market for cellular and fixed-line telecommunications services, we may be required to perform an impairment test on our telecommunications assets. In 2011, as a result of sharply worsening conditions in the fixed-line market, we recorded asset impairment charges of NIS 235 million for the fixed-line business and goodwill impairment of NIS 87 million with respect to the VOB/ISP and ILD group of Cash Generating Units ("CGUs") of the fixed line segment. At December 31, 2012 and 2013, we conducted required asset impairment tests and determined that no goodwill impairment should be recorded as of these dates. (See "Item 5A.1d - Impairment test of Fixed-Line Goodwill as of December 31, 2013.") However, continued increases in the level of competition for cellular, fixed-line and data transmission services may bring further downward pressure on prices which may require us to perform further impairment tests of our assets. Such impairment tests may lead to recording additional significant impairment charges, which could have a material negative impact on our operating and net profit.

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

Pursuant to a non-exclusive agreement we entered into in November 2012 with Apple Distribution International for the purchase and resale of iPhone handsets in Israel, we agreed to purchase a minimum quantity of iPhone handsets per year, for a period of three years. These purchases represent a significant portion of our expected handset purchases over that period. If we fail to meet the minimum quantities and do not reach an agreement with Apple regarding this matter we may be in breach of the agreement which may involve payment of damages, which would increase our costs.

3D.2g We depend on a limited number of suppliers. Our results of operations could be adversely affected if our suppliers fail to provide us with adequate supplies of network equipment and handsets or maintenance support on a timely basis.

Network suppliers. We purchased our network equipment, such as switching equipment, base station controllers and base transceiver stations and network software, mainly from Ericsson as well as from Nokia and other suppliers. As of January 2008, we purchase all our UMTS network equipment from Ericsson. In October 2010, we entered into an

agreement with Ericsson for the upgrade and modernization of our networks and the deployment of our fourth generation network in Israel.

The initial term of our current agreement with Ericsson ends on December 31, 2014. Towards the end of the initial term, we will examine the scope of the deliverables and services actually provided by Ericsson under the agreement. If Ericsson provided less than the scope to which we were entitled, we may choose that Ericsson provide during 2015 the services and deliverables that were not provided. We also have an option to extend the initial term by ten additional periods of one year each. The fees for support and maintenance services for the years 2015 onwards have already been agreed, in the event we wish to extend them beyond the initial term. However, if we wish to extend the initial term for future purchases, purchase prices for the years 2015 onwards must still be negotiated and agreed. We are therefore, as a practical matter, materially dependent on Ericsson as our sole vendor for our UMTS and LTE networks.

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

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

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

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

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

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

In order to attract and retain the maximum number of subscribers in our highly competitive market, we design specific tariff plans to suit the preferences of various subscriber groups. We require sophisticated information systems to record accurately subscriber usage pursuant to the particular terms of each subscriber plan, as well as accurate database management and operation of a very large number of tariff plans. From time to time, we have detected some discrepancies between certain tariff plans and the information processed by our internal information systems, such as

applying an incorrect rebate or applying an incorrect tariff to a service, resulting in a higher or lower charge. We have invested substantial resources to refine and improve our information and control systems and ensure that our tariff plans are appropriately processed by our information systems. We have also taken steps to remedy the identified discrepancies. Despite our investments, we may experience discrepancies in the future due to the multiplicity of our plans and the scope of the processing tasks. Further, while we invest substantial efforts in monitoring our employees and third-party distributors and dealers that market our services, it is possible that some of our employees, distributors or dealers may offer terms and make (or fail to make) representations to existing and prospective subscribers that do not fully conform to applicable law, our license or the terms of our tariff plans. As a result of these discrepancies, we may be subject to subscribers' claims, including class action claims, and substantial sanctions for breach of our license that may materially adversely affect our results of operations.

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

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

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

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

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

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

While, to the best of our knowledge, the handsets that we market comply with the applicable laws that relate to acceptable Specific Absorption Rate (“SAR”) levels, we rely on the SAR levels published by the manufacturers of these handsets and do not perform independent inspections of the SAR levels of these handsets. As the manufacturers’ approvals refer to a prototype handset, and not for each and every handset, we have no information as to the actual level of SAR of the handsets along the lifecycle of the handsets, including in the case of repaired handsets. See also “Item 4B.13f Other Licenses”. Furthermore, our network sites comply with the International Council on Non-Ionizing Radiation Protection standard, a part of the World Health Organization, which has been adopted by the Israeli Ministry of Environmental Protection.

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

A class action was filed against us and three other operators alleging, among other things, that health effects were caused due to a lack of cell sites, resulting in elevated levels of radiation, mainly from handsets. The plaintiffs stressed

that health damages are not a part of the claim. The parties filed a request to approve a settlement agreement that is subject to the court's approval. Another class action was also filed against us and three other operators alleging, among other things, that the supply of accessories that are intended for carrying cellular handsets on the body are sold in a manner that contradicts the instructions and warnings of the cellular handset manufacturers and the recommendations of the Ministry of Health, and without disclosing the risks entailed in the use of these accessories when they are sold or marketed. The parties filed a request to approve a settlement agreement that is subject to the court's approval.

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

The perception of increased health risks related to network sites may cause us increased difficulty in obtaining leases for new network site locations or renewing leases for existing locations or otherwise in installing mobile telecommunication devices. If it is ever determined that health risks existed or that there was a deviation from radiation standards which would result in a health risk from sites, other telecommunication devices or handsets, this would have a material adverse effect on our business, operations and financial condition, including through exposure to potential liability, a reduction in subscribers and reduced usage per subscriber. Furthermore, we do not expect to be able to obtain insurance with respect to such liability.

3D.2k In the event critical elements of our networks which provide mobile, fixed-line, ISP and ILD services are damaged or rendered non-operational, we may not be able to replace them or return them to service quickly. As a result, we may not be able, for an indeterminate period of time, to provide services to a substantial portion of our subscribers, furnish some services properly or at all, charge for services provided or ensure data security, causing loss of revenues, a duty of compensation to subscribers, damage to our brand and reputation, and loss of customers.

Some elements of our network, particularly our mobile network, perform critical functions for broad sectors of our network operation, such as switching, billing and data platforms. If such a critical element were damaged or ceased proper operation due to natural causes (such as fire, water, extreme weather conditions, earthquake), technical failures or hostile activities (see "Item 3D.2p The political and military conditions in Israel may adversely affect our financial condition and results of operations.") or cyber incidents generated either externally through accidental malfunctioning or deliberate intrusion, or internally as a result of technical breakdown, damages may result to us or to our customers. For example, an entire sector of our network coverage or all of it may be rendered non-functioning, which means that we would not be able to provide telecommunications services to a substantial portion of our subscribers; or we may be unable to provide certain services, or to provide them without disruptions or charge for services rendered, or we may experience loss of data of the Company or of our customers stored with us. During 2013, we experienced an increase in cyber incident attempts. Although we have integrated systems to protect against events such as cyber incidents and prepared Disaster Recovery Plans ("DRP"), it is not possible to determine in advance whether our defense systems and recovery plans will continue to be entirely effective, or how quickly we will be able to restore service. In the event we are unable to provide telecommunications services to a substantial portion of our subscribers, whether temporarily or for an extended period of time, our business and short- and long-term results of operations will be materially negatively affected, we may be exposed to legal claims and liability to our subscribers, our brand and reputation may be damaged, we may suffer a loss of customers, and we may be required to compensate our customers, which may adversely affect our results of operation.

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

We may face competition from existing or future technologies that have the technical capability to handle mobile and fixed-line telephone calls, and to interconnect with local and international telephone networks and the Internet. Such new and evolving technologies, include fixed-line and, private and shared radio networks, broadband wireless access services, Over the Top or Internet-based voice and multimedia services, WiFi technologies and VoC. For example, internet-based services that provide user experience largely equivalent to our offerings, such as Voice over IP ("VoIP"), messaging services (Skype, Viber, whatsapp), and video services (youtube, video portals) are already available. In

addition, the rapid development in recent years of technologies that allow international calls to be placed over the Internet without the need to use the services of an ILD has caused a decrease in the amount of international call minutes placed through the ILD services and also serve as an alternative for fixed-line communications. In particular, the risk posed by VoIP is that the purchase of a data package alone will be sufficient for the provision of most cellular voice, data and messaging services.

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

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

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

In addition to a number of legal and administrative proceedings arising in the ordinary course of our business, we have been named as defendants in a number of civil and criminal proceedings related to our network infrastructure, which may result in civil liabilities or criminal penalties against us or our officers and directors, and consumer claims regarding, for example, our tariff plans and billing methods, which may result in significant monetary damages and civil penalties. The costs that may result from these lawsuits are only accrued when it is more likely than not that a liability, resulting from past events, will be incurred and the amount of that liability can be quantified or estimated within a reasonable range. The amount of the provisions recorded is based on a case-by-case assessment of the risk level, and events arising during the course of legal proceedings may require a reassessment of this risk. The Company's assessment of risk is based both on the advice of legal counsel and on the Company's estimate of the financial exposure if the verdict is in favor of the plaintiff. If we underestimate the potential exposure, our financial results will be adversely affected. See "Item 8A.1 Legal And Administrative Proceedings".

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

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

Our ability to provide commercially viable fixed-line and cellular telephone services depends upon our ability to interconnect with the telecommunications networks of existing and future fixed-line, cellular telephone and international operators in Israel in order to complete calls between our customers and parties on the fixed-line or other cellular telephone networks. All fixed-line, cellular telephone and international operators in Israel are legally required to provide interconnection to, and not to discriminate against, any other licensed telecommunications operator in Israel. We have interconnect relations with all the Israeli operators, including Bezeq and HOT Telecom, and we also depend on their internet broadband access infrastructure in order to provide ISP services and VoB fixed telephony services to the residential market. See "Item 3D.1b If insufficient or improperly implemented, regulatory initiatives

that are intended to allow telecommunication providers, such as Partner, that do not have their own fixed-line infrastructure to include the infrastructure component as part of their bundled service offerings may negatively affect our business and results of operations."

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

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

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

3D.2o Our marketing strategy relies on using the international Orange brand. If our brand license agreement terminates or is revoked, we will lose one of our main competitive strengths.

Our marketing strategy relies on the use of the international Orange brand, which we license from Orange Brand Services Limited, a member of the France Telecom Group (“Orange”). The license granted to us under the agreement that was entered into on July 1, 1998, shall be in effect for as long as we are able and legally eligible under the laws of Israel to offer telecommunications services to the public in Israel and for as long as we comply with the terms of the agreement. Under the brand license agreement, Orange may terminate our license if we have materially breached the agreement and such breach has not been remedied within a certain time period. If we lose the use of the Orange brand, we would lose one of our main competitive strengths and have to create and position a new brand, which could require substantial time and financial resources. As a result, our business and results of operation may be negatively affected.

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

The political and military conditions in Israel directly influence us. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. Hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners and political instability within Israel or its neighboring countries are likely to cause our revenues to fall and harm our business. During the last decade, there has been a high level of violence between Israel and the Palestinians, including missile strikes by Hamas against Israel, which led to an armed conflict between Israel and the Hamas in December 2008 and January 2009 and more recently in November 2012. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. There is evidence that Iran has a strong influence among extremist groups in areas that neighbor Israel, such as Hamas in Gaza and Hezbollah in Lebanon. This situation may potentially escalate in the future to violent events which may affect Israel and us. Ongoing violence between Israel and its Arab neighbors and Palestinians may have a material adverse effect on the Israeli economy, in general, and on our business, financial condition or results of operations. During such periods, incoming and outgoing tourism may be affected which consequently may have an adverse effect on our financial results. In particular, in recent conflicts, missile attacks have occurred on civilian areas, which could cause substantial damage to our infrastructure network, reducing our ability to continue serving our customers as well as our overall network capacity. In addition, in the event political unrest and instability in the Middle East, including changes in some of the governments in the region, causes investor concerns resulting in a reduction in the value of the shekel, our expenses in non-shekel currencies may increase, with a material adverse effect on our financial results.

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

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

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

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

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

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

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

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

Our bank borrowings and repayments of principal and interest on our Series B Notes due 2016, Series C Notes due 2018, Series D Notes due 2021 and Series E Notes due 2017 are currently in shekels, of which Series B and C, and bank borrowings, at a total principal of NIS 1,799 million (including current maturities, less offering expenses) are linked to CPI. We may not be able to raise our tariffs in a manner that would fully compensate for any increase in the CPI. Therefore, an increase in the rate of inflation may also have a material adverse impact upon us by increasing our financial expenses without an offsetting increase in revenue. See “Item 11. Quantitative and Qualitative Disclosures About Market Risk” for more information regarding the Company’s exposure to exchange rate fluctuations and inflation.

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

Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 relating to the evaluation of our internal control over financial reporting required substantial resources, management time and attention. We expect these efforts to require a continued commitment of resources. If we fail to maintain the adequacy of our internal controls, we may not be able to conclude on an ongoing basis that we have effective internal control over financial reporting. Although our management has concluded that our internal control over financial reporting was effective as of December 31, 2013, we may identify material weaknesses or other disclosable conditions relating to internal control over financial reporting in the future. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and significant effort and expense, and could have a material adverse effect on our operating results and on the market price of our ordinary shares.

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

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

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

For the year ended December 31, 2011, the Company distributed dividends in an amount of NIS 350 million. For the year ended December 31, 2012, the Company distributed dividends in an amount of NIS 160 million. No dividends have been declared for the year ended December 31, 2013.

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

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

3D.3 RISKS RELATED TO OUR PRINCIPAL SHAREHOLDERS

3D.3a 30.87% of our issued and outstanding shares and voting rights are held by our largest shareholder, who has entered into a shareholders' agreement with our second largest shareholder, whose holdings, when aggregated with those of its parent company, amount to 13.95% of our issued and outstanding shares and voting rights.

As of January 31, 2014, our largest shareholder, S.B. Israel Telecom Ltd. ("S.B. Israel Telecom"), held approximately 30.87% of our issued and outstanding shares following the change of control transaction in January 2013 pursuant to which S.B. Israel Telecom acquired shares from Scailex Corporation Ltd. ("Scailex") and Leumi Partners Ltd. The holdings of our second largest shareholder, Scailex, an Israeli corporation listed on the Tel Aviv Stock Exchange that is indirectly controlled by Mr. Ilan Ben-Dov, together with the holdings of its parent company, Suny Electronics Ltd., amount to approximately 13.95% of our issued and outstanding shares. See "Item 7A.1 Principal Shareholders".

As part of the change of control transaction, S.B. Israel Telecom and Scailex have signed a shareholders' agreement regarding, among others, the exercise of their voting rights (in which they have agreed to hold a preliminary meeting to coordinate a uniform vote in advance of each shareholders' meeting) and their consent regarding nomination of directors in Partner. See "Item 7A Major Shareholders – Shareholders' Agreement".

As our largest shareholder, S.B. Israel Telecom has the ability to significantly influence our business through its ability to appoint directors serving on our Board of Directors and thereby substantially control all actions that require approval of our Board of Directors.

S.B. Israel Telecom and Scailex are not obligated to provide us with financial support or to exercise their rights as shareholders in our best interests or in the best interests of our other shareholders and noteholders, and either one or both may engage in activities that conflict with such interests. If the interests of S.B. Israel Telecom and Scailex conflict with the interests of our other shareholders and noteholders, those shareholders and noteholders could be disadvantaged by the actions that these shareholders may pursue. However, our largest shareholders are subject to the fairness duty of a controlling shareholder under the Israeli Companies Law. See "Item 6C.13 Duties of a Shareholder".

For more information regarding our major shareholders see "Item 7A Major Shareholders and 7A.1 Principal Shareholders".

ITEM 4. INFORMATION ON THE COMPANY

4A. History and Development of the Company

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

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

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

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

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

- In August 2000, we completed an offering, registered under the US Securities Act of 1933, as amended, of \$175 million (approximately \$170.5 million after deducting commissions and offering expenses) in 13% unsecured senior subordinated notes due 2010. These notes were redeemed in August 2005.
- On March 31, 2001, we had over 1,000,000 cellular subscribers.
- In July 2001, we registered our ordinary shares for trading on the Tel Aviv Stock Exchange.
- In December 2001, the Ministry of Communications awarded us two bands of spectrum: one band of GSM 1800 spectrum and one band of 2100 UMTS third generation spectrum.
- In June 2002, our license was extended until February 2022.
- In August 2003, we had over 2,000,000 cellular subscribers.
- In December 2004, we commercially launched our 3G network.
- In March 2005, we completed a debt offering, raising NIS 2.0 billion in a public offering in Israel of notes due 2012.
- In April 2005, we repurchased approximately 33.3 million shares from our Israeli founding shareholders, representing approximately 18.1% of our outstanding shares immediately before the repurchase.
- In the third quarter of 2005, our Board of Directors and shareholders approved the distribution of our first cash dividend, in the amount of NIS 0.57 per share, totaling approximately NIS 86.4 million.
- In March 2006, we launched services based on the High Speed Downlink Packet Access (“HSDPA”) technology. HSDPA is a technological enhancement to our 3G services that offers subscribers the ability to access our 3G services at higher speeds. The HSDPA technology has been deployed to support up to 21 Mbps on the downlink and 5.76 Mbps on the uplink.
- In July 2006, we purchased Med-1 I.C.–1 (1999) Ltd.’s fiber-optic transmission business for approximately NIS 71 million, in order to enable us to reduce our transmission costs as well as to provide our business customers with bundled services of transmission of data and voice and fixed-line services.
- In January 2007, we were granted a domestic fixed license by the Ministry of Communications, and in February 2007 we were granted a network termination point license.
- In December 2008 and January 2009, we launched three additional non-cellular business lines: VoB telephony services, ISP services and Web VOD (video on demand).
- In October 2009, Scailex became our principal shareholder through acquiring the entire interest in the Company of our previous controlling shareholder. Scailex is indirectly controlled by Mr. Ilan Ben-Dov.
- In February 2010, the District Court approved the application submitted by the Company for a special dividend distribution in the total amount of NIS 1.4 billion (exceeding the surpluses for distribution) to the Company’s shareholders (“the capital reduction”). Following the District Court’s approval, a total amount of NIS 1.4 billion or approximately NIS 9.04 per share was paid on March 18, 2010, to shareholders and ADS holders of record on March 7, 2010, which resulted in a reduction of the shareholders’ equity by an equal amount.

- On March 3, 2011, we acquired all of the outstanding shares of 012 Smile Telecom Ltd., a leading provider of broadband and traditional telecommunications services in Israel. 012 Smile's broadband services include broadband Internet access (ISP) with a suite of value-added services, specialized data services and server hosting, as well as new innovative services such as local telephony via voice over broadband (VOB) and a WiFi network of hotspots across Israel. Traditional voice services include ILD, hubbing, roaming and signaling and calling card services. 012 Smile services residential and business customers, as well as Israeli cellular operators and international communication services providers through its integrated multipurpose network. 012 Smile's network allows it to provide services to almost all of the homes and businesses in Israel. The acquisition of 012 Smile supported our strategy of becoming a leading comprehensive communications group, expanding our range of services and products.
- On January 29, 2013, S.B. Israel Telecom, an affiliate of Saban Capital Group, a private investment firm, based in Los Angeles, California, specializing in the media, entertainment and communications industries, became our principal shareholder through acquiring 30.87% of our issued and outstanding shares, principally from our previous controlling shareholder, Scailex. See "Item 7A Major Shareholders".
- On November 8, 2013, we entered into a 15-year network sharing agreement with HOT Mobile pursuant to which, subject to the approval by the Israeli authorities, the parties would create a 50-50 joint venture, which would operate and develop a cellular network to be shared by both companies (inter alia, as a result of pooling both companies' radio access network infrastructures to create a single radio access network). See "Item 4B.9 Our Network"

For information on our capital expenditures for the last three financial years, and for the principal capital expenditures currently in progress, see "Item 4B.9 Our Network" and "Item 5B Liquidity and Capital Resources".

4B. Business Overview

Partner Communications Company Ltd. is a leading Israeli telecommunications company, providing a range of cellular and fixed-line telecommunication services. We offer our subscribers technologies and services that we believe are advanced cellular data services through external or internal (in laptops) cellular modems, tablets and smartphones as well as competitive tariff plans.

As part of our strategy to extend our evolution into a diversified multi-service communications group, we supply our services through two business segments:

- the cellular business segment, our main business, which represents the substantial portion of our total revenues. The cellular business segment includes all services provided over our cellular networks including airtime, interconnect, roaming and content services. In addition, the cellular business segment's activities include sales of relevant equipment including cellular handsets, tablets, (including WIFI only tablets) laptops, datacards, modems including built-in modems in laptops and related equipment and accessories. On December 31, 2013, we had approximately 2,956 thousand cellular subscribers, representing an estimated 29% of total Israeli cellular telephone subscribers at that date. As of that date, approximately 72% of our subscriber base (approximately 2,133,000 subscribers) was represented by subscribers who subscribe to post-paid tariff plans and 28% (approximately 823,000 subscribers) by subscribers who subscribe to pre-paid tariff plans. (For a definition of "subscriber", see "Item 3A Selected Financial Data"); and
- the fixed-line business segment, which includes a number of services provided over fixed-line networks including (1) ISP services that provides access to the internet as well as home WiFi networks, including VAS such as anti-virus and anti-spam filtering; and fixed-line voice communication services provided

through VOB; (2) Transmission services and PRI; and (3) ILD services, outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services. In addition, this segment includes sales of related equipment such as domestic routers, smartboxes and related equipment.

We market our services mainly under the Orange brand which is licensed to us and has been used successfully in other markets around the world to promote telecommunications services. Throughout the years Orange has been the leading telecommunications brand in Israel. We also market some of our Fixed-Line Services under the 012 Smile brand and some of our Cellular Services under the 012 Mobile brand.

Our GSM/UMTS network covered 99% of the Israeli population at year-end 2013. We currently operate our GSM network in the 900 MHz and 1800 MHz bands and the UMTS network in the 2100 MHz band and in the 900 MHz band. Our services provided on the GSM network (2G) and on our UMTS/HSPA/ HSPA+ network (3G) include standard and enhanced services, as well as value-added services and products. See "Item 4B.6 Services and Products".

In 2013, we were named by marketest, a multi-discipline research and consulting firm, as the number one company among the large cellular companies in Israel in their "market-test rating for customer experience". In 2013, we were named by the Maala organization in their highest platinum category for corporate social responsibility for the sixth consecutive year.

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

We believe that the following special characteristics differentiate the Israeli market from other developed cellular telecommunications markets:

- **High Rate of Unlimited Packages.** Israeli cellular operators provide, among other price-competitive offers, a particularly high rate of unlimited voice and text packages, and various data packages consisting of relatively high volumes of data at competitive prices.
- **Lack of Migration Barriers.** Due to regulatory changes, the Israeli cellular market to date has limited migration barriers. Operators are no longer able to offer beneficial packages to residential or small business customers that commit to any contract periods, are prohibited from selling locked handsets and are not allowed to charge exit fees or link the sale of handsets to services. In addition, there is full number portability.
- **Cellular Telephone Market Saturation.** Since 1994, the market has sustained a rapid annual rate of growth from a 2.6% penetration rate at year-end 1994 to an estimated penetration rate in Israel at December 31, 2013, of 125%, representing approximately 10.1 million subscribers out of an estimated population of approximately 8.1 million. The total number of estimated cellular telephone subscribers includes dormant subscribers and subscribers to multiple networks as well as other subscribers who are not included in the Israeli population figures, such as Palestinians, visitors, and foreign workers.
- **Entrance of Additional Operators.** The regulatory changes in the telecommunications industry, particularly with respect to additional entrants that include cellular operators and MVNOs, have created a high level of competition in the industry.
- **Favorable Geography.** Israel covers an area of approximately 8,000 square miles (20,700 square kilometers) and its population tends to be centered in a small number of densely populated areas. In addition, the terrain of Israel is relatively flat. These factors facilitate the roll out, maintenance and subsequent upgrades of a cellular network in a cost effective manner.
- **High Penetration of Smartphones.** Published market data shows that the relatively young Israeli population has a propensity to accept and use high technology products. The level of penetration of smartphones in the Israeli market is also estimated to be one of the highest in the world.

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

Bezeq and the HOT Group are the only telecommunications services providers with their own nationwide fixed-line infrastructure. The markets for ILD services and ISP services are competitive. The internet market is split between internet infrastructure providers and internet service providers (ISP). While there are only two internet infrastructure providers, many telecommunication companies, including Partner, hold ISP licenses.

Fixed-line Services

Bezeq is the incumbent provider of fixed-line telephony services in Israel and holds approximately 60% of the market. The other providers of fixed-line telephony services are HOT Telecom, that holds approximately 20% of the market and Partner and Cellcom that hold approximately 9% and 7%, respectively, of the market.

Broadband and Internet services

The Israeli fixed-line broadband market is characterized by a regulatory structural separation between the providers of the infrastructure services and the providers of internet access services. Based on the reports of Bezeq and HOT Telecom, at the end of September 2013, there were approximately 1.985 million subscribers, and the household penetration rate was approximately 85%. The only providers of fixed-line infrastructure in the market are Bezeq through xDSL technology and HOT Telecom through cable modem technology. xDSL services were launched by Bezeq in 2000 and currently represent approximately 60% of broadband connections. Cable modems, which account for the rest of the market, have been available since 2002.

HOT Telecom announced in 2010 that it had completed the upgrade of its network to UFI (Ultra Fast Internet) and Bezeq completed upgrading its network to high speed NGN in 2012.

In August 2013, the Israel Broadband Company (IBC), was granted licenses after winning the tender published by the State of Israel for the election of a minority shareholder in the Israel Electric Corporation telecommunication project. IBC intends to introduce a new business model which may enable it to reach the retail market through the services of ISPs. According to media reports, IBC plans to launch a web portal in which it would offer ISP services to end users. ISPs which reach agreements with IBC would be listed on such a web portal. For further details see "Item 4B.13d - xi Election Procedure of the Electricity Company".

Internet access is currently provided by three major Internet service providers, or ISPs - Netvision, Bezeq International and us -- as well as some other niche players. The Company estimates that it is the second largest ISP in the market. All three major providers are also suppliers of ILD services (see below).

Until 2011, the Israeli ISPs were connected to the World Wide Web through an underwater communications cable owned and operated by Med Nautilus, a subsidiary of Telecom Italia SpA. Since January 2012, Bezeq International has its own underwater communications cable and in February 2012, the Tamares Group's underwater communications cable commenced operations. These additional underwater cables have increased the effective bandwidth of international data connectivity and reduce costs for ISPs. However, proposed regulation published for public comments by the Ministry of Communications in November 2011 proposes certain limitations on the terms of agreements with Med Nautilus, which would, among other effects, limit the discounts and capacity which Med Nautilus may provide and force ISP providers (other than Bezeq International) to purchase capacity on less favorable terms and prices. For further details see "Item 3D.1c Other regulatory developments may have a negative impact on the Company's business and results of operation."

International long distance services

ILD services in Israel have been open for competition since December 1996. There are currently eight players in this market. The three major players are: 012 Smile, Bezeq International and Netvision, who are estimated to hold together approximately 90% of the market. The other players are Xfone Communications, and Telzar International Communications Services Ltd., which commenced operations in 2011, and Hashikma N.G.N International Telecommunications 015 Ltd, Golan Telecom and HOT Mobile, that commenced operations in 2012. Beginning in 2012, as part of the unlimited packages that the cellular companies began offering their customers, most of them, including the Company, included ILD services to certain destinations in these packages. Proposed regulations intend, inter alia, to allow all general telecommunications licensees (including MVNOs) to provide international call services to international destinations included in their subscribers' tariff plans and only calls to destinations not included in the subscriber's plans would be routed through ILD providers. See "Item 4B.13d - ix Hearings and Examinations". Such regulations may alter the ILD market structure in Israel and decrease the volume of international calls routed through ILD providers.

4B.3 OUR STRATEGY

We intend to continue to create value for our shareholders, customers and employees. In order to accomplish this, we intend to:

- Pursue our Evolution into a Diversified Multi-service Communications Group. In order to compete with the emerging comprehensive telecommunications groups, we are continuing to broaden and diversify our portfolio of products and services to evolve into a diversified multi-service communications and media service provider. Our goal is to provide a full range of telecommunications and media services which will enable customers to satisfy all their telecommunications needs through us. Our high quality network enables our customers to benefit from advanced and high quality services. In addition to our major business providing cellular telecommunications services, our services offering range includes fixed-line telephony, ISP services, transmission services, and ILD services and other accompanying telecom and media services. We also intend to further enrich our media and content offerings in order to attract new customers and increase the level of loyalty and satisfaction of our existing customer base. Our licenses to operate in various telecommunications areas enable us to provide a wide range of services that will potentially be used to create a bundle of telecom and other adjacent services which we believe will favorably affect our ability to limit churn rates, increase customer loyalty, maximize the synergy between our lines of business and generate additional streams of revenues. Upon the establishment of a wholesale market in the fixed-line telecommunications market, we will strive to compete in the infrastructure market so that we may be able to provide our customers with a comprehensive package of services including television services.
- Drive Customer Satisfaction through Customer Centric Strategy. We have always believed that customer satisfaction is a key concern. We place a priority on and wish to lead the market in striving for excellence in the customer experience. We do so by differentiating ourselves from our competitors through continuous examination of our customers' needs, requirements and experience so that we may offer tailored packages to the various sectors. We provide our customers with a high level of accessible customer service at our service centers, call centers and digital services. In order to further provide high quality services to our customers and meet their needs, we have established a retail division that focuses on all of the retail interfaces with the customers. Internally, we seek to improve and align all company business model elements to deliver consistent satisfaction at each step of the customer's experience.
- Increasing Network Speed, Quality and Efficiency. We have had and shall continue to have, a commitment to ensure the quality of our network in all its domains: cellular, fixed-line telephony, ISP and transmission and the integration of technological progress to support usage growth. We continuously invest in our network platforms and transmission network and are preparing our network for upgrading to LTE, while ensuring smooth migration from existing networks to next generation networks. We are at an advanced stage of LTE deployment. Following the network sharing agreement with HOT Mobile, we expect to improve the coverage and quality and to accelerate the development of our cellular network infrastructure, while reducing operating costs.
- Improve Efficiency. We place a premium on improving operational efficiency, adjusting costs and workforce to a level appropriate for evolving market conditions. The intense competition in the Israeli telecom market requires us to further reduce costs to align them with reduced revenues. The network sharing agreement with HOT Mobile marks an additional step in the adjustment of Partner's operational structure to the changing market conditions, while continuing to allocate resources to improve the advanced services that the Company provides its customers. In order to increase efficiency, we are reorganizing and consolidating Company real estate including by adjusting the size of some of our service centers and their deployment in a manner that will enable us to provide our customers with a full range of services in accessible locations. See

"Item 4B.9 Our Network".

- Growth in Mobile Broadband. We are pursuing growth in mobile broadband to capitalize on the rapid increase in demand for ubiquitous mobile data services and devices. In this context, we are responding to the rapid growth of mobile data traffic, and adopting targeted segmentation and pricing strategies as well as taking advantage of different broadband connection modes, to deliver a valuable quality of broadband service to users.
- Company Culture. We believe that our employees are the Company's main and most significant asset and that each individual should be a key advocate of the Company's services and products. The successful execution of the Company's strategy depends on the motivation, loyalty and capabilities of our employees. Therefore we place great importance on forums that allow us to learn from our employees about their experience with the customer. Part of the Company's culture is to encourage an open discussion among all levels of employees including an "open door" policy of the CEO and a direct access to management. We allocate resources for the training of our employees in order to meet the continuous and changing requirements of our business and invest in their welfare by addressing their needs through various forums and modes of communication.

4B.4 COMPETITIVE STRENGTHS

We believe that the following competitive strengths differentiate us from our competitors and will assist us in achieving our mission and implementing our strategies:

- High Quality Networks. We believe that we set high standards for network quality. We constantly invest in upgrading our network to the most advanced software and hardware, in all network domains – Radio Network, Fixed transmission network, fixed and mobile core network platforms, underlying IP infrastructure and supporting active and passive infrastructure (such as AC/DC power system, A/C, cabling, and antennae). We also continuously add more base cellular stations to gain better, denser site grids which give better coverage and capacity, resulting in a better quality of service in terms of accessibility (i.e. setup success), retainability (i.e. drop probability) and quality (e.g. peak and average data rates and voice quality). These investments, together with the use of sophisticated network planning, optimization and monitoring tools and techniques, have produced a high quality network which has been branded as the Orange “Ultranet”.
- Strong Brand Identity. Since the launch of our full commercial operations in the cellular segment, we have made a substantial investment in promoting our brand identities in Israel to represent quality, innovation and customer service. Our marketing activities have resulted in wide-scale recognition of our brands for cellular and fixed-line services in Israel.
- Focus on Customer Experience. Since we believe that customer satisfaction is a key concern, we provide a quality customer experience through quick, simple and reliable handling of customer needs and interactions, which we have achieved through investments in technology, offering tailored packages to the various sectors, launching a new portfolio of smartphones and tablets, and new communications products as well as training of customer service skills.
- Variety of communication products. We believe that our fixed-line telephony, ISP services, transmission services and ILD services, strengthen our position in the communications market. Offering a variety of combined mobile and fixed-line products and services will enable us to better compete with the bundled services of other players, increase customer loyalty, and serve as an additional source of revenue.
- Strong and Motivated Management Team. We have been able to attract a number of Israeli senior managers from the telecommunications, high-tech and consumer products industries. Our management team is

experienced and highly respected and, we believe, well-positioned to manage and lead the Company.

4B.5 MARKETING AND BRAND

We believe that a focused marketing strategy is critical to support our goal of sustaining our position as a leading provider of quality and innovative communications solutions in Israel. Our marketing strategy is based upon the international Orange brand in which we continuously invest in order to maintain its high position in the telecommunications market.

Our marketing strategy emphasizes high value for money, network quality, quality of customer service and innovation. Subsequent to acquisition of 012 Smile in 2011, the Company markets some of its services under 012 Smile and 012 Mobile.

In order to better address our customer needs, while maintaining customer value, we launched the 012 Mobile brand in order to compete in the cellular low price competitive landscape, thus supporting the premium pricing of the Orange brand among the incumbent cellular operators. While the Orange brand is differentiated by a superior network, customer centric approach, expansive customer service, wide distribution and service channels, wide variety of handsets as well as technical guidance, 012 Mobile is characterized by highly competitive pricing, simplicity and digital customer service. In order to promote our advanced new handsets, tariffs and services, we employ a large number of promotional activities and use a broad range of advertising media. During 2013, we continued to pursue an advertising presence in the media in order to maintain high exposure for our brand and advanced technologies. Our main advertising activities focus on promoting the 'Ultranet - The best and fastest cellular network in Israel', subscribership and usage of 3G and HSPA services, and of advanced mobile applications and content such as mobile broadband using data-cards and smartphones, as well as increasing loyalty among our customers. Our marketing strategy focuses on promoting our services to various segments of the Israeli population. We advertise our services in several languages. In addition to traditional media, we promote our brand and services by sponsoring and initiating cultural and community programs. We use the distinctive Orange brand logo in our promotional activities and advertising. See "Item 4B.12 Intellectual Property".

In 2013, the price competition in the market intensified and we maintained our customer centric strategy and invested in our customers by launching 'ONE' customers program which grants our clients a high level of service, a variety of handpicked and customized discounts, offers and monthly surprises.

4B.6 SERVICES AND PRODUCTS

Our principal business, which provides approximately 80% of our revenues in 2013, (excluding inter-segment revenues) was derived from providing Cellular Services and handset sales for the cellular market in Israel. Approximately 20% of our revenues (excluding inter-segment revenues) are generated through our Fixed-Line Services and handset sales for the fixed-line market.

Our goal is to provide the best mobile broadband and fixed- line network, offering a wide range of products, services and content to the cellular and fixed- line customers and provide an excellent customer experience.

Cellular Services. Our major service is cellular telephony service – provided on both our 2G and 3G networks. Our basic offer includes domestic mobile calls, international dialing, roaming, voice mail, call waiting, call forwarding, caller identification, conference calling, short message services ("SMS"), intelligent network services (such as VPN and funtone), fax transmission, mobile broadband at speeds of up to 42 Mbps¹ and other services as a mobile portal of content services and applications including a rich selection of television, games and music under the Orange brand. We have concluded content agreements with a variety of content providers and suppliers in the Israeli television and entertainment industry.

1 The cellular data transmission speed is not constant and is dependent on various factors including coverage, network availability, the chosen connectivity technology, the handset, and cellular, internet and other telecommunication networks.

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Our main focus throughout 2013 was to continue to expand our 3G and HSPA business in Israel, to prepare the network for LTE technologies, and to enhance our relationship with our customers through active retention activities. To meet these goals, we are implementing our strategic network upgrade project, in which all network radio and core elements are being upgraded to Ericsson's most advanced products range. We have also expanded our transmission network to support the demand for high data transmission rates, and we introduced a third radio carrier for HSPA services, utilizing part of our existing 900 MHz spectrum. In parallel, we have also expanded our 3G handset portfolio to cater to several specific market segments, including the launch of the Infinity private label and mobile broadband solutions. Finally, we have enhanced our content portal offering and launched several innovative customer retention activities including our mobile application "MyOrange".

Due to the continuous penetration of smartphones and combined service price plans providing considerable volumes of unlimited packages of voice calls and text messages and various limited packages of data consumption on the cellular network, the Company expects that purchases of cellular data packages will continue to increase during the upcoming year.

The Company began offering, in late December 2012, an HD Voice service. This technology extends the frequency range of audio signals transmitted over the mobile voice call, resulting in higher quality speech transmission. HD Voice service provides numerous benefits compared to traditional voice transmission, including clearer overall sound quality; easier voice recognition; greater distinction between similar sounds, reduced background noise, and enhanced clarity for faint talkers. HD voice is now supported on our network for a growing range of mobile handsets, including all the most advanced smartphones that support this feature.

Fixed-line Services. We offer fixed-line services that include ISP services as well as home Wi-Fi networks, ILD services, transmission services and VoB telephony services.

- **ISP services.** As an internet service provider, we offer our customers ISP services and as a reseller we offer internet access. Our ISP services offering includes email accounts, home WiFi networking as well as additional value added services. Furthermore, we offer an advanced set of communications services that house web servers and related software and provide connectivity to the Internet for business customers.
- **ILD services.** As an international long distance provider, we offer our residential and business customers international telephony services including direct international dialing services, international and domestic pre-paid and post-paid calling cards, and call-back services. In addition, we offer our business customers international toll-free numbers and an international cellular service that offers fixed rates on calls from anywhere in the world. As an international long distance provider, we also provide hubbing traffic routing between network operators for termination of long distance calls outside of Israel.
- **Transmission.** We provide fixed-line transmission and data capacity services. Our fixed-line capacity also includes capacity which we lease from other land-line telecommunications service providers. The services we offer include primarily connectivity services by which we provide high quality, dedicated, point-to-point connection for business customers and telecommunications providers, as well as fixed-line services to business customers.
- **VoB.** This service allows users to make and receive telephone calls over the Internet through an internet connection. We offer traditional voice services to residential and business customers throughout Israel. Our service includes Quality of Service, which ensures high quality voice transmission regardless of the load on the internet connection, and a home gateway which is unique in the Israeli market for its range of sophisticated functionalities, including call "hijack" between the customer's Orange fixed and Orange mobile telephone lines and a variety of domestic dialing for business customers.

4B.6a Handsets

Following the launch of our HSPA network, most of our handset sales were smartphone handsets that enable customers to use content services with high-speed rates of data transmission, cellular modems and lap-tops with HSPA embedded data cards and tablets. As of 2013, we are not allowed to sell handsets with rebates on usage, due to regulatory changes.

4B.6b Tariff Plans

As of December 31, 2013, approximately 72% of our cellular subscriber base (approximately 2,133,000 subscribers) subscribed to post-paid tariff plans, and 28% (approximately 823,000 subscribers) subscribed to pre-paid tariff plans.

Business cellular tariff plans. Our post-paid cellular business tariff plans offer features attractive to business users such as bundles including unlimited amounts of call minutes and SMS (subject to reasonable use) as well as browsing packages; bundles with fixed amounts of call minutes and SMS and browsing packages; tariff plans with fixed tariffs for airtime usage without adding the interconnect charges imposed by other cellular and fixed-line providers for calls made by our subscribers that terminate on third party networks; and providing discounts for calls to designated numbers within a subscriber's calling circle. Our business cellular tariff plans for large business customers with over 100 subscribers, include commitment periods of up to 36 months.

Private customer cellular tariff plans. Most of our post-paid cellular tariff plans for private customers are also bundles including unlimited amounts of call minutes and SMS (subject to reasonable use) as well as browsing packages, or bundles with fixed amounts of call minutes and SMS and browsing packages. We also offer tariff plans that allow our subscribers to control their maximum monthly usage. The elements of our cellular tariff plans for post-paid private customers are packaged and marketed in various ways to create tariff packages attractive to target markets, including families, military, teens, students, family members of business customers and other sectors. Since February 2011, our private customer subscriber agreements do not have any commitment period.

Since 2012, the Company has launched cellular tariff plans under a new brand, "012 Mobile", based on the 012 Smile brand. Under this brand, the Company offers plans mainly under a digital self-service model through a dedicated website (including web-chat with customer representatives) at competitive prices. These tariff plans were launched in order to compete with offers of new operators launched in 2012.

Since 2012, the Company offers special discounts to customers with two or more subscribers in particular cellular plans, and to customers with subscribers in both cellular and fixed-line plans including VoB and ISP.

Under our pre-paid plans, upon purchase of a SIM card or phone card or prepayment by credit card, customers can use our network, including some of our value-added services, without the need to register with us or enter into any contract. Our pre-paid plans enable us to compete in the pre-paid cellular services market.

Fixed-line tariff plans. For our Fixed-Line Services, we have a wide range of diverse plans to meet the needs of the various sub-markets. In the ILD services market we have tariff plans based on call destinations and level of use. We also offer pre-paid plans for our various services. Our Internet Service prices are based on bandwidth. We have also launched an unlimited plan for our VoB packages.

4B.6c International Roaming

Roaming allows a mobile phone subscriber to place and to receive calls while in the coverage area of a network to which he does not subscribe and to be billed for such service by his home network. Facilitating international roaming was a primary design goal of the GSM system from its inception. A GSM roamer can therefore expect to enjoy substantially the same services, features and security while traveling as he does at home. However, the Ministry of Communications may introduce new regulations that would limit our revenues from roaming services. See "Item 4B.13d - ix Hearings and Examinations" and also "Recent and potential future regulation and negotiation of roaming tariffs, both within Israel and elsewhere, may increase our roaming expenses, decrease our roaming revenues and prevent us from raising our tariffs. If our competitors, including new entrants into the telecommunications market, can deliver a more cost effective roaming service or more effective roaming solutions than we do, our subscribers may migrate to those competitors and our results of operations could be adversely affected."

At December 31, 2013, we had commercial roaming relationships with 438 operators in 185 countries or jurisdictions and 269 3G roaming agreements in 121 countries. We also have agreements with satellite operators, providing global coverage, requiring the use of unique handsets. Creating roaming relationships with multiple operators in each country increases potential incoming roaming revenue for us and gives our subscribers more choice in coverage, services and prices in that country.

The 3G roaming agreements enable our 3G roamers to initiate video calls, high speed data and video and audio content while abroad. Since we operate our GSM services on the 900 MHz band, which is the most widely-used band among GSM operators worldwide in terms of handsets, and also on the 1800 MHz band, all of our roaming enabled subscribers may roam to most countries where we have roaming capability using their own handsets without modification. In some countries cellular networks use either the 1900 MHz band of GSM or other technologies (GSM 850, CDMA or UMTS) with which we have established international roaming. Our subscribers who own dual or tri-band handsets that work on GSM 1900 as well as GSM 900 may also use their own handsets in countries that deploy GSM 1900 frequency with networks using GSM 1900. Other subscribers who advise us of their intention to visit those countries are either loaned free of charge a compatible handset into which they insert their SIM, thus retaining their own phone number, phone book and all other regular features, or are given the option to rent such handsets at their destination upon their arrival.

4B.6d Value-Added Services

Cellular Services. In addition to standard mobile value-added services, See "Item 4B.6 Services and Products", we offer a variety of value-added services including among others, various content services, GPS, mail services, backup and synchronizing services, visual voice mail and vehicle fleet management. These services and others are important to our business as they create differentiating factors and increase customer usage, satisfaction and retention. We continuously track all major market developments regarding value-added network services, and we intend to implement and offer those services that are likely to be popular with customers and which would add value to our business.

Fixed-line Services. In addition to standard fixed-line value-added services, we offer a variety of value-added services that include defense and security services for the computer and e-mail that include among others, parental monitoring control, firewall, web hosting, anti-virus and site filtering based on the customer's restriction definition, and other value added internet services including hosting, cloud- based hosted services and virtual switchboard.

In November 2013, a new Retail Division was established to be responsible for all of the Company's working centers, stores and dealers that had previously been part of the Customers Division. The Retail Division is responsible for all aspects of handsets, equipment and accessories including procurement, logistics and final sale to the customer through

the various sale channels of the Company as well as handset maintenance through the Company's repair services and labs. Our customer support and service provides several channels for our customers: call centers, walk-in centers and self-service support, which include web-based services, mobile application, Interactive Voice Response ("IVR"), and automated SMS.

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

Walk-in Centers. We currently operate 29 service and sales centers across Israel. These centers provide a face-to-face, uniformly designed, contact channel and offer all services that we provide to customers: sales, handset upgrade, handset maintenance, tablet sales, fixed-line services (such as VOB and ISP) and other services (such as finance, rate-plan changes and subscription to new services) as well as accessories sales. Lease agreements for our retail stores and service centers are for periods of two to ten years. We have the option to extend the lease agreements for different periods including the initial lease period. See also Note 19 to the consolidated financial statements.

Self-Service. We provide our cellular customers with various self-service channels, such as IVR, web-based services, services via SMS and services via WAP. These channels provide general and specific information, including tariff plans, account balance, billing-related information and roaming tariffs. They also provide customers with information regarding trouble shooting and handset operation, and enable customers to activate services and to download content. These channels also allow customers to purchase various cellular services and update tariff plans.

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

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

- ISO 9001:2008, which focuses on fulfillment of clients and legal requirements;
- ISO 14001:2004, which coordinates our commitment to habitat and environment; and
- OHSAS 18001:2007, which directs our efforts to provide a safe and healthy work environment at our premises.

4B.7 SALES AND DISTRIBUTION

We apply a multi-channel approach to target various market segments and to coordinate our cellular and fixed-line sales strategy for both our business as well as private customers.

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

4B.7a Direct Sales Channels

Orange Sales and Service Centers: All of our walk-in centers in stores and malls serve as sales centers. The face-to-face contact enables customers to get the “feel and touch” of new handsets, tablets and services demonstrated by our representatives.

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

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

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

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

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

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

In addition, as of December 31, 2013, we have 24 Orange stands in shopping centers throughout the country, as well as four stores that specialize in sales and handset upgrades.

4B.7b Indirect Sales Channels

We have agreements with many traditional dealers that provide over 50 points of sale, selling a range of our products. The private dealer network is an important distribution channel because of its ability to attract existing cellular users to our network. Our dealer network focuses primarily on sales to individual customers and, to a lesser extent, small business customers. These dealers specialize in sales for post-paid customers and handset and tablet sales.

In addition we have agreements with 14 prepaid distributors that specialize in sales for pre-paid customers and distribution of pre-paid plans to sub-dealers.

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

All indirect sales channels are supported by a specialized “dealer support” call center providing information, support and coordination of appointments of car-kit installations.

The 012 Mobile cellular services are marketed through the internet as well as through retail chains and traditional dealers that sell the 012 Mobile SIM card.

4B.8 POST-PAID CUSTOMER CONTRACTS AND CREDIT POLICY

As of 2011, our standard subscriber agreements with most of our private subscribers are without commitment periods. Each of our business subscribers that has more than 100 lines signs an agreement with a commitment period of up to 36 months (generally including a commitment to pay the monthly charge for the full 36 months). Subscribers are billed monthly for airtime charges and charges per services. Roaming access for direct debit subscribers is subject to credit scoring by our credit supervisors with the assistance of outside credit agencies and may require additional guarantees or deposits.

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

Most of our cellular subscribers pay for the handsets in 18 or 36 installments, which are charged directly to their credit card or to their monthly bill. If the subscriber opts to pay for the installment via his monthly bill, the outstanding installment payments are not secured. Subscribers acquiring more than a certain number of handsets are subject to a

credit scoring review performed by Partner's credit supervisors with the assistance of outside credit agencies.

4B.9 OUR NETWORK

We have built an extensive, resilient and advanced network system in Israel, allowing us to offer our services with extensive coverage and consistent high quality. During the years ended December 31, 2012 and 2013, we made capital expenditures of NIS 343 million and NIS 246 million (\$71 million), respectively, in our network infrastructure, including optic fibers.

4B.9a Overview

Our network is a converged fixed and mobile telecommunications network. For mobile services we built a third generation wireless network, which offers full interactive multimedia capabilities. This technology brings wire-free networks significantly closer to the capabilities of fixed-line networks. Improvements in coding and data compression technology provide better voice quality and more reliable data transmission. UMTS is the global standard adopted for the implementation of third generation wireless telecommunications capable of data rates of up to 42 Mbps in the down-link and is the 3G technology we use. HSPA is a technological enhancement to our 3G services that offers subscribers the ability to access our 3G services at higher speeds for downloading (HSDPA) and uploading (HSUPA) data. The network infrastructure is LTE capable and is in a process of full LTE upgrade and launch subject to regulatory approval.

Cellular Network Sharing Agreement. On November 8, 2013, we entered into a 15-year network sharing agreement with HOT Mobile, which remains subject to approval by Israeli regulatory authorities. Pursuant to the network sharing agreement, the parties would create a 50-50 joint venture, which would operate and develop a radio access network to be shared by both companies starting with a pooling of both companies' radio access network infrastructures to create a single pooled radio access network. The joint venture would seek to improve network efficiency by reducing the number of network sites, while improving network coverage and capacity and introducing new technology. As a result, the shared network would optimize operating costs, including required maintenance and reduce environmental impact.

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

Our network sharing arrangement with HOT Mobile marks an additional step in the adjustment of Partner's operational structure to changing market conditions, while continuing to allocate resources to improve the advanced services that the Company provides its customers on the most advanced cellular network in Israel. See also "Item 3D.2b The network sharing agreement recently entered into by Partner may not provide the anticipated benefits and may lead to unexpected costs." and "Item 5A.1c Entry into Network Sharing Agreement."

4B.9b Infrastructure

As of December 31, 2013, our GSM network domain consisted of 2,027 macrobase transceiver stations, 125 microbase transceiver stations and 653 indoor transceiver stations, all linked to 6 base station controllers. The base station subsystem is controlled by 3 cellular switching centers. Base transceiver stations, cellular switching centers and base station controllers are interconnected by approximately 8,500 transmission links. Ericsson supplies our base station controller and base transceiver station sites for our GSM and GPRS network.

As of December 31, 2013, our UMTS network domain consisted of 2,017 macrobase transceiver base stations, 53 microbase transceiver stations and 602 indoor transceiver stations, all linked to 22 radio network controllers. The base station subsystem is controlled by 4 mobile switching centers and 8 media gateways. The base transceiver stations, the

mobile switching centers and the radio network controllers are interconnected by the above-mentioned 8,500 transmission links for voice services, and a dedicated IP radio access network and a mobile packet backbone network (IP-RAN, MPBN) for data traffic. As of January 2008, Ericsson is our sole 3G UTRAN and core network equipment supplier, and we are progressively replacing equipment purchased from other suppliers with Ericsson equipment. See “Item 4B.9g Suppliers”.

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

In addition, our network is interconnected with two public switched telephone companies, Bezeq and HOT Telecom, in several locations across Israel. Our network is also connected to all of the cellular networks, all the Israeli international operators, the fixed-line telephone network of the Palestine Telecommunication Co. Ltd. ("Paltel"), and the cellular network of Wataniya Palestine Mobile Telecommunication Company ("Wataniya"), and indirectly to the cellular network of Palestine Cellular Communications Ltd. ("Jawwal"). Our transmission network is made up mainly by our own microwave links and fiber optic infrastructure, while for sites that are unreachable with our own transmission, we lease lines from Bezeq and other operators. Currently approximately 32% of our transmission network consists of leased lines. Our fiber-optic and microwave transmission network enables us to reduce our transmission costs as well as to provide our business customers with bundled services of data and voice transmission and fixed-line services. Currently, our transmission network has more than 16 hundred kilometers of fiber optics and more than 12 hundred kilometers of microwave links.

Our GSM and UMTS radio networks covered 99% of the Israeli population at year-end 2013. We are continuing to expand and improve the coverage, capacity and quality of our UMTS network.

4B.9c Network Design

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

With these quality parameters in mind, we rolled out our UMTS/HSPA network starting in 2004, which shares locations with the GSM sites. In December 2007, we signed an agreement with LM Ericsson Israel Ltd. (Ericsson") for the replacement of third party 3G radio equipment existing in our network, and in October 2010, we signed an agreement with Ericsson for the upgrade of our existing fixed-mobile network and the deployment of our fourth generation network. Ericsson is currently the main supplier of our network. See "Item 4B.9g Suppliers".

We use monitoring probes and counters to ensure network quality.

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

In our Fixed-Line business we offer telephony lines using VoB technology, PRI voice trunks, Internet Services, data transmission and ILD services targeting households and business customers in the Israeli market. These services are provided over third parties' existing network infrastructure as well as our own partial infrastructure. In order to provide the Fixed-line Services in the residential market, we developed a home gateway box (smartbox), that provides the customer with a setup of a home network WiFi based on the protocol 802.11n, FXS and DECT supported phones, and

built-in firewall. This solution enables us to provide services to our customers such as call “hijack” which allows customers to retrieve incoming mobile line calls on their fixed-line and vice-versa, improved email accounts, anti-virus and site filtering based on the customer’s restriction definition.

4B.9d Spectrum Allocation and Capacity

Spectrum availability is limited and is allocated by the Ministry of Communications through a licensing process. Pursuant to the terms of our license and subsequent allocations, we were allocated 2x10.4 MHz in the 900 MHz frequency band, of which 2x4.8 MHz are shared with Jawwal which operates in the West Bank and the Gaza Strip. For a discussion of the risks associated with regulatory developments in spectrum allocation, see “Item 3D.1g We may not be allocated sufficient spectrum band or any spectrum at all needed in order to provide fourth generation (4G) services, and we may be required to terminate the use of certain spectrum or to share with another operator some of the spectrum we are currently using on an exclusive basis. These requirements may adversely affect our network quality and capacity as well as our ability to provide our customers with advanced technology services, which may adversely affect our ability to compete and our results of operations.”

We were also allocated two additional bands of spectrum: 2 x 10 MHz of GSM 1800 spectrum and 2 x 10 MHz of UMTS/HSDPA third generation in the 2100 MHz frequency band. We operate GSM 1800 MHz band base transceiver stations that enhance the capacity of our GSM 900 MHz network, and improve our GSM 900 MHz network’s quality. In May 2012, we shifted 5MHz of our 900MHz spectrum from the 2G GSM network to the 3G HSPA+ network.

4B.9e Enabling Systems

Our UMTS network offers advanced applications and services including, among others, a UMTS content portal offering a variety of services such as live TV channels, games, maps and directions application, wide range of music (MP3) services. We have installed a video gateway and a streaming server, enabling us to offer our customers a range of video services on UMTS handsets.

4B.9f Site Procurement

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

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

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

See “Item 4B.13g Network Site Permits” for a description of the approvals that are required for the erection and operation of network sites and the requirement to provide indemnification undertakings to local committees.

4B.9g Suppliers

Suppliers for our cellular network. For a number of years, we purchased our network equipment, such as switching equipment, base station controllers and base transceiver stations and network software, from Ericsson and

Nokia. Starting in January 2008, we purchase all our UMTS network equipment from Ericsson, and in 2010 we entered into an agreement with Ericsson, for the upgrade of our existing cellular networks and the deployment of our fourth generation network. As a result, Ericsson has gradually become our sole supplier of radio equipment and our main supplier of our other network infrastructures, such as GSM, GPRS and UMTS equipment, voice and data core switches, base station controllers, base transceiver stations, operation support systems and transmission systems equipment. See “Item 10C Material Contracts”. See also “Item 3D.2g We depend on a limited number of suppliers. Our results of operations could be adversely affected if our suppliers fail to provide us with adequate supplies of network equipment and handsets or maintenance support on a timely basis.”

We continue to purchase certain network components, for our cellular, fixed and ISP services, from various other key suppliers. For example, Alcatel-Lucent provides the Company with a pre-paid system that allows subscribers to pay set amounts in advance and thereby allows subscribers to manage their expenses for services. Alcatel-Lucent also provides an Intelligent-Network system, which implements Value Added voice Services such as VPN and Funtone (Music Ring-back Tone). Juniper Networks Ireland Ltd. supplies ISP infrastructure to the Company including routers and security solutions.

Handset Suppliers. In 2009, we entered into a three-year agreement with Apple for the purchase and resale of iPhone handsets in Israel and upon its expiry in 2012 we entered into a new agreement with Apple for an additional three-year period. See "Item 10C Material Contracts". During 2013, Apple was a major supplier of the Company's iPhone handsets. In addition, during 2013, we purchased most of our Samsung handsets from Scailex. See "Item 7B.2 Transactions With Scailex".

Suppliers for our fixed-line network. Only the Bezeq and HOT Groups own fixed-line telecommunications infrastructures in Israel. As a result, we rely on interconnection with the Bezeq and HOT Groups' infrastructure. Bezeq supplies the Company with fixed-line transmission services for connecting traffic between approximately 68% of the Company's sites and its switches. The HOT Group supplies the Company with interconnect lines between the broadband backbone and the ISP backbone. See "Item 3D.1b If insufficient or improperly implemented, regulatory initiatives that are intended to allow telecommunication providers, such as Partner, that do not have their own fixed-line infrastructure to include the infrastructure component as part of their bundled service offerings may negatively affect our business and results of operations." In addition, for hard-line connection to all major Western European countries and the United States, Med Nautilus supplies the Company with transmission services through its submarine infrastructure. See "Item 10C Material Contracts".

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

4B.9h Interconnection

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

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

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

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

For a discussion of the Ministry of Communications' reduction of interconnect tariffs see "Item 4B.13d - ii Reduction Of Interconnect Tariffs to Be Paid to Fixed-line Operators".

Two of our subsidiaries have a domestic fixed-line license. Our subsidiaries are connected directly with all other telecommunication networks operating in Israel. The interconnection fees are set by the Interconnection Regulations.

4B.10 COMPETITION

An overview of our principal competitors and of some aspects of the competitive environment for telecommunications services is set forth below. For further information regarding the impact of regulation and regulatory changes on competition, including measures to enable new service providers to enter the market, and the competitive pressures arising from the development of full-service telecommunications providers and new technologies, see “Item 3D.1 RISKS RELATING TO THE REGULATION OF OUR INDUSTRY.” and “Item 3D.2a As a result of substantial and continuing changes in our regulatory and business environment, our operating results have decreased significantly in the past two years. Our operating results may continue to decline in 2014 and beyond, which may adversely affect our financial condition.”

4B.10a Competitors in the Cellular Services market

There are currently five cellular telephone network operators in Israel: Partner, Cellcom, Pelephone, HOT Mobile, and Golan Telecom. Except for Golan Telecom, these cellular operators are part of the four main telecommunications groups. In addition, there are three active MVNO operators – Hashikma Communications Marketing Ltd., (“Rami Levy”); Alon Cellular Ltd. (“Alon Cellular”); and Home Cellular Ltd. (“Home Cellular”).

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

The table below sets forth an estimate of each operator’s share of total subscribers in the Israeli cellular market at December 31, 2009, 2010, 2011, 2012 and estimates for 2013.

Estimated Market Shares*	2009		2010		2011		2012		2013	
Partner	32	%	32	%	32	%	29	%	29	%
Cellcom	34	%	34	%	34	%	32	%	31	%
Pelephone	29	%	29	%	29	%	28	%	26	%
HOT Mobile	5	%	5	%	5	%	8	%	8	%
Golan Telecom and others	-		-		-		3	%	6	%

* Based on Partner subscriber data, as well as information contained in published reports, and public statements issued by other operators. The estimated market shares for 2013 are also based on data regarding the number of subscribers porting between operators.

Cellcom is an Israeli corporation founded in 1994, that is traded both on the Tel Aviv stock exchange as well as NYSE. The company's major beneficial shareholder until January 2014 was Discount Investment Corporation Ltd, a majority-owned subsidiary of IDB Development Corporation, which in turn is a majority-owned subsidiary of IDB Holding Corporation Ltd (“IDB”). In January 2014, the Israeli court approved a creditors' arrangement for IDB, under which (if implemented) IDB Development would be controlled by the Elzstain - Extra group, led by Mr. Eduardo Elzstain and Mr. Mordechai Ben Moshe. The creditors' arrangement is subject to receipt of requisite approvals under applicable law. A request to annul the court's approval of the creditors' arrangement for IDB and an appeal against such a decision to the Supreme Court were filed by former controlling shareholders of IDB. In August 2011, Cellcom acquired Netvision, an Israeli operator of domestic fixed-line services using VoB technology, PRI, transmission and data communications services, ISP services and ILD. Cellcom operates nationwide cellular telephone networks based

on GSM 1800 MHz/GPRS,EDGE and UMTS/HSDPA HSUPA technologies as well as fixed-line telephony, transmission and data services.

Pelephone is an Israeli corporation that is a wholly-owned subsidiary of Bezeq, Israel's largest telecommunications provider and the primary fixed-line operator that is controlled by B Communications Ltd., a company indirectly controlled by Shaul Elovitz, the controlling shareholder of Eurocom, which is the official distributor of the Nokia group in Israel. Bezeq and its subsidiaries offer fixed-line telephony services, cellular telephony services, PRI, internet broadband access, ISP services, transmission and data communications services, ILD services and multi-channel television services. Since 2009, Pelephone has a UMTS/HSPA network.

New Operators

HOT Mobile holds a general license to provide mobile telecommunications services. HOT Mobile's legacy network is an iDEN network. HOT mobile is held indirectly by the Altice Group, a French media group, controlled by Mr. Patrick Drahi, who also holds control of HOT Telecommunications Systems Ltd. ("HOT Telecommunications"), a multi-channel television operator in Israel. In December 2012, HOT Telecommunications was delisted from the Tel-Aviv Stock Exchange. The HOT Group's main areas of activity are multi-channel television services, fixed-line telephony services, PRI, internet broadband access, transmission and data communications services as well as ISP services through its subsidiary HOT-NET. In November 2011, HOT Telecommunications acquired all of the outstanding shares of HOT Mobile. HOT Mobile's cellular license was amended to include UMTS frequencies allocated subsequent to winning a Ministry of Communications' tender offer for frequencies in the 2100 Mhz spectrum. The HOT Group, which operates its 3G services under the brand name of HOT Mobile, is required to utilize the 2100 MHz spectrum to build full country coverage. Since this network is currently only partially deployed, its subscribers roam on Pelephone's network that has nationwide coverage.

Partner and HOT Mobile entered into a rights of use agreement, which took effect on November 8, 2013, and is valid until January 4, 2017. Under the rights of use agreement, Partner will provide services to HOT Mobile in the form of rights of use to Partner's radio cellular network in order to supplement HOT Mobile's current network coverage. According to the rights of use agreement, HOT Mobile will pay Partner fixed base payments with additional variable payments based on traffic volume exceeding a defined threshold.

Golan Telecom, is a privately owned company, owned by Michael Golan, Xavier Niel and the Parienti family and began operations in early 2012 after winning a Ministry of Communications' tender offer for frequencies in the 2100 Mhz spectrum. Golan Telecom signed a national roaming agreement with Cellcom.

Under the terms of HOT Mobile and Golan Telecom's licenses, the companies which won the UMTS frequency tender offer were required to pay a minimal fee as well as a guarantee for the balance to the Ministry of Communications before starting operations and to pay the balance of the fee to ensure compliance with the terms of the license after 5 years. However, as an incentive for these companies to rapidly build and expand their customer base, the final total amount of their fees and guarantees is calculated according to the level of the coverage of their services and will be reduced as the level of coverage increases. This incentive has been a significant factor in the aggressive marketing strategies and pricing of the additional entrants in order to gain market share, which, in light of the current saturation of the Israeli cellular market, has resulted in loss of market share by existing companies, including Partner, and substantial downward pressure on tariffs. In November 2013, the Ministry of Communications reduced HOT Mobile's license guarantee because it achieved the market share goal of 7%.

MVNOs

The Ministry of Communications has granted MVNO licenses to 11 companies, 5 of which had entered the market as of December 31, 2013. The major MVNOs are Rami Levy, which is a subsidiary of a major Israeli discount supermarket chain, Home Cellular which is a subsidiary of a leading group that owns, among others, hardware and home furnishing stores, and Alon Cellular which is owned by Alon Holdings, and also controls a leading retail and gas

station chain. In December 2011, we signed a hosting agreement with Alon Cellular with respect to their use of Partner's network as an MVNO. However, Pelephone has reported that in December 2013, Alon Cellular signed a hosting agreement with Pelephone; we have not received any formal notification from Alon Cellular. We are at this time uncertain as to the implications for the Company of the new hosting agreement between Pelephone and Alon Cellular, since we lack information regarding the scope of services that the Company will continue to provide to Alon Cellular by virtue of our prior hosting agreement with Alon Cellular (until the date of its termination). We are also uncertain as to whether our agreement with Alon Cellular will terminate prior to the original termination date. In light of the above, the Company is unable, at this stage, to evaluate the effect of the hosting agreement signed between Alon Cellular and Pelephone on our financial results. In May 2013, we signed a hosting agreement with Azi Communications Ltd. with respect to their use of Partner's network as an MVNO.

Other competitors

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

Several service providers offer competitive roaming solutions. The service is offered, inter alia, by the International Long Distance vendors as well as by specialized enterprises.

4B.10b Selected new technologies affecting the competitive environment for Cellular Services

The Ministry of Communications updated fixed operators' licenses to allow for the provision of VoC based services. For a discussion of the risks created by our competitive environment, including risks arising in connection with government measures to increase competition, see "Item 3D.1b If insufficient or improperly implemented, regulatory initiatives that are intended to allow telecommunication providers, such as Partner, that do not have their own fixed-line infrastructure to include the infrastructure component as part of their bundled service offerings may negatively affect our business and results of operations."

4B.10c Competitors in Fixed-line Services

In the fixed-line market, we compete with Bezeq, Israel's largest telecommunications provider and the primary fixed-line operator, HOT Telecom, and other telecommunication services providers who are entering the fixed-line market. Both the Bezeq Group and HOT Group provide cellular telephony services, ILD services, PRI, internet broadband access, ISP services, transmission and data communications services and multi-channel television services.

The Bezeq Group offers bundles of services subject to its structural separation limitations and provided that the bundle may not include a fixed-line telephony service of Bezeq, the parent company. The HOT Group may offer bundled services of fixed-line, internet broadband access and multi-channel television ("triple"). The bundle of services currently offered by the HOT Group does not include cellular services (other than a bundle of cellular services with ISP services recently offered by its subsidiaries HOT Mobile and HOT-NET). The Ministry of Communications allowed HOT Telecom LLP, HOT Telecommunication and HOT Mobile to sell and market each other's services and exchange information regarding such marketing activities.

Upon an effective wholesale fixed-line market, the Ministry of Communications may cancel the structural separation imposed on the Bezeq and HOT Groups. This will allow the groups to offer attractive bundles that include all of the above services that may result in a loss of market share by Partner in all relevant telecom markets.

There are currently two major fixed ISP providers in Israel that we compete with: Bezeq International and Netvision from the Cellcom Group. The three companies hold approximately 90% of the ISP market. HOT-NET is estimated to hold approximately 9% of the ISP market, and the remaining 2% of the ISP market is estimated to be held by smaller operators.

In the ILD services market, we compete with Netvision, Bezeq International, Xphone 018 Ltd, Hashikma N.G.N International Communications 015 Ltd. Telzar International Telecommunication Service Ltd, Golan Telecom International Ltd. and HOT Mobile International Telecommunications Ltd.

See also "Item 4B.2 Special characteristics of the Fixed-Line Telecommunications Industry in Israel".

4B.11 INFORMATION TECHNOLOGY

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

While many of our systems have been developed by third-party vendors, all of them have been modified and refined to suit our particular needs. In certain instances, we have developed critical information technology systems internally to meet our specific requirements. For example, significant segments of our CRM and business information infrastructure were developed internally and were designed to integrate our customer service outreach with our overall sales and marketing effort. In connection with our transformation into a diversified multi-service communications provider, we are upgrading our CRM, Enterprise Service Bus (“ESB”) and Enterprise Resource Planning (“ERP”) systems with systems that are better suited to our current and future needs.

We have upgraded many of our older servers in the infrastructure to newer and stronger servers. All the servers that we have upgraded that are used for core applications are installed in two different sites. In addition, the Company invested resources to improve the quality of the IT processes and billing accuracy.

4B.12 INTELLECTUAL PROPERTY

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

We have entered into a brand license agreement with Orange International Developments Limited, a subsidiary of Orange Limited, formerly Orange plc, further assigned to Orange Brand Services Limited, a member of the France Telecom Group (“Orange”). Under this agreement, we have the exclusive right to use the Orange brand in Israel. The term of the brand license agreement began on July 1, 1998. The license was royalty-free until June 2013; however, pursuant to an amendment to the brand license agreement entered into in January 2012, we began paying royalties in April 2012. Royalties payable are based on a percentage of the Company’s revenues from the provision of services offered under the Orange brand. Under the brand license agreement, we are required to comply with the Orange brand guidelines established by Orange. We have the right to use the Orange brand as long as we are able and legally eligible under the laws of Israel to offer telecommunications services to the public in Israel. However, the brand license agreement may be terminated by mutual agreement or by either party if it determines that the other party has materially breached the agreement and such a breach has not been remedied within a certain time period. We also entered into a brand support/technology transfer agreement with Orange Personal Communications Services Limited, further assigned to Orange. The agreement is intended to enable Orange to provide us with information and expertise to support the orange brand in Israel at an agreed cost. See “Item 3D.2o Our marketing strategy relies on using the international Orange brand. If our brand license agreement terminates or is revoked, we will lose one of our main competitive strengths.”

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

4B.13 REGULATION

4B.13a Overview

We operate within Israel primarily under the Telecommunications Law, the Wireless Telegraphy Ordinance (New Version), 1972 (the “Wireless Telegraphy Ordinance”), the regulations promulgated by the Ministry of Communications and our license. The Ministry of Communications issues the licenses which grant the right to establish and operate mobile telephone and other telecommunication services in Israel, and sets the terms by which such services are provided. The regulatory framework under which we operate consists also of the Planning and Building Law, the Consumer Protection Law, 1981, and the Non-Ionizing Radiation Law. Additional areas of Israeli law may be relevant to our operations, including antitrust law, specifically the Restrictive Trade Practices Law, 1988, the Class Actions Law, 2006, and administrative law.

4B.13b Telecommunications Law

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

General licenses, which relate to telecommunications activities over a public network or for the granting of nationwide services or international telecommunications services, have been awarded to the Bezeq Group, to the HOT Group, to four other cellular operators besides Partner and to the international operators. In addition, the Ministry of Communications has granted MVNO licenses to a number of companies.

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

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

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

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

Frequency Fees. Under the Telegraph Regulations, the Company is committed to pay an annual fixed fee for each frequency used. For the year 2011, the Company paid an amount of NIS 11 million which is after a deduction of amounts the Company was eligible to receive in accordance with the High Court of Justice's decision; the amount due before the reduction was NIS 58 million. For the years 2012 and 2013, the Company paid a total amount of approximately NIS 59 and NIS 60 million, respectively. See also Note 20(b)(1) to the consolidated financial statements.

Royalties. Pursuant to the Communications Regulations (Telecommunications and Broadcasting) (Royalties), 2001, we must pay royalties to the State of Israel every quarter based on our chargeable revenues, as defined in the regulation, from mobile telephone services (including, among other, airtime, monthly subscription fees, roaming services and non-recurring), on a cumulative basis, excluding value-added tax. Revenues for purposes of royalty calculation also exclude payments transferred to other telecommunications license holders, bad debts, payments for roaming services to foreign mobile telephone operators and certain other revenues. The rate of these royalties has decreased in recent years. The royalty rate for 2012 was set at 1.3% and for 2013 was set at 0%.

4B.13c Fair Competition and Antitrust Law

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

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

The Israeli Commissioner of Restrictive Trade Practices expressed his view in the past that the cellular telephone industry in Israel operates as an oligopoly, and in July 2011 the Israeli Parliament approved an amendment to the Restrictive Trade Practices Law.

4B.13d Regulatory Developments

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

4B.13d - i New Roaming Regulation

Following a hearing held by the Ministry of Communications, effective February 2014, the mobile radio telephone (MRT) licenses of all of the cellular operators in Israel will be amended so that as a default, the access to cellular internet services abroad will be blocked, unless the subscriber requested to have access to such services or has purchased a roaming services package or has extended his existing package. Implementation of the Ministry's decision may have a negative effect on the Company's financial results.

4B.13d - ii Reduction Of Interconnect Tariffs to Be Paid to Cellular Operators

In September 2010, the interconnect tariffs payable to Israeli cellular operators by other Israeli telecommunications operators were updated:

- the maximum interconnect tariff payable by a telecommunications operator to a cellular operator for the completion of a call in its cellular network was reduced from the tariff of NIS 0.251 per minute to NIS 0.0687 per minute effective January 1, 2011; to NIS 0.0634 per minute effective January 1, 2012; to 0.0591 per minute effective January 1, 2013; and to NIS 0.0555 per minute effective January 1, 2014; and
- the maximum interconnect tariff payable by a telecommunications operator to a cellular operator for sending an SMS message to its cellular network was reduced from the tariff of NIS 0.0285 to NIS 0.0016 effective January 1, 2011; to NIS 0.0015 effective January 1, 2012; to NIS 0.0014 effective January 1, 2013; and to NIS 0.0013 effective January 1, 2014.

The tariffs do not include VAT and are to be updated annually on January 1 of each year starting January 1, 2011, in accordance with the CPI, using the average annual CPI for the year 2009 (as defined by the Israeli Central Bureau of Statistics) as the basic CPI. In addition, the interconnect tariffs were linked to the royalty rates that applied to telecommunication operators in accordance with the royalty regulations.

The maximum, updated and CPI-adjusted tariff per minute excluding VAT effective January 1, 2014 is NIS 0.0615 for completion of a call in a cellular network and NIS 0.0014 excluding VAT for completion of an SMS message.

4B.13d - iii Reduction Of Interconnect Tariffs to Be Paid to Fixed-line Operators

In October 2013, the Ministry of Communications published its decision following a hearing conducted regarding a change in interconnect tariffs for the completion of a call on a fixed-line network. According to the decision, effective December 1, 2013, the maximum uniform tariff for the completion of a call on a fixed-line network will be NIS 0.01 (1 agora), excluding VAT per minute, for all hours of the day, instead of the current tariffs of NIS 0.0421 per minute during peak hours and NIS 0.0234 per minute during off-peak hours. The tariff will be updated annually in accordance with changes to the CPI. Accordingly, on January 1, 2014, the tariff was adjusted to NIS 0.0101 excluding VAT per minute.

4B.13d - iv Regulatory Consumer Amendments

On January 1, 2013, an amendment to the Consumer Protection Law became effective according to which if a supplier overcharges a consumer in a continuous transaction in which the supplier lawfully charges the consumer's bank account or credit card in installments, the supplier will refund the consumer the overcharged amount within four business days together with interest as well as an additional payment for the consumer's expenses in the amount of NIS 16. In addition, the amendment determined that if the supplier overcharged and did not refund the consumer, the court may award compensation without proof of damages up to an amount that does not exceed NIS 10,000.

In August, 2012, the Parliamentary Economics Committee approved a reform with respect to the import of cellular handsets that includes two facilitations that are intended to remove import barriers: the exemption from the need to receive a commercial license and the exemption from the need to receive a type approval for the import of new cellular handsets that meet acceptable European and American standards. The reform became effective in September 2012. In October 2012, the Ministry of Communications granted Partner an exemption from the need to receive a

commercial license for handsets and an exemption from the need to receive a type approval that will be effective until December 31, 2013. On December 8, 2013, the Ministry of Communications extended the said exemption until December 31, 2015.

On June 9, 2013, the Ministry of Communications' decision from December 2012 became effective that shortens the portability process between operators from three hours to forty minutes in the cellular segment and seventy minutes in the fixed-line segment. In addition, as of May 2013, in accordance with the Ministry of Communications' decision, the receiving operator must send the subscriber wishing to port an SMS with a random code that will be required in order to process the porting in order to prevent cases of erroneous porting.

On October 31, 2013 the Ministry of Communication clarified that the practice of offering special tariff plans and/or special promotions only to subscribers who migrated from one operator to the other and not to all of the new subscribers ("win back"), shall be considered a violation of the anti-discrimination clause in the cellular licenses. These amendments may have an adverse affect on the Company's results of operations.

4B.13d - v LTE Spectrum Allocation

The Ministry of Communications announced at the beginning of 2013 of its intention to allocate LTE frequencies in the 1800 spectrum and for that purpose summoned all of the operators as well as other parties for a consultation on the matter. In March 2013, we presented our position before the frequency committee, that if the Ministry of Communications decides to exclude us from the tender, it will have a negative effect on the deployment of LTE networks in Israel and would place us at a competitive disadvantage in comparison to our competitors. The Ministry of Communications has still not published a tender for the allocation of LTE frequencies. Until we receive further details regarding this allocation of spectrum, we are unable to evaluate the impact that the intended change in spectrum allocation, if it occurs, will have on our business or our results of operations.

On November 4, 2013, the Ministry of Communications granted Partner an experimental license for LTE trials in the 1800 Mhz band.

4B.13d - vi The Promotion of Competition and the Reduction of Centralization Law

The Promotion of Competition and the Reduction of Centralization Law (the “Centralization Law”) was enacted in Israel on December 11, 2013. The Centralization Law seeks to regulate the allocation of rights to promote competition and avoid the centralization of control over businesses.

The Centralization Law imposes new constraints and procedures on the allocation and extension by government regulatory authorities and ministers (the “State”) of various rights, including in the telecommunications field. The new procedures include consultation with a Centralization Reduction Committee (established by the Centralization Law) or the Controller of Trade Practices, as applicable. The Centralization Law applies to Partner as a result of rights granted to it under its operating licenses, or which it may seek in the future, and could therefore require that the specified procedures be followed before the State may approve further rights allocations or extensions. These provisions of the Centralization Law enter into effect on December 11, 2014 (except provisions regarding extensions of rights, which enter into effect on December 11, 2017). These procedures, if deemed necessary to promote competition and avoid centralized control, could be more restrictive than those currently applied to us, and as a result may impede or prevent allocations to us of telecommunications or other rights, which could limit our ability to expand our business. The Centralization Law may also limit transfers of interests in Partner which exceed certain thresholds of Partner’s outstanding capital.

In addition, the Centralization Law imposes restrictions on corporate structures where, among other situations, one public company controls multiple layers of subsidiary public companies (called “pyramids”), and it seeks to limit such structures to no more than two layers of public companies. For existing pyramids, the Centralization Law requires that the number of layers of public companies be reduced to three layers within four years (by December 2017) and to two layers within six years (by December 2019). To facilitate reduction of layer corporations before the end of the four-year or six-year periods (as applicable), the Centralization Law establishes several simpler and easier procedures for acquiring securities held by the public, such as lowering the majority required for arranging acquisitions of such securities.

In the event that a layer corporation controls another layer corporation in breach of the Centralization Law, a court may appoint a trustee with whom the shares held in breach will be deposited for their sale; the court will have wide discretion to issue other orders.

Partner currently may be deemed to be a layer corporation of a pyramid structure, such that the Centralization Law may require changes in our shareholder base within four or six years. Such changes may impact management of the Company and may have an adverse effect on our share price, depending on if and how our shares may be transferred

to comply with the Centralization Law.

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From June 2014 until the last applicable date for required reductions in layers (December 2017 or 2019), the Centralization law imposes stricter corporate governance constraints on the Board structure of certain layer corporations. Specifically, the Centralization Law requires that, starting at the third layer of corporations in a pyramid and for deeper layers, the Board of Directors must meet the following requirements, among others: (i) there must be a majority of independent directors ("Bilty Tluyim") under the Israeli Companies Law; (ii) the minimal number of external directors ("Dahatzim") shall be half the Board members minus one rounded upwards; and (iii) the votes of the controlling shareholder will be disregarded in the election (and re-election) of external directors ("Dahatzim"). The General Meeting for appointment of new external directors ("Dahatzim"), if needed to achieve compliance with the interim requirements, must take place by September 10, 2014. The Israeli Securities Authority may impose a financial penalty ("Izum Caspi") on a layer corporation for a breach of the aforementioned duty to appoint external directors or independent directors for more than ninety days (unless the breach stems from a lack of the required majority of votes for the appointment at the General Meeting). However, under an initial draft of regulations recently proposed under the Centralization Law, some classes of corporations, including Partner, may be exempted from these interim requirements.

The Centralization Law also authorizes the Minister of Finance and the Governor of the Bank of Israel to set restrictions on granting credits to an entity ("ta'agid") or, in the aggregate, to a business group (i.e., a controlling party and corporations under its control) by financial institutions. It is not currently clear if and to what extent such restrictions may be adopted and applied to us, and thus whether they will add further constraints on our ability to obtain credit from financial institutions in the future.

The Centralization Law is new, and critical elements will need to be provided by future regulations and other formal publications, including clearly identifying persons and entities to which different constraints apply. As a result, the precise ramifications of the Centralization Law for Partner cannot be fully ascertained at this time.

4B.13d - vii Securities Administrative Enforcement

An amendment to the Israeli Securities laws, which came into force in January 2011, established administrative enforcement measures for handling certain violations of certain securities and securities-related laws supervised by the Israeli Securities Authority, or ISA. This amendment allows the ISA to impose various civil enforcement measures, including financial sanctions, payment to the harmed party, prohibition of the violator from serving as an executive officer for a certain period of time, annulment or suspension of licenses, approvals and permits granted under such laws and an agreed settlement mechanism as an alternative for a criminal or administrative proceeding. In case of a violation by a corporation, the amendment provides for additional responsibility of the Chief Executive Officer in some cases, unless certain conditions have been met, including the existence of procedures for the prevention of the violation, as part of an internal enforcement plan. The Company is prohibited from insuring, paying or indemnifying directors or senior officers for financial sanctions imposed on them in accordance with this amendment subject to certain exemptions set forth in the law. The Company has begun implementing an internal enforcement plan in accordance with this amendment.

4B.13d - viii Network Neutrality

In July 2009, the Ministry of Communications published an instruction to cellular operators and ISPs in Israel to maintain "network neutrality" by avoiding any limitation on applications or protocol usage on the Internet or any other action which might be considered discriminatory against content providers or which might harm consumers. As part of an amendment to the Telecommunications Law in 2011, new provisions regarding the obligation to maintain "network neutrality" on the Internet while browsing from cellular phones became effective.

On January 20, 2014, the Economics Committee of the Parliament approved a draft bill according to which the instruction to maintain “network neutrality “ should be broadened to apply to all operators in the telecommunications field and not only cellular operators as well as those that engage in import, distribution, sale or maintenance of telecommunications equipment that is meant or required for the receipt of services of the various telecommunications operators.

In addition, the Ministry of Communications clarified in September 2012 that cellular operators were prohibited from blocking or limiting subscribers’ ability to define handset equipment as a “hot spot” that broadcasts WiFi in a manner that allows additional nearby equipment to use the cellular internet of the subscriber (“Tethering”).

4B.13d - ix

Hearings and Examinations

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

- **Roaming fees.** The Ministry of Communications is evaluating the cost of roaming and may introduce new regulations that would limit fees charged by Israeli cellular companies for calls made by the customers of foreign network operators while they are in Israel and using our network, as well as for calls made by our own customers using their handsets abroad. The Ministry of Communications has requested additional and more specific international roaming data from the cellular companies. Because we consider roaming charges to be a significant source of revenue, such regulatory limits could adversely affect our revenues.
- **Internet video services.** The Ministry of Communications and the Council for Cable TV and Satellite Broadcasting have published a public hearing in order to determine whether there is a need to regulate the provision of video services over the internet which might compete with multiple channel television services. In October 2011 the Ministry of Communications published its recommendations that included conditions for the adoption of suitable regulation and monitoring of television broadcasts over the internet and the establishment of a continuing implementation team in order to update the existing regulation in the existing broadcasting market and to apply regulation to television broadcasts over the internet. In February 2014, the Minister of Communications appointed a public committee for the evaluation of the regulation of commercial broadcasting in Israel. The committee's scope of evaluation includes, inter alia, future regulation of new entrants that shall distribute audio-visual content over the internet. The committee is expected to submit its recommendations by August 2014. Such internet video regulation may affect the Company's launch of television services.
- **Frequency fees.** The Ministry of Communications is conducting a re-assessment of the frequency fees set forth in the law in order to support effective allocation and the utmost utilization of the frequencies.
- **Pricing of international calls.** In January 2011, the Ministry of Communications published a hearing regarding the pricing of international calls to mobile phone destinations. The Israeli international calls operators currently set higher rates for international calls to mobile phone destinations than those for fixed-line destinations. In this consultation the Ministry proposes to regulate the price difference between international calls to mobile phone destinations and those for fixed-line destinations in one of two possible manners: (1) setting a uniform maximal surcharge for international calls to mobile destinations to be added to the cost of a call to fixed-line destinations in each country or (2) requiring the mobile telephony operators to set a uniform call fee for both types of destinations to each foreign country. The revenues of the Company would be adversely affected if these proposed new regulations are adopted.
- **Underwater cable services.** In November 2011, the Ministry of Communications published a hearing regarding a proposed regulation related to the underwater international telecom connection from Israel, proposing certain limitations on the agreements with Med Nautilus, Partner's provider, which shall, among other effects, limit the discounts and capacity Med Nautilus may provide to the Company, in order to provide new company protections for Tamares Telecom, a new company which has recently laid an underwater cable, to facilitate Tamares' entry into the fixed-line telecommunications market. More specifically, the Ministry of Communications may set, for a specified period of time, the minimum tariffs which Tamares' main competitor, Med Nautilus, may charge its customers, including Partner, as well as maximum capacity which it may offer its customers, thus creating a place in the market for Tamares at rates which will protect its new business. Because Bezeq International Ltd. ("Bezeq International") has its own underwater cable and may supply itself with its own international transmission services at a lower cost, our ability to compete on price with Bezeq for services in the international fixed-line telecommunications market may be reduced.

- ISP access fees. In June 2012, the Ministry of Communications published a hearing in which it proposes to abolish the payment that internet service providers are currently required to pay to broadband internet access infrastructure providers - the fixed-line operators (currently Bezeq and HOT Telecom) - for the transfer of the traffic between end users and the ISPs. In accordance with the Ministry's proposal, the payment for the broadband internet access infrastructure service shall be paid only by the end users. The Company submitted its response in August 2012.
- Roaming services during emergencies. In September 2012, the Ministry of Communications published a hearing with respect to roaming during a state of emergency or during a significant continuous malfunction in which the Ministry of Communications considers determining that under certain conditions, upon the Minister of Communications' instruction, cellular operators that have their own network infrastructure, will be required to provide roaming services to the subscribers of other cellular operators that have network infrastructure, whose network has been rendered non-functioning for a significant amount of time following an event resulting from a state of emergency, a telecommunications crisis or during a significant continuous malfunction. The Company submitted its response to the hearing in October 2012. The revenues of the Company would be adversely affected if these proposed new regulations are adopted.
- WLAN permit exemptions. In October 2012, the Ministry of Communications published a hearing with respect to exemptions from erection and operation permits of Wireless Local Access Network (WLAN) access points that operate on frequencies set forth in the Wireless Telegraph Ordinance, according to which the Ministry of Communications is considering to determine the following:
 - i. To allow the installation of WLAN access points anywhere and to remove the existing limitation regarding installations in bordered surroundings only (for example: cafes, airports and malls).
 - ii. To allow general and exclusive general licensees for the provision of domestic fixed-line services to offer their services through the use of WLAN technology and not to allow Mobile Network Operators licensees (MNOs) or Mobile Virtual Network Operators (MVNOs) to provide their services through the same technology.
 - iii. To determine that the erection and operation of the said access points shall be exempt from the need to obtain a permit.

The Company submitted its response to the hearing in November 2012.

In December 2013, the Ministry of Communications published a secondary hearing regarding this matter in which it proposed the following: (1) Cellular and fixed-line licensees will not be allowed to use the technology; or (2) to enable Cellular and fixed-line licensees to use the technology provided they do not charge an additional or separate payment for use of the WLAN.

- Premium services. In July 2013, the Ministry of Communications published a hearing that is intended to regulate the manner of provision of premium services so that all of the services will be provided through only three prefixes, two of which shall be blocked as a default. An international operator will be able to provide premium services without having to route the call abroad as long as the services will be provided through the prefixes designated for the provision of premium services. The revenues of the Company may be adversely affected by the results of this hearing.
- Unified license. In August 2013, the Ministry of Communications published a hearing regarding the obligation of all existing Licensees, except Bezeq and HOT Telecom to be regulated by a unified general license. In the hearing, it is proposed by the Ministry that existing licensees be obliged to conform to the unified license, under

which ILD services, special fixed-line services, ISP services, MVNO and NTP services shall be provided. Existing Licensees shall be obliged to conform to the terms of the unified license within a set period of time to be determined and afterwards to merge all relevant activities into a single corporate entity. Since the provisions of the draft unified license vary from those of the relevant existing licenses (and in many cases are more stringent compared to those of the existing licenses), such an obligation might burden the Company's activity in the relevant segments and may have adverse effect on our financial results. The Company submitted its response to the hearing in October 2013.

- Intervention in international call market. In October 2013, the Ministry of Communications published a hearing regarding new regulation of the international call market. In the hearing, it is proposed by the Ministry to allow all General Licensees (including MVNOs) to provide international call services to their subscribers, with respect to the international destinations which are included in the subscriber's tariff plan and to international destinations for which the tariff is lower or equal to the tariff of a call on the Licensee's network. The Ministry of Communications also proposes in the hearing that the General Licensees (such as cellular operators) would not be allowed to collect an interconnect fee for outgoing international calls. The revenues of the Company may be adversely affected by the results of the hearing.
- Imposition of financial sanctions. The Ministry of Communications' supervision department has served the Company with a number of supervision reports for alleged claims of breach of our license or the Telecommunications Law to which the Company has submitted its responses. If the Ministry of Communications imposes financial sanctions for the alleged breaches of the license or the Telecommunications Law, this could have an adverse effect on our financial condition or results of operations.

4B.13d - x

The Ministry of Communications policy regarding the fixed-line telecommunications sector

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

A. Sale of wholesale services:

- i. The Universal Infrastructure Operators that provide retail telecommunication services will be required to offer wholesale services to the other telecommunication providers, that will offer services on the owners' infrastructure (the wholesale market), based on non-discriminatory conditions.
- ii. The wholesale services tariffs and the terms of agreement shall be determined through negotiations between the Universal Infrastructure Operators and the service providers. An infrastructure owner that reaches an agreement with such other provider shall be required to offer the same terms, without discrimination, to all other providers. Affiliates of the infrastructure owner shall also be allowed to purchase wholesale services as long as these will be provided without discrimination to all other providers.
- iii. The Ministry of Communications shall intervene and set the wholesale tariffs and said terms of agreement, in case an agreement has not been reached between the parties within 6 months from the date of the publication of the policy document or if the agreement between the parties includes tariffs or terms that are unreasonable, may harm the competition, may harm the public welfare or may harm the interest of the service provider.

B. Structural Separation

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

- ii. The Minister of Communications shall consider providing leniencies or abolishing the structural separation (and replacing it with an accounting separation) between the fixed-line infrastructure owner and its affiliated cellular operator, in accordance with the development of the wholesale market and the pace of development of competition based on packaged services that combine fixed-line services and cellular services in the private sector.
- iii. In case a proper and appropriate wholesale market does not develop within 24 months from the date of the publication of the policy document, the Minister of Communications shall act to impose a structural separation in the fixed-line infrastructure owners, between the infrastructure and the services provided through this infrastructure to the end-customers.

C. Supervision over Bezeq Tariffs

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

D. Television Broadcasts

- i. The Ministry of Communications shall examine imposing a requirement to offer unbundled television services that are included in services packages that include telecommunication services (fixed-line and mobile) or broadband access services, which means a requirement to provide them at the same tariff as part of a service package or separately.
- ii. The abolishing of the structural separation with respect to multi-channel television shall be done if there is a reasonable possibility to provide a basic package of television services through the internet by service providers that do not own fixed-line infrastructure.

In June 2013, since no agreement had been achieved according to clause a(iii) above, the Ministry of Communications published a hearing regarding a basic offering of wholesale services and their prices, that an infrastructure owner shall be required to offer on the same terms, without discrimination, to all providers ("Standard Offering"). On January 14, 2014 the Ministry of Communications published its decision regarding the minimum six wholesale services to be included in the Standard Offering.

On January 15, 2014, the Ministry of Communications published a hearing regarding the provision of wholesale services and price determination in Bezeq's network only. The hearing includes a service portfolio for Bit Stream Access ("BSA") service. The hearing includes, inter alia, recommendations for the maximum tariffs of wholesale services in Bezeq's network that will be set in regulations. The last date for submission of responses to the hearing is March 10, 2014.

4B.13d - xi Election Procedure of the Electricity Company

The Ministries of Finance, National Infrastructures and Communications and the Israeli Electric Corporation the Israeli national electric company published in October 2011 an election process to elect a controlling shareholder, investor and co-founder of a new telecommunication company that will establish a new nationwide FTTH internet broadband access infrastructure (two such infrastructures already exist in Israel, owned by Bezeq and HOT Telecom, respectively).

In August 2013, the Minister of Communications granted Israel Broadband Company- IBC, a general license for the provision of fixed-line telecom services (infrastructure). IBC is owned by Israel Electric Corporation (40%) and a consortium of companies elected as the winning bidder in the election process, which is comprised of the following companies: ViaEuropa Israel Ltd., RAPAC Communication & Infrastructure Ltd., BATM advanced Communication Ltd., Tamares Holdings Sweden AB and Zisapel Properties (1992) Ltd. and Cisco Systems Finance International (60%).

Under its general license, IBC is permitted to provide its services only to other telecom licensees.

IBC was also granted a special license for the provision of domestic fixed-line data communication. According to local media reports, IBC is permitted under its special license, to provide its services to major commercial customers.

4B.13d - xii Accessibility for Disabled Persons

Regulations regarding accessibility based on the Equality Law for Disabled Persons have entered into force in October 2013. The regulations address issues including physical accessibility to our customer service centers as well as to information such as forms, pamphlets and telephone customer services. We believe that the costs required to comply with such regulations may be significant. The regulations under discussion allow relief to disabled persons against non-compliant companies of NIS 50,000 without having to prove damages and may provide grounds for class actions. The said regulations have been amended with respect to accessibility to buildings.

4B.13d - xiii Anti-Trust Regulation.

Pursuant to the Israeli Restrictive Trade Practices Law, 1988, if the Anti Trust Commissioner decides that the Israeli cellular market is oligopolistic, the Director General will have the authority to give instructions to all or some of the participants in our market, in order to, among other objectives, maintain or increase the competition level among the participants, the Director General's authority would include the ability to issue orders to remove or to ease entry or transfer barriers, to terminate a participant's activity, or otherwise to regulate the activities of the market.

4B.13e Our Mobile Telephone License

On April 7, 1998, the Ministry of Communications granted to us a general license to establish and operate a mobile telephone network in Israel. The Ministry of Communications amended our license in February 2002 to include the provision of 3G services by us and extended our mobile telephone license through 2022.

Under the terms of the amended license, we have provided a \$10 million guarantee to the State of Israel to secure the Company's adherence to the terms of the license.

On March 9, 2005, our license was further amended. The principal elements of this amendment are as follows:

- Our founding shareholders and their approved substitutes must hold, in the aggregate, at least 26% of each of our means of control. Furthermore, the maintenance of at least 26% of our means of control by our founding shareholders and their approved substitutes allows Partner to be protected from a license breach that would result from a transfer of shares for which the authorization of the Ministry of Communications was required, but not obtained.
- Israeli entities from among our founding shareholders and their approved substitutes must hold at least 5% of our issued and outstanding share capital and of each of our means of control. "Israeli entities" are defined as individuals who are citizens and residents of Israel and entities formed in Israel and controlled, directly or indirectly, by individuals who are citizens and residents of Israel, provided that indirect control is only through entities formed in Israel, unless otherwise approved by the Israeli Prime Minister or Minister of Communications.

- At least 10% of our Board of Directors must be appointed by Israeli entities, as defined above, provided that if the Board of Directors is comprised of up to 14 members, only one such director must be so appointed, and if the Board of Directors is comprised of between 15 and 24 members, only two such directors must be so appointed.
- Matters relating to national security shall be dealt with only by a Board of Directors committee that has been formed for that purpose. The committee includes at least 4 members, of which at least one is an external director. Only directors with the required clearance and those deemed appropriate by Israel's General Security Service may be members of this committee. Resolutions approved by this committee shall be deemed adopted by the Board of Directors.
- The Ministry of Communications shall be entitled to appoint an observer to the Board of Directors and its committees, subject to certain qualifications and confidentiality undertakings.

Term. Our license authorizes us on a non-exclusive basis to establish and operate a mobile telephone network in Israel. A mobile telephone network is a wireless telephone network through which mobile telephone service is provided to the public. Our license allocates to us specified frequencies and telephone numbers. Our license was originally valid for a period of ten years (until April 2008), but has been extended until 2022.

The license may be extended for an additional six-year period upon our request to the Ministry of Communications, and a confirmation from the Ministry of Communications that we have met the following performance requirements:

- observing the provisions of the Telecommunications Law, the Wireless Telegraphy Ordinance, the regulations and the provisions of our license;
- acting to continuously improve our mobile telephone services, their scope, availability, quality and technology, and that there has been no act or omission by us harming or limiting competition in the mobile telephone sector;
- having the ability to continue to provide mobile telephone services of a high standard and to implement the required investments in the technological updating of our system in order to improve the scope of such services, as well as their availability and quality; and
- using the spectrum allocated to us efficiently, compared to alternative applications.

At the end of this additional six-year period, we may request renewal of our license for successive six-year periods thereafter, subject to regulatory approval.

Contracting with Customers. Pursuant to our license, our standard agreement with customers must receive the Ministry of Communications' approval. We have submitted our standard agreement to the Ministry of Communications for approval pursuant to our license. To date, we have not received any comments from the Ministry of Communications regarding this agreement.

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

Payments. Our license specifies the payments we may charge our subscribers. These include one-time installation fees, fixed monthly payments, airtime fees, payments for the use of other telecommunication systems, payments for handset maintenance and payments for additional services. In some of our tariff plans we have chosen to charge only for airtime and use of services. See “Item 4B.6b Tariff Plans.”

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

Conversely, we must allow other network operators to interconnect to our network. See “Item 4B.9h Interconnection”

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

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

Universal Service. We are required to provide any third generation service with the same coverage as our existing network within 24 months from the commercial launch of each such service.

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

License Conditions. Our license imposes many conditions on our conduct. We must at all times be a company registered in Israel. Our license may not be transferred, mortgaged or attached without the prior approval of the Ministry of Communications. We may not sell, lease or mortgage any of the assets which serve for the implementation of our license without the prior approval of the Ministry of Communications, other than in favor of a banking corporation which is legally active in Israel, and in accordance with the conditions of our license.

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

- voting rights in Partner;
- the right to appoint a director or managing director of Partner;
- the right to participate in Partner’s profits; or

- the right to share in Partner's remaining assets after payment of debts when Partner is wound up.

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

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

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

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

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

- the founding shareholders or their approved substitutes of Partner continue to hold in the aggregate at least 26% of the means of control of Partner;
- our Articles of Association include the provisions described in this paragraph;
- we act in accordance with such provisions;
- our Articles of Association provide that an ordinary majority of the voting power at the general meeting of Partner is entitled to appoint all the directors of Partner other than external directors.

The amendment of our license providing for the dormant share mechanism does not apply to our founding shareholders.

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

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

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

- Israeli entities from among our founding shareholders and their approved substitutes must hold at least 5% of our issued share capital and of each of our means of control.
- The majority of our directors, and our general manager, must be citizens and residents of Israel.
- Neither the general manager of Partner nor a director of Partner may continue to serve in office if he has been convicted of certain legal offenses.
- No trust fund, insurance company, investment company or pension fund that is an Interested Party in Partner may: (a) hold, either directly or indirectly, more than 5% of any means of control in a competing mobile radio telephone operator without having obtained a permit to do so from the Ministry of Communications, or (b) hold, either directly or indirectly, more than 5% of any means of control in a competing mobile radio telephone operator in accordance with a permit from the Ministry, and in addition have a representative or appointee who is an Office Holder in a competing mobile radio telephone operator, unless it has been legally required to do so, or (c) hold, either directly or indirectly, more than 10% of any means of control in a competing mobile radio telephone operator, even if it received a permit to hold up to 10% of such means of control.
- No trust fund, insurance company, investment company or a pension fund that is an Interested Party in a competing mobile radio telephone operator may: (a) hold, either directly or indirectly, more than 5% of any means of control in Partner, without having obtained a permit to do so from the Ministry of Communications; or (b) hold, directly or indirectly, more than 5% of any means of control in Partner in accordance with a permit from the Ministry of Communications, and in addition have a representative or appointee who is an Office Holder in Partner, unless it has been legally required to do so; or (c) hold, either directly or indirectly, more than 10% of any means of control in Partner, even if it received a permit to hold up to 10% of such means of control.
- Partner, an Office Holder or Interested Party in Partner, or an Office Holder in an Interested Party in Partner does not control a competing mobile radio telephone operator, is not controlled by a competing mobile radio telephone operator, by an Office Holder or an Interested Party in a competing mobile radio telephone operator, by an Office Holder in an Interested Party in a competing mobile radio telephone operator, or by a person or corporation that controls a competing mobile radio telephone operator.

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

- We have illegally ceased, limited or delayed any one of our services;
- Any means of control in Partner or control of Partner has been transferred in contravention of our license;
- We fail to invest the required amounts in the establishment and operation of the mobile radio telephone system in accordance with our undertakings to the Ministry of Communications;
- We have harmed or limited competition in the area of mobile radio telephone services;
- A receiver or temporary liquidator is appointed for us, an order is issued for our winding up or we have decided to voluntarily wind up; or
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Partner, an Office Holder in Partner or an Interested Party in Partner or an Office Holder in an Interested Party of Partner is an Interested Party in a competing mobile radio telephone operator or is an Office Holder in a competing mobile radio telephone operator or in an interested party in a competing mobile radio telephone operator without first obtaining a permit from the Ministry of Communications to do so or has not fulfilled one of the conditions included in such permit. See “Item 4B.13e-Our Mobile Telephone License-Our Permit Regarding Cross Ownership.”

In addition, our amended license, like the licenses of our competitors, provides that if we participate in a future tender for a mobile telecommunications license, we may be required by the terms of a new tender, if we win such tender, to transfer our network to another operator according to terms which the Ministry of Communications may decide upon and to cease providing mobile telephony services.

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

- A change has occurred in the suitability of Partner to implement the actions and services that are the subject of our license.
- A change in our license is required in order to ensure effective and fair competition in the telecommunications sector.
- A change in our license is required in order to ensure the standards of availability and grade of service required of Partner.
- A change in telecommunications technology justifies a modification of our license.
- A change in the electromagnetic spectrum needs justifies, in the opinion of the Ministry of Communications, changes in our license.
- Considerations of public interest justify modifying our license.
- A change in government policy in the telecommunications sector justifies a modification of our license.
- A change in our license is required due to its breach by Partner.

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

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

- "Office Holder" means a director, manager, company secretary or any other senior officer that is directly subordinate to the general manager.
- "Control" means the ability to, directly or indirectly, direct the activity of a corporation, either alone or jointly with others, whether derived from the governing documents of the corporation, from an agreement, oral or written, from holding any of the means of control in the corporation or in another corporation, or which derives from any other source, and excluding the ability derived solely from holding the office of director or any other office in the corporation. Any person controlling a subsidiary or a corporation held directly by him will be deemed to control any corporation controlled by such subsidiary or by such controlled corporation. It is presumed that a person or corporation controls a corporation if one of the following conditions exist: (1) such person holds, either directly or indirectly, fifty percent (50%) or more of any means of control in the corporation; (2) such person holds, either directly or indirectly, a percentage of any means of control in the corporation which is the largest part in relation to the holdings of the other Interested Parties in the corporation;

or (3) such person has the ability to prevent the taking of business decisions in the corporation, with the exception of decisions in the matter of issuance of means of control in a corporation or decisions in the matters of sale or liquidation of most businesses of the corporation, or fundamental changes of these businesses.

- “Controlling Corporation” means a company that has control, as defined above, of a foreign mobile radio telephone operator.
- “Interested Party” means a person who either directly or indirectly holds 5% or more of any type of means of control, including holding as an agent.

Our Permit Regarding Cross Ownership

Our license generally prohibits cross-control or cross-ownership among competing mobile telephone operators without a permit from the Ministry of Communications. In particular, Partner, an Office Holder or an Interested Party in Partner, as well as an Office Holder in an Interested Party in Partner may not control or hold, directly or indirectly, 5% or more of any means of control of a competing mobile radio telephone operator. Our license also prohibits any competing mobile radio telephone operator or an Office Holder or an Interested Party in a competing mobile radio telephone operator, or an Office Holder in an Interested Party in a competing mobile radio telephone operator or a person or corporation that controls a competing mobile radio telephone operator from either controlling, or being an Interested Party in us.

However, our license, as amended on April 14, 2002, also provides that the Ministry of Communications may permit an Interested Party in Partner to hold, either directly or indirectly, 5% or more in any of the means of control of a competing mobile radio telephone operator if the Ministry of Communications is satisfied that competition will not be harmed, and on the condition that the Interested Party is an Interested Party in Partner only by virtue of a special calculation described in the license and relating to attributed holdings of shareholders deemed to be in control of a corporation.

4B.13f Other Licenses

Domestic Fixed-line License. In January, 2007, the Ministry of Communications granted Partner Land-Line Communication Solutions Limited Partnership, which is fully owned by the Company, a license for the provision of domestic fixed-line telecommunications services. The license expires in twenty years but may be extended by the Ministry of Communications for successive periods of ten years provided that the licensee has complied with the terms of the license and has acted consistently for the enhancement of telecom services and their enhancement. The licensee deposited a bank guarantee in the amount of NIS 10 million with the Ministry of Communications upon receiving the license which shall be used to secure the licensee’s obligations under the License. The general conditions of the mobile telephone license described above, generally apply to this license, subject to certain modifications. In addition to any 10% share transfer requiring the prior approval of the Ministry of Communications, the license additionally requires approval prior to a third party acquiring the ability to exercise significant influence over us. In this context, holding 25% of our means of control is presumed to confer significant influence. The license was amended in February 2007 to grant us the right to offer VoB services using the infrastructure of Bezeq and HOT Telecom to access customers and to provide them with fixed-line telephony service. The License was further amended in July 2007 to incorporate the provision of transmission and data communications services that were previously provided for under a transmission license that was granted in July 2006. In March 2009, we were also granted a domestic fixed-line license to provide fixed-line services to the Israeli populated areas in the West Bank. The license is effective until March 2019.

012 Smile was also granted a similar domestic fixed-line license by the Ministry of Communications in December 2005 for 20 years that may be extended under similar conditions as our domestic fixed-line license and a license to provide domestic fixed-line services to the Israeli populated areas in the West Bank which is valid until February 2018.

ISP License. In March 2001, we received a special license granted by the Ministry of Communications, allowing us through our own facilities to provide internet access to fixed-line network customers. The license is valid until April 2018. We began supplying commercial ISP services beginning in January 2009. We were also granted a special license to provide ISP services to the Israeli populated areas in the West Bank which is valid until April 2018. We have applied for an extension to these licenses.

012 Smile was also granted a similar ISP license by the Ministry of Communications in December 2009 that is valid until December 2014 and a special license to provide ISP services to the Israeli populated areas in the West Bank which is valid until February 2016.

International Long Distance License. In December 2009, the Ministry of Communications granted 012 Smile, a license for the provision of International Long Distance services. The license expires in twenty years but may be extended by the Ministry of Communications for successive periods of ten years provided that the licensee has complied with the terms of the license and has acted consistently for the enhancement of telecom services and their enhancement. The Ministry of Communications also granted 012 Smile, a license for the provision of International Long Distance services to the Israeli populated areas in the West Bank which is valid until February 2018.

NTP License. In February 2007 we received a special license granted by the Ministry of Communications allowing us to provide certain telecom services, including providing and installing equipment and cabling, representing the subscriber with local fixed operators, and establishing and operating control facilities within a subscriber's premises. The license is valid until February 2017.

012 Smile was also granted a similar NTP license by the Ministry of Communications in December 2009 that is valid until December 2014.

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

4B.13g Network Site Permits

Permits of the Ministry of Environmental Protection

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

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

Local Building Permits

The Planning and Building Law requires that we receive a building permit for the construction of most of our antennas. The local committee or local licensing authority in each local authority is authorized to grant building permits, provided such permits are in accordance with National Building Plan No. 36 which came into effect on June

15, 2002. The local committee is made up of members of the local municipal council. The local committee is authorized to delegate certain of its powers to subcommittees on which senior members of the local authority may sit.

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

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

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

National Building Plan No. 36

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

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

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

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

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

Wireless access devices

We have set up several hundred small communications devices, called wireless access devices, pursuant to a provision in the Telecommunications Law which we and other participants in cellular telecommunications, believe exempts such devices from the need to obtain a building permit. Beginning in 2008, following the filing of a claim that the exemption does not apply to cellular communications devices, the Attorney General filed an opinion regarding this matter stating that the exemption does apply to wireless radio access devices under certain conditions and instructed the Ministry of Interior to prepare regulations setting conditions that would limit the exemption to extraordinary circumstances. Following the instruction of the Attorney General, several inter-ministerial discussions and hearings have taken place without agreement being reached as to the final version of the regulations. The approval of the regulations was brought to the Economic Committee where the regulations were not approved. The chairman of the Economic Committee advised that he intended to meet with representatives of the relevant governmental ministries in an effort to seek a version of the regulations that would be acceptable by all committee members. Following two petitions that were filed with the High Court of Justice opposing the Attorney General's recommendation that the exemption apply under certain conditions, on September 16, 2010, the Supreme Court issued an interim order prohibiting further construction of wireless access devices in cellular networks in reliance on the exemption from the requirement to obtain a building permit. On February 16, 2011, and on July 18, 2012, the Supreme Court narrowed the scope of the interim injunction so that repair or replacement of existing wireless access devices is permitted under certain conditions that will be determined in a judgment. On September 6, 2011, the Supreme Court ruled that it would allow the two new UMTS operators to erect new wireless access devices without a need for a permit in accordance with the terms set forth in the decision. If a definitive court judgment holds that the exemption does not apply to cellular devices at all or if the regulations finally approved do not apply the exemption to wireless access devices, this could adversely affect the Company's existing network. As a result, we may be required to remove existing devices and would not be able to install new devices on the basis of the exemption. Our network capacity and coverage would then be negatively impacted, which could have an adverse effect on our revenue and results of operations.

Other Approvals

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

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

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

We have received approval from the Ministry of Communications for selling and distributing all of the handsets and other terminal equipment we sell. The Ministry of Environmental Protection also has authority to regulate the sale of handsets in Israel, and under the new Non-Ionizing Radiation Law, certain types of devices, which are radiation sources, including cellular handsets, have been exempted from requiring an approval from the Ministry of Environmental Protection so long as the radiation level emitted during the use of such handsets does not exceed the radiation level permitted under the Non-Ionizing Radiation Law. Since June 15, 2002, we have been required to provide information to purchasers of handsets on the Specific Absorption Rate (“SAR”) levels of the handsets as well as its compliance with certain standards pursuant to a regulation under the Consumer Protection Law. We attach a brochure to each handset that is sold that includes the SAR level of the specific handset. Such brochures are also available at our service centers and the information is also available on the Company’s website. SAR levels are a measurement of non-ionizing radiation that is emitted by a hand-held cellular telephone at its specific rate of absorption by living tissue. While, to the best of our knowledge, the handsets that we market comply with the applicable laws that relate to acceptable SAR levels, we rely on the SAR published by the manufacturer of these handsets and do not perform independent inspections of the SAR levels of these handsets. As the manufacturers’ approvals refer to a prototype handset and not for each and every handset, we have no information as to the actual SAR level of each specific handset and throughout its lifecycle, including in the case of equipment repair.

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

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

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

4C. Organizational Structure

We currently have five wholly-owned subsidiaries, Partner Future Communications 2000 Ltd., an Israeli corporation; Partner Net Ltd., an Israeli corporation; Partner Land-Line Communications Solutions LLP, an Israeli limited partnership; Partner Business Communications Solutions, LLP, an Israeli limited partnership; and, since March 3, 2011, 012 Smile. 012 Smile has four wholly-owned subsidiaries, 012 Telecom Ltd., 012 Mobile GP Ltd., Golden Lines 012 Telecommunication Services 2001 Ltd., and 012 Mobile Limited Partnership, all Israeli corporations. Partner Future Communications 2000 Ltd. serves as the general partner and the Company serves as the limited partner of each of the limited partnerships. On October 28, 2009, we became a subsidiary of Scailex. On January 29, 2013, S.B. Israel Telecom acquired 30.87% of our issued and outstanding shares, principally from Scailex. See "Item 7A.1 Principal Shareholders".

On November 8, 2013, the Company entered into a 15-year network sharing agreement with HOT Mobile, which remains subject to approval by Israeli regulatory authorities. Pursuant to the network sharing agreement, the parties would create a 50-50 joint venture, which would operate and develop a cellular network to be shared by both companies, starting with a pooling of both companies' radio access network infrastructures to create a single radio access network. See "Item 4B.9 Our Network".

4D. Property, Plant and Equipment

Headquarters

We lease our headquarter facilities in Rosh Ha-ayin, Israel, in three sites with a total of approximately 56,163 gross square meters (including parking lots). The leases for each site have different lengths and specific terms, but we believe that our current office facilities are adequate for the foreseeable future, and that we will be able to extend the leases or obtain alternate or additional facilities, if needed, on acceptable commercial terms. In the beginning of 2014, an amendment to the lease agreements for its headquarters facility in Rosh Ha'ayin was signed, according to which the lease term is extended until the end of 2024. The rental payments are linked to the Israeli CPI. We also lease five call centers in Haifa, Jerusalem, Rehovot, Rishon Lezion (012 call center) and Beer-Sheva. The leases for each site have different lengths and specific terms. We believe that our current call center facilities are adequate for the foreseeable future, and that we will be able to extend the leases or obtain alternate or additional facilities, if needed, on acceptable commercial terms.

Network

For a description of our telecommunications network, see "Item 4B.9 Our Network" above.

We lease most of the sites where our mobile telecommunications network equipment is installed throughout Israel. At December 31, 2013, we had 2,806 network sites (including micro-sites). The lease agreements relating to our network sites are generally for periods of two to ten years. We have the option to extend the lease periods up to ten years (including the original lease period).

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

Difficulties obtaining required permits could continue and therefore affect our ability to maintain cell network sites. In addition, as we grow our subscriber base and seek to improve the range and quality of our services, we need to further expand our network, and difficulties in obtaining required permits may delay, increase the costs or prevent us from achieving these goals in full. See "Item 3D.1 RISKS RELATING TO THE REGULATION OF OUR INDUSTRY" and "Item 4B.13 Regulation".

On November 8, 2013, the Company entered into a 15-year network sharing agreement with HOT Mobile, which remains subject to approval by Israeli regulatory authorities. Pursuant to the network sharing agreement, the parties would create a 50-50 joint venture, which would operate and develop a cellular network to be shared by both companies, starting with a pooling of both companies' radio access network infrastructures to create a single radio access network. See "Item 4B.9 Our Network".

Service Centers and Points of Sale

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

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

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ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

5A. Operating Results

5A.1 OVERVIEW

5A.1a Key Financial and Operating Data

The table below sets forth a summary of selected financial and operating data for the years ended December 31, 2011, 2012 and 2013.

	Year ended December 31,		
	2011	2012	2013
Revenues (NIS million)	6,998	5,572	4,519
Operating profit (NIS million)	1,036	865	409
Income before taxes (NIS million)	742	631	198
Profit for the Year (NIS million)	443	478	135
Capital expenditures (NIS million)	468	558	413
Cash flow provided by operating activities net of investment activities (NIS million)	485	1,234	1,041
Cellular Subscribers (end of period, thousands)	3,176	2,976	2,956
Annual cellular churn rate (%)	29%	38%	39%
Average monthly usage per cellular subscriber (MOU) (in minutes)	397	450	522
Average monthly revenue per cellular subscriber (ARPU) (NIS)	111	97	83

5A.1b Business Developments in 2013

In 2013, the level of competition in the Israeli telecommunications market remained very intense and as a result, the continued substantial price erosion in the market had a significant impact on the Company's business results.

At the end of December 2013, the Company's active cellular subscriber base (including mobile data and 012 Mobile subscribers) was approximately 2.96 million, including approximately 2.1 million post-paid subscribers or 72% of the base, and approximately 823,000 pre-paid subscribers, or 28% of the subscriber base. Total cellular market share (based on the number of subscribers) at the end of 2013 was estimated to be approximately 29%, unchanged from the previous year.

Over 2013, the cellular subscriber base declined by approximately 20,000. The post-paid subscriber base increased by approximately 31,000, which was more than offset by a decrease in the pre-paid subscriber base by approximately 51,000. The decrease in the pre-paid subscriber base was largely attributed to the pre-paid subscribers moving to post-paid subscriber packages as a result of the significant price erosion (and hence increasing attractiveness) in these products.

The annual churn rate for cellular subscribers in 2013 was 39%, slightly higher than 38% in 2012, mainly reflecting the continued intense competition in the cellular subscriber market.

The monthly Average Revenue Per User (ARPU) for cellular subscribers for the year 2013 was NIS 83 (US\$ 24), a decrease of approximately 14% from NIS 97 in 2012. The decrease mainly reflected the continued price erosion in the key cellular services including airtime, content, data and roaming services, due to the persistent fierce competition in the cellular market, partially offset by an increase in revenues from wholesale services provided to MVNO's hosted on the Company's network.

The monthly average Minutes of Use per subscriber (MOU) for cellular subscribers in 2013 was 522 minutes, an increase of 16% from 450 minutes in 2012. This increase largely reflected the continued increase in the proportion of cellular subscribers with bundled packages that include large or unlimited quantities of minutes. In view of this trend, we believe that reporting MOU is no longer relevant to understanding the results of operation, and we therefore will no longer be reporting MOU figures in the future.

The number of active fixed-lines including 012 Smile was approximately 299,000 lines at the end of 2013, compared with approximately 288,000 lines at the end of 2012, an increase of 4%. The ISP subscriber base was approximately 583,000 as of the end of 2013, compared with approximately 587,000 at the end of 2012, a decrease of 1%. Due to market developments in 2013, and in particular the increasing prevalence of bundled offerings in the market, we believe that the numbers of fixed-lines and ISP subscribers no longer provide any meaningful insight into the results of operation, and we therefore will not be reporting them in the future.

In order to mitigate the impact of the competition on the price erosion and decrease in revenues, the Company continued to adjust its cost structure and to implement operational efficiency measures through 2013, which was reflected in a decrease in operating expenses (excluding cost of equipment sold and depreciation & amortization expenses) of NIS 471 million in 2013 compared with 2012. This decrease largely reflected the efficiency savings resulting from the reduction in the Company workforce by approximately one third on an average basis (average of workforce at beginning and end of year), as well as decreases in payments to transmission, communication and content providers and in royalty expenses.

5A.1c Entry into Network Sharing Agreement

On November 8, 2013, the Company entered into a 15-year network sharing agreement with HOT Mobile, which remains subject to approval by Israeli regulatory authorities. Pursuant to the network sharing agreement, the parties would create a 50-50 joint venture, which would operate and develop a radio access network to be shared by both companies, starting with a pooling of both companies' radio access network infrastructures to create a single pooled radio access network. See "Item 4B.9 Our Network."

According to the provisions of the network sharing agreement, HOT Mobile will pay Partner a onetime amount, which will be paid by the beginning of year 2017, and afterwards each party will bear half of all capital expenditures relating to the shared network. The bearing of the operating costs of the shared network will be according to a pre-determined mechanism, according to which one half of the operating costs will be shared equally by the parties, and one half will be divided according to the relative volume of traffic of each party in the shared network. Partner expects that the network sharing agreement will provide material financial benefits to Partner in terms of both the anticipated upfront payment by HOT Mobile (to be made in January 2017, or earlier if either party exercises its right under the agreement to advance the payment date) and savings in operational expenses and capital investments; however, such financial benefits are dependent on regulatory approval of the agreement without requiring substantial changes, as well as the other factors set forth in the related risk factor. See "Item 3D.2b The network sharing agreement recently entered into by Partner may not provide the anticipated benefits and may lead to unexpected costs."

5A.1d Acquisition of 012 Smile

On March 3, 2011, the Company completed the acquisition of all of the issued and outstanding shares of 012 Smile Telecom Ltd. ("012 Smile"), from Merhav-Ampal Energy Ltd. ("Ampal"). 012 Smile is an Israeli private company, which provides international long distance services, internet services and local telecommunication fixed-line services (including telephony services using VoB). 012 Smile had revenues of approximately NIS 1,112 million during the 11 months starting February 1, 2010, the date on which 012 Smile's business activities began to operate under a new company.

The purchase price for the acquisition of 012 Smile was NIS 650 million, which included the acquisition of all of the outstanding shares of 012 Smile and a loan from the previous shareholder to 012 Smile. As part of the acquisition, we also guaranteed the bank loans and other bank guarantees, which were provided to 012 Smile, in a total amount of approximately NIS 800 million. According to the purchase agreement, 012 Smile assigned to Ampal the right to receive payments due from a third party in an amount of approximately NIS 40 million.

At the time of the acquisition, the purchase assumed an enterprise value for 012 Smile of approximately NIS 1.45 billion. This included fixed assets, intangible assets of customer relations, brand name, Rights of Use (“ROU”) of international transmission cables and goodwill. 012 Smile was financed principally through long term bank loans totaling approximately NIS 500 million that have an index (Israeli consumer price index (“CPI”)) linked rate of 3.42% with a final maturity at the end 2019. During 2012, 012 Smile prepaid the current portion of the outstanding linked principal amount of the loan (NIS 31 million), which was due originally on December 31, 2012. As of December 31, 2013, the principal due by 012 Smile, including the CPI adjustment, was NIS 200 million.

Impairment of Fixed-Line Assets and Goodwill as of December 31, 2011.

During December 2011, Bezeq International Ltd. completed the installation of an underwater cable between Israel and Italy and began commercial use thereafter. In addition, Tamares Telecom Ltd. was in the final stages of laying another underwater cable which was completed in January 2012, allowing new communication channels between Israel and Western Europe. The additional capacity significantly increased the level of competition in the market for international connectivity services that, until December 2011, had been comprised of a sole monopoly supplier. The increased competition in the market for international connectivity services during the fourth quarter of 2011 that lead to a sharp decline in prices and the Company’s expectations for increased competition in the retail ISP market, that would lead to a decrease in prices and market share, indicated the need to perform an impairment test on certain assets of the fixed-line segment. The impairment test as of December 31, 2011, was performed by management with the assistance of an independent assessor, Giza Singer Even Ltd., with the recoverability of the relevant assets being assessed based on value-in-use calculations. As a result of the testing, impairment charges in a total amount of NIS 235 million were recognized for the fixed-line business in 2011:

- a) Trade name by NIS 14 million, recorded in selling and marketing expenses;
- b) Customer relationships by NIS 73 million, recorded in selling and marketing expenses; and
- c) Right of use by NIS 148 million, recorded in the cost of revenues.

In addition, the Company’s Management performed, as required, its annual impairment review of goodwill, with the assistance of Giza Singer Even Ltd., again assessing recoverability of fixed-line segment assets based on value-in-use calculations. As a result of the impairment test, the Company recorded an impairment charge to goodwill in respect of the fixed-line business units in the amount of NIS 87 million in 2011. The total impact of the impairment charges on operating profit in 2011 was a reduction of NIS 322 million. The total impact on profit, including the resulting increase in deferred tax assets, net, of NIS 11 million, was a reduction of NIS 311 million.

In addition, the Company recorded an impairment of fixed-line subscriber acquisition costs in the total amount of NIS 27 million in the second half of 2011, following an amendment to the Telecommunications Law which limits subscriber exit fines in the fixed-line market.

Impairment test of Fixed-Line Goodwill as of December 31, 2012.

Since the beginning of 2012, management undertook a program to integrate the fixed-line segment structure, which included aggregating all the fixed-line activities of the Group under the responsibility of the Head of Fixed-Line Division. As a result of this integration, the reporting and monitoring structure was aligned with the fixed-line segment, and goodwill, amounting to NIS 407 million at year-end 2012, is now allocated to a single group of CGUs which constitute all the operations of the fixed-line segment.

For the purpose of impairment testing as of December 31, 2012, this group of CGUs represented the lowest level within the Group at which goodwill is monitored by management for internal reporting purposes.

For the purpose of the goodwill impairment test as of December 31, 2012 and thereafter, the recoverable amount was assessed by management with the assistance of an external independent expert, Giza Singer Even. Ltd. based on value-in-use calculations. The value-in-use calculations use pre-tax cash flow projections covering a five-year period. Cash flows beyond the five-year period to be generated from continuing use are extrapolated using estimated growth rates. The growth rates do not exceed the long-term average growth rate of the fixed-line communications services business. The key assumptions used are as follows:

Terminal growth rate	(negative 0.2%)
After-tax discount rate	11.7%
Pre-tax discount rate	15.7%

The impairment test as of December 31, 2012, was based on assessments of financial performance and future strategies in light of current and expected market and economic conditions. Trends in the economic and financial environment, competition and regulatory authorities' decisions, or changes in competitors' behavior in response to the economic environment may affect the estimate of recoverable amounts. See also Note 2(h) to the consolidated financial statements.

As a result of the impairment test, the Company determined that no goodwill impairment existed as of December 31, 2012, compared to December 31, 2011.

Impairment test of Fixed-Line Goodwill as of December 31, 2013.

As explained above, since the beginning of 2012, management undertook a program to integrate the fixed-line segment structure, which included aggregating all the fixed-line activities of the Group under the responsibility of the Head of Fixed-Line Division. As a result of this integration, the reporting and monitoring structure was aligned with the fixed-line segment, and goodwill, amounting to NIS 407 million at year-end 2012, is now allocated to a single group of CGUs which constitute all the operations of the fixed-line segment.

For the purpose of impairment testing as of December 31, 2013, this group of CGUs represented the lowest level within the Group at which goodwill is monitored by management for internal reporting purposes.

For the purpose of the goodwill impairment test as of December 31, 2013, the recoverable amount was assessed by management with the assistance of an external independent expert, Giza Singer Even. Ltd. based on value-in-use calculations. The value-in-use calculations use pre-tax cash flow projections covering a five-year period. Cash flows beyond the five-year period to be generated from continuing use were extrapolated using estimated growth rates. The growth rates do not exceed the long-term average growth rate of the fixed-line communications services business. The key assumptions used are as follows:

Terminal growth rate	(negative 0.3%)
After-tax discount rate	11.7%
Pre-tax discount rate	15.8%

The impairment test as of December 31, 2013, was based on assessments of financial performance and future strategies in light of current and expected market and economic conditions. Trends in the economic and financial environment, competition and regulatory authorities' decisions, or changes in competitors' behavior in response to the economic environment may affect the estimate of recoverable amounts. See also Note 4(a)(4) and Note 2(h) to the consolidated financial statements.

As a result of the impairment test, the Company determined that no goodwill impairment existed as of December 31, 2013, compared to December 31, 2011.

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Sensitivity Analysis:

The headroom of the fixed-line segment assets fair value over the book value as of December 31, 2012 and 2013 was approximately 13.6% and approximately 9.5% respectively.

A sensitivity analysis for the recoverable amount as of December 31, 2013, was performed for a change of the after-tax discount rate within the range of $\pm 10\%$ multiplied by the variable 11.7% (10.53% to 12.87%), assuming all other variables constant. Sensitivity analysis was also performed for a change of the terminal permanent growth rate within the range of $\pm 1\%$ of the variable minus 0.3% (minus 1.3% to 0.7%), assuming all other variables constant. Based on the results of the sensitivity analysis, we concluded that no impairment charge was required. However, considering an extreme scenario whereby increasing the discount rate above 12.3% and simultaneously decreasing the permanent growth rate below minus 0.8% would indicate an impairment.

See Note 13 to the consolidated financial statements included herein.

See also Note 5 to the consolidated financial statements included herein.

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

On October 25, 2010, the Company signed an agreement with LM Ericsson Israel Ltd. (“Ericsson”) for the upgrade of its existing networks and the deployment of a fourth generation network in Israel (the “Agreement”). The Agreement includes the upgrade, replacement and the expansion of certain parts of the Company’s existing cellular and fixed-line networks and the maintenance of its networks, including enhancement of the Company’s abilities with respect to the cellular and fixed-line ISP services it provides. The commercial operation of the fourth generation network by the Company is subject to the allocation of the relevant frequencies by the Ministry of Communications. The term of the Agreement is until December 31, 2014.

The total net amount, following all discounts and settlements, some of which are conditional, that the Company will be required to pay for the capital expenditure and maintenance services is approximately \$100 million (approximately NIS 360(*) million). Payments will be made in quarterly installments throughout the term of the Agreement. See “Item 5F Aggregate Contractual Obligations”. The Company allocates the net amount between capital expenditures and maintenance based on their relative fair values. The amount relating to support and maintenance is approximately \$12 million (NIS 43 million (*)). The transaction resulted in accelerated depreciation of the replaced equipment, throughout the replacement period, whereas the main impact of the accelerated depreciation was recorded during the year 2011. The Company recorded accelerated depreciation of NIS 16 million in the fourth quarter of 2010 and of NIS 67 million in 2011. The effect of depreciation acceleration in 2012 and 2013 was immaterial. As of December 31, 2011, 2012 and 2013, the depreciated cost of the replaced equipment was approximately NIS 30 million, NIS 4 million and NIS 1 million, respectively.

(*) The transaction is denominated in USD and translated above into NIS using the exchange rate as of the transaction date October 25, 2010 (1 USD = 3.599 NIS).

5A.1f Bezeq Agreement

In April 2012, the Company entered into a five-year agreement with Bezeq, the Israel Telecommunication Corp., Ltd., effective as of January 1, 2012, for the supply of transmission services for use in Partner’s mobile network. According to the agreement, the minimum annual commitment was NIS 55 million for the year 2012 and will gradually increase to NIS 71 million for the year 2016 due to the increase in the scope of the capacity to be purchased in accordance with

the layout agreed upon by the parties. The minimum commitment as of December 31, 2013 is NIS 203 million.

5A.1g Rights of Use Agreement with HOT Mobile

Partner and HOT Mobile entered into a rights of use agreement, which took effect on November 8, 2013 and is valid until January 4, 2017. Under the rights of use agreement, Partner will provide services to HOT Mobile in the form of rights of use to Partner's radio cellular network in order to supplement HOT Mobile's current network coverage. According to the rights of use agreement, HOT Mobile will pay Partner fixed base payments with additional variable payments based on traffic volume exceeding a defined threshold. The overall impact of the rights of use agreement on Partner's quarterly and annual financial results is difficult to assess at this time, since it will depend on the volume of HOT Mobile's traffic carried by Partner, the market dynamics resulting from HOT Mobile's access to Partner's cellular network, potentially unanticipated costs for fulfilling Partner's obligations under the agreement, and other variables which are not possible to anticipate and quantify accurately.

5A.1h New Principal Shareholder

On January 29, 2013 the Company announced the closing of the transaction between Scailex and S.B. Israel Telecom, an affiliate of Saban Capital Group, pursuant to which Scailex sold and transferred to S.B. Israel Telecom approximately 28.82% of the issued and outstanding share capital of Partner. In addition, the Company has been informed by S.B. Israel Telecom that a transaction with Leumi Partners, for the purchase of approximately 2.06% of the issued and outstanding share capital of Partner, was completed with the closing of the transaction between Scailex and S.B. Israel Telecom.

Accordingly, following the consummation of the above transactions, S.B. Israel Telecom holds approximately 30.87% of the issued and outstanding share capital of the Company. In addition, S.B. Israel Telecom and Scailex, which, together with its parent company, still holds approximately 13.95% of Partner issued and outstanding share capital, have signed a shareholders' agreement regarding, among other matters, the exercise of their voting rights and their consent regarding nomination of directors in Partner. See "Item 3D.3a 30.87% of our issued and outstanding shares and voting rights are held by our largest shareholder, who has entered into a shareholders' agreement with our second largest shareholder, whose holdings, when aggregated with those of its parent company, amount to 13.95% of our issued and outstanding shares and voting rights."

5A.1i Significant regulatory developments

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

5A.1j Revenues

We derive revenues from both rendering services and selling equipment.

Our principal source of revenues is from the sale of cellular network services to subscribers, primarily network airtime usage fees, and content and data fees (including SMS) as well as interconnect fees from other operators, fees for roaming, services, fees for extended handset warranty and fees from other operators (virtual and network) that use our network to provide services to their customers.

The fixed-line business segment derives revenues from a number of services provided over fixed-line networks including transmission services, international long distance services, PRI lines and SIP trunks for business sector customers, VoB telephony services and ISP services.

Cellular equipment revenues are derived from sales of cellular handsets, datacards, modems, tablets (including WIFI only tablets) and laptops, related equipment, car kits and accessories.

For the fixed-line business segment, equipment revenues include domestic routers, smartboxes and DECT phones, as well as related accessories.

We recognize revenues from network services (cellular, fixed-line and ISP) at the time we provide the service to the subscriber. We recognize revenues from equipment only upon delivery and the transfer of ownership to the subscriber.

5A.1k Cost of Revenues

The principal components of our cost of revenues are:

- Payments to transmission, communication and content providers
- Cost of handsets, accessories and ISP related equipment
- Depreciation, amortization and impairment charges
- Wages, employee benefits expenses and car maintenance
- Operating lease, rent and overhead expenses
- Network and cable maintenance
- Cost of handling, replacing or repairing handsets
- Car kit installation, IT support, and other operating expenses
- Payments to internet service providers (“ISPs”)
- Amortization of rights of use

5A.1l Selling and Marketing Expenses

The principal components of our selling and marketing expenses are:

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

5A.1m General and Administrative Expenses

The principal components of our general and administrative expenses are:

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

- Depreciation

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5A.1n Other Income, Net

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

- Unwinding of trade receivables
- Capital gain (loss) from sale of property and equipment

5A.1o Finance Costs, Net

The principal components of our finance expenses are:

- Interest expenses
- Linkage expenses to CPI
- Fair value loss from derivative financial instruments, net
- Interest costs in respect of liability for employee rights upon retirement

The principal components of our finance income are:

- Net foreign exchange rate gains
- Interest income from cash equivalents
- Fair value gain from derivative financial instrument, net

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

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

- Number of subscribers
- Average monthly revenue per subscriber (ARPU)
- Churn rate.

In previous years, the Company also considered Minutes of Use (MOU) to be a key cellular business indicator. However, in view of the continued increase in the proportion of cellular subscribers with bundled packages that include large or unlimited quantities of minutes, the Company believes that reporting MOU is no longer relevant to understanding the results of operation.

5A.1q Critical Accounting Estimates and Judgments

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

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

(1) Estimating service revenues earned but not yet billed

The Company recognizes service revenues based upon minutes, seconds and packages used, net of credits and adjustments for service discounts. Because the Company's billing cycles use cut-off dates, which for the most part do not coincide with the Company's reporting periods, the Company is required to make estimates for service revenues earned but not yet billed at the end of each reporting period. These estimates are based primarily upon actual unbilled usage of the Company's network by the customers, and also on historical data and trends. Actual billing cycle results may differ from the results estimated at the end of each period depending on subscriber usage and rate plan mix.

(2) Assessing the useful lives of assets

The useful economic lives of the Company's assets are an estimate determined by management. The Group defines useful economic life of its assets in terms of the assets' expected utility to the Group. This estimation is based on assumptions of future changes in technology or changes in the Group's intended use of these assets, and experience of the Group with similar assets, and legal or contract periods where relevant. The assets estimated economic useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. See also Note 2 (e) and Note 2(f) to the consolidated financial statements.

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

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

The Company recorded in 2011 an impairment charge to certain assets in an amount of NIS 262 million. No impairment charges were recognized in 2012 and 2013. See note 13 to the consolidated financial statements.

(4) Assessing the recoverable amount of goodwill for annual impairment tests

The recoverable amounts of CGUs to which goodwill has been allocated have been determined based on the value-in-use calculations. Determining the estimates of the future cash flows is based on management past experience and management best estimate for the economic conditions.

The Group recorded in 2011 an impairment charge to goodwill in an amount of NIS 87 million. No impairment charges were recognized in 2012 or 2013. See Note 13 to the consolidated financial statements.

The key assumptions used in the December 31, 2013 test are as follows:

Terminal growth rate	(negative 0.3%)
After-tax discount rate	11.7%
Pre-tax discount rate	15.8%

The impairment test as of December 31, 2013 was based on assessments of financial performance and future strategies in light of current and expected market and economic conditions. Trends in the economic and financial environment, competition and regulatory authorities' decisions, or changes in competitors' behavior in response to the economic environment may affect the estimate of recoverable amounts.

Sensitivity Analysis:

The headroom of the fixed-line segment assets fair value over the book value as of December 31, 2012 and 2013 was approximately 9.5% respectively.

Sensitivity analysis was performed for the recoverable amount as of December 31, 2013, for a change of the after-tax discount rate within the range of $\pm 10\%$ multiplied by the variable 11.7% (10.53% to 12.87%), assuming all other variables constant. Sensitivity analysis was also performed for a change of the terminal permanent growth rate within the range of $\pm 1\%$ of the variable minus 0.3% (minus 1.3% to 0.7%), assuming all other variables constant. Results showed that no impairment charge was required. However, considering an extreme scenario whereby increasing the discount rate above 12.3% and simultaneously decreasing the permanent growth rate below minus 0.8% would indicate an impairment.

(5) Assessing allowance for doubtful accounts

The allowance is established when there is objective evidence that the Group will not be able to collect amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, or delinquency or default in debtor payments are considered indicators that a trade receivable is impaired. The amount of the allowance is determined as a percentage of specific debts doubtful of collection, and taking into consideration the likelihood of recoverability of accounts receivable based on the age of the balances, the Group's historical write-off experience net of recoveries, changes in the credit worthiness of the Group's customers, and collection trends. The trade receivables are periodically reviewed for impairment.

(6) Considering uncertain tax positions

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

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

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

Provisions are recorded when a loss is considered probable and can be reasonably estimated. Judgment is necessary in assessing the likelihood that a pending claim or litigation against the Group will succeed, or a liability will arise, quantifying the possible range of final settlement. These judgments are made by management with the support of internal specialists, or with the support of outside consultants such as legal counsel. Because of the inherent uncertainties in this evaluation process, actual results may be different from these estimates.

(2) Considering sales with multiple deliverables

The Group made judgments to determine that certain sales of equipment with accompanying services constitute an arrangement with multiple deliverables that are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole, and accordingly, consideration received is allocated to each

deliverable based on the relative fair value of the individual element. See also note 2(n)(2) to the consolidated financial statements.

(3) Determining probability of future utilization of deferred tax assets

Deferred tax assets are recognized to the extent that their utilization is probable. The utilization of deferred tax assets will depend on whether it is probable that sufficient and suitable taxable profits will be available in the future, against which the reversal of the temporary differences can be deducted, taking into account any legal restrictions on the length of loss-carryforward period. Various factors are used to assess the probability of the future utilization of deferred tax assets, including past operating results, operational plans, loss-carryforward periods, and tax planning strategies. See also note 25 to the consolidated financial statements.

5A.2 RESULTS OF CONSOLIDATED OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2013
COMPARED TO THE YEAR ENDED DECEMBER 31, 2012

	New Israeli Shekels Year ended December 31, 2013 In millions			
	Cellular segment	Fixed-line segment	Elimination	Consolidated
Segment revenue - Services	2,876	908		3,784
Inter-segment revenue - Services	31	177	(208)	
Segment revenue - Equipment	703	32		735
Total revenues	3,610	1,117	(208)	4,519
Segment cost of revenues - Services	2,070	747		2,817
Inter-segment cost of revenues- Services	175	33	(208)	
Segment cost of revenues - Equipment	664	29		693
Cost of revenues	2,909	809	(208)	3,510
Gross profit	701	308		1,009
Operating expenses	544	135		679
Other income, net	77	2		79
Operating profit	234	175		409
Adjustments to presentation of Adjusted EBITDA				
–Depreciation and amortization	545	155		700
–Other	5	*		5
Adjusted EBITDA	784	330		1,114
Reconciliation of Adjusted EBITDA to profit before income tax				
- Depreciation and amortization				700
- Finance costs, net				211
- Other				5
Profit before income tax				198

* Representing an amount less than 1 million.

	New Israeli Shekels			
	Year ended December 31, 2012			
	In millions			
	Cellular segment	Fixed-line segment	Elimination	Consolidated
Segment revenue - Services	3,564	1,076		4,640
Inter-segment revenue - Services	28	134	(162)	
Segment revenue - Equipment	896	36		932
Total revenues	4,488	1,246	(162)	5,572
Segment cost of revenues - Services	2,351	861		3,212
Inter-segment cost of revenues- Services	134	28	(162)	
Segment cost of revenues - Equipment	787	32		819
Cost of revenues	3,272	921	(162)	4,031
Gross profit	1,216	325		1,541
Operating expenses	584	203		787
Other income, net	110	1		111
Operating profit	742	123		865
Adjustments to presentation of Adjusted EBITDA				
–Depreciation and amortization	562	164		726
–Other	10	1		11
Adjusted EBITDA	1,314	288		1,602
Reconciliation of Adjusted EBITDA to profit before income tax				
- Depreciation and amortization				726
- Finance costs, net				234
- Other				11
Profit before income tax				631

Revenues. Total revenues in 2013 were NIS 4,519 million (US\$ 1,302 million), a decrease of 19% from NIS 5,572 million in 2012.

Revenues from services. Annual service revenues totaled NIS 3,784 million (US\$ 1,090 million) in 2013, decreasing by 18% from NIS 4,640 million in 2012.

Revenues from equipment. Equipment revenues in 2013 totaled NIS 735 million (US\$ 212 million), a decrease of 21% compared with NIS 932 million in 2012. The decrease was due to a significant decrease in the number of sales of cellular devices, partially offset by an increase in the average sales price which largely reflected a higher proportion of sales of high end smartphones (in particular iPhones and Samsung Galaxy) and tablets.

Gross profit from equipment sales. The gross profit from equipment sales in 2013 was NIS 42 million (US\$ 12 million), compared with NIS 113 million in 2012, a decrease of 63%, reflecting both the lower number of sales and lower profit margins following the heightened competition in the handset market from independent importers and distributors.

Operating expenses, Operating expenses ("Opex", including cost of service revenues, selling, marketing and administrative expenses and excluding depreciation and amortization) totaled NIS 2,791 million (US\$ 804 million) in 2013, a decrease of 14% or NIS 471 million from 2012, largely reflecting the efficiency savings resulting from the reduction in the Company workforce by approximately one third on an average basis (average of workforce at beginning and end of year), as well as a decrease in transmission expenses, payments to content and communications providers, royalties to the State and other expenses. Including depreciation and amortization expenses, Opex in 2013 decreased by 13% compared with 2012. See also Note 22 to our consolidated financial statements.

Operating profit. Operating profit for 2013 was NIS 409 million (US\$ 118 million), a decrease of 53% compared with NIS 865 million in 2012.

Finance costs, net. Finance costs, net in 2013 were NIS 211 million (US\$ 61 million), a decrease of 10%, compared with NIS 234 million in 2012. The decrease was mainly due to a decrease in interest expenses resulting from the lower level of average debt, together with foreign exchange gains, partially offset by early loan repayment fines of NIS 17 million in 2013 and by higher CPI linkage expenses as a result of the larger increase in the CPI level in 2013 compared with 2012.

Profit before income tax. Profit before income taxes for 2013 was NIS 198 million (US\$ 57 million), a decrease of 69% from NIS 631 million in 2012.

Income taxes on profit. Income taxes on profit for 2013 were NIS 63 million (US\$ 18 million), a decrease of 59% from NIS 153 million in 2012.

The effective tax rate for 2013 was 32%, compared with 24% in 2012. The increase in the effective tax rate was mainly due to the higher percentage of unrecognized expenses than in last year, due to the decline in profit before tax.

See also Note 25 (b) to our consolidated financial statements.

Profit. Profit for 2013 was NIS 135 million (US\$ 39 million), a decrease of 72% compared with 2012. Based on the weighted average number of shares outstanding during 2013, basic earnings per share or ADS, was NIS 0.87 (US\$ 0.25), a decrease of 72% compared to NIS 3.07 in 2012.

Adjusted EBITDA. Adjusted EBITDA in 2013 totaled NIS 1,114 million (US\$ 321 million), a decrease of 30% from NIS 1,602 million in 2012. As a percentage of total revenues, Adjusted EBITDA in 2013 was 25%, compared with 29% in 2012.

Adjusted EBITDA as reviewed by the Chief Operating Decision Maker ("CODM"), represents earnings before interest (finance costs, net), taxes, depreciation, amortization (including amortization of intangible assets, deferred expenses-right of use, and share based compensation expenses) and impairment charges, as a measure of operating profit. Adjusted EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. Adjusted EBITDA may not be indicative of the Company's historic operating results nor is it meant to be predictive of potential future results. We use the term "Adjusted EBITDA" to highlight the fact that amortization includes amortization of deferred expenses – right of use and employee share-based compensation expenses; it is fully comparable to EBITDA information which has been previously provided for prior periods.

5A.2a Cellular Services Business Segment

Total Revenues, Total revenues for the cellular segment in 2013 were NIS 3,610 million (US\$ 1,040 million), a decrease of 20% from NIS 4,488 million in 2012.

Revenues from services. Service revenues for the cellular segment in 2013 were NIS 2,907 million (US\$ 838 million), decreasing by 19% from NIS 3,592 million in 2012. The decrease was mainly a result of the price erosion of Post-Paid and Pre-Paid cellular services, following increased competition due to the activity of new competitors (new operators and MVNOs), and the transfer of existing customers to "unlimited plans" since May 2012. The decrease also reflected the lower Post-Paid cellular subscriber base which was approximately 3.5% lower on an average basis (average of subscriber base at beginning and end of year) in 2013 compared with 2012, as well as lower roaming services revenues, as a result of price erosion in roaming services.

Pre-paid cellular subscribers contributed service revenues in a total amount of approximately NIS 360 million (US\$ 104 million) in 2013, a decrease of 24% from approximately NIS 475 million in 2012, as a result of the price erosion in pre-paid services and the decrease in the number of pre-paid subscribers.

Revenues from equipment. Revenues from cellular equipment sales in 2013 totaled NIS 703 million (US\$ 203 million), decreasing by 22% from NIS 896 million in 2012. The decrease was due to a significant decrease in the number of sales of cellular devices, partially offset by an increase in the average sales price which largely reflected a higher proportion of sales of high end smartphones (in particular iPhones and Samsung Galaxy) and tablets.

Gross profit from equipment sales. The gross profit from cellular equipment sales in 2013 was NIS 39 million (US\$ 11 million), compared with NIS 109 million in 2012, a decrease of 64%, reflecting both the lower number of sales and lower profit margins following the heightened competition in the handset market from independent importers and distributors.

Operating expenses, Operating expenses for the cellular segment (including cost of service revenues, selling, marketing and administrative expenses and excluding depreciation and amortization expenses) totaled NIS 2,239 million (US\$ 645 million) in 2013, a decrease of 10% or NIS 258 million from 2012, largely reflecting the efficiency savings resulting from the reduction in the salaries and related workforce expenses, as well as a decrease in payments to content and communications providers, royalty expenses due to the State and in the cost of handling, replacing or repairing handsets. See also Note 22 to our consolidated financial statements. Including depreciation and amortization expenses, operating expenses decreased by 11%.

Cost of service revenues, The cost of service revenues (excluding inter-segment costs) decreased by 12% from NIS 2,351 million in 2012 to NIS 2,070 million (US\$ 596 million) in 2013, largely as a result of the decrease in salaries and related expenses as well as decreases in payments to content providers, royalty expenses due to the State (as a result of the royalty rate of 0% for 2013 compared with 1.3% for 2012), and the cost of handling, replacing or repairing handsets. See also Note 22 to our consolidated financial statements.

Selling, marketing, general and administration expenses, Selling, marketing, general and administration expenses for the cellular segment in 2013 amounted to NIS 544 million (US\$ 157 million), decreasing by 7% from NIS 584 million in 2012. The decrease mainly reflected decreases in salaries and related expenses, as well as decreases in credit card and other commissions and in marketing and advertising expenses. See also Note 22 to our consolidated financial statements.

Operating profit. Overall, operating profit for the cellular segment in 2013 was NIS 234 million (US\$ 67 million), decreasing by 68% compared with NIS 742 million in 2012, largely reflecting the impact of the decrease in service revenues, partially offset by the reduction of operating expenses, as described above.

Adjusted EBITDA. Adjusted EBITDA for the cellular segment was NIS 784 million (US\$ 226 million) in 2013, decreasing by 40% from NIS 1,314 million in 2012, largely reflecting the impact of the decrease in service revenues, partially offset by the reduction of operating expenses, as described above. As a percentage of total cellular revenues,

Adjusted EBITDA for the cellular segment in 2013 was 22%, compared with 29% in 2012.

5A.2b Fixed-Line Services Business Segment

Total revenues, Total Revenues in 2013 for the fixed-line segment were NIS 1,117 million (US\$ 322 million), a decrease of 10% compared with NIS 1,246 million in 2012.

Revenues from services. Service revenues for the fixed-line segment totaled NIS 1,085 million (US\$ 313 million) in 2013, a decrease of 10% compared with NIS 1,210 million in 2012. The decrease mainly reflected price erosion in fixed-line services including local fixed-lines, international calls and internet services. The price erosion resulted from increased competition in the various fixed-line markets, arising from in the popularity of bundles that include cellular services together with fixed-line services at heavily discounted prices, and the increasingly competitive market for international calls.

Revenues from equipment. Revenues from equipment sales in the fixed-line segment in 2013 totaled NIS 32 million (US\$ 9 million), compared with NIS 36 million in 2012.

Operating expenses. Operating expenses for the fixed-line segment (including cost of service revenues, selling, marketing and administrative expenses and excluding depreciation and amortization and impairment charges) totaled NIS 760 million (US\$ 219 million) in 2013, a decrease of 18% or NIS 167 million from 2012. The decrease largely reflected the efficiency savings resulting from the reduction in salaries and related workforce expenses, as well as a decrease in transmission costs, network maintenance expenses and in payments to internet service providers (ISP). See also Note 22 to our consolidated financial statements. Including depreciation and amortization expenses, operating expenses decreased by 16%.

Cost of service revenues. The cost of service revenues (excluding inter-segment costs) for the fixed-line segment decreased by 13% from NIS 861 million in 2012, to NIS 747 million (US\$ 215 million) in 2013. The decrease was largely due to lower salaries and related workforce expenses, as well as decreases in transmission costs, network maintenance expenses and in payments to internet service providers (ISP). See also Note 22 to our consolidated financial statements.

Selling, marketing, general and administration expenses. Selling, marketing, general and administration expenses for the fixed-line segment in 2013 amounted to NIS 135 million (US\$ 39 million), a decrease of 33% from NIS 203 million in 2012. This mainly reflected lower salaries and related workforce expenses as well as a decrease in operating lease, rent and overhead expenses and in marketing and advertising expenses. See also Note 22 to our consolidated financial statements.

Operating profit. Operating profit for the fixed-line segment was NIS 175 million (US\$ 50 million) in 2013, an increase of 42% compared to NIS 123 million in 2012. The increase in operating profit reflected the impact of the efficiency measures which reduced operating expenses over the period, partially offset by the decrease in service revenues.

Adjusted EBITDA. Adjusted EBITDA for the fixed-line segment increased by 15% from NIS 288 million in 2012 to NIS 330 million (US\$ 95 million) in 2013, reflecting the reduction of operating expenses partially offset by the decrease in service revenues. As a percentage of total fixed-line revenues, Adjusted EBITDA for the fixed-line segment in 2013 was 30%, compared with 23% in 2012.

5A.3 RESULTS OF CONSOLIDATED OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2012, COMPARED TO THE YEAR ENDED DECEMBER 31, 2011

The consolidation of 012 Smile into Partner's financial results following its acquisition on March 3, 2011, had a significant impact on the results of the fixed-line segment, as set forth below, but did not affect the results of the cellular segment.

	New Israeli Shekels Year ended December 31, 2011 In millions			Consolidated
	Cellular segment	Fixed-line segment	Elimination	
Segment revenue – Services	4,219	1,005		5,224
Inter-segment revenue – Services	29	122	(151)	
Segment revenue – Equipment	1,748	26		1,774
Total revenues	5,996	1,153	(151)	6,998
Segment cost of revenues – Services	2,601	969		3,570
Inter-segment cost of revenues- Services	122	29	(151)	
Segment cost of revenues – Equipment	1,379	29		1,408
Cost of revenues	4,102	1,027*	(151)	4,978
Gross profit	1,894	126		2,020
Operating expenses	712	290*		1,002
Impairment of goodwill		87		87
Other income, net	105			105
Operating profit (loss)	1,287	(251)		1,036
Adjustments to presentation of Adjusted EBITDA				
–Depreciation and amortization	590	182		772
–Impairment of intangible assets, deferred expenses and goodwill		349		349
–Other (mainly employee share based compensation expenses)	19	2		21
Adjusted EBITDA	1,896	282		2,178
Reconciliation of Adjusted EBITDA to profit before tax				
- Depreciation and amortization				772
-Impairment of intangible assets, deferred expenses and goodwill				349
- Finance costs, net				294
- Other (mainly employee share based compensation expenses)				21
Profit before income tax				742

*Including impairment charges, see Note 13 to the consolidated statements.

On March 3, 2011, Partner concluded the acquisition of 012 Smile, an Israeli operator of international telecommunications services and local fixed-line services and a provider of internet services. The consolidated results of 2011 therefore include the results of 012 Smile from March 3, 2011, forward.

Revenues. Total revenues in 2012 were NIS 5,572 million, a decrease of 20% from NIS 6,998 million in 2011.

Revenues from services. Annual service revenues totaled NIS 4,640 million in 2012, decreasing by 11% from NIS 5,224 million in 2011. Service revenues for the cellular segment in 2012 were NIS 3,592 million, decreasing by 15% from NIS 4,248 million in 2011. The decrease was mainly a result of the intense price erosion of cellular services including voice and data services, following the entry of new competitors (new operators and MVNO's) in the first half of the year, as well as the continued decrease in revenues from roaming services. The decrease also reflected the lower post-paid cellular subscriber base which decreased by approximately 4% on an average basis over 2011.

Service revenues for the fixed-line segment reached NIS 1,210 million in 2012, an increase of 7% compared with NIS 1,127 million in 2011. The increase largely reflected the contribution of 012 Smile to the Company's results for the full year in 2012, compared to only ten months in 2011 (from the date of acquisition in March 2011). The impact of 012 Smile's contribution was partially offset by price erosion in fixed-line services due to tougher competitive market conditions, and a gradual decrease in the average number of internet service subscribers over the period.

Revenues from equipment. Equipment revenues in 2012 totaled NIS 932 million, a decrease of 47% compared with NIS 1,774 million in 2011. The decrease largely reflected a significant decrease of approximately 50% in the quantity of cellular equipment sold, reflecting increased competition from independent importers and distributors, the impact of the Company's strategy to require more stringent payment terms, a general decrease in market demand, and an end to the use of special discounts for customers with new handsets.

Operating expenses. Operating expenses (including cost of service revenues, selling, marketing and administrative expenses and excluding depreciation and amortization expenses) totaled NIS 3,262 million in 2012, a decrease of 7% or NIS 255 million from 2011, largely reflecting the series of efficiency measures undertaken over 2011, and in particular the reduction of the workforce by approximately 40% over the period. See also Note 22 to our consolidated financial statements. The decrease was despite the full-year contribution of 012 Smile in 2012 compared with only a ten-month contribution in 2011.

Operating profit. Operating profit for 2012 was NIS 865 million, a decrease of 17% compared with reported operating profit for 2011 including an impairment charge impact of NIS 322 million (related to certain fixed-line assets). The decrease amounted to 36% when compared with operating profit before the impact of the impairment.

Finance costs, net. Finance costs, net in 2012 were NIS 234 million, a decrease of 20% compared with NIS 294 million. The decrease was mainly due to the lower level of average debt in 2012 compared with 2011, together with a lower level of expenses linked to changes in the consumer price index ("CPI") of 1.4% over 2012 compared with 2.6% over 2011.

Profit before income tax. Profit before income taxes for 2012 was NIS 631 million, a decrease of 15% from NIS 742 million in 2011.

Income taxes on profit. Income taxes on profit for 2012 were NIS 153 million, a decrease of 49% from NIS 299 million in 2011.

The effective tax rate for 2012 was 24%, compared with 29% in 2011 (before the impact of the impairment). The decrease in the tax rate as above was mainly due to the utilization of previously unrecognized tax losses and other

temporary differences against taxable income.

See also Note 25 (b) to our consolidated financial statements for 2012.

Profit. Profit in 2012 was NIS 478 million, an increase of 8% compared with reported profit in 2011 of NIS 443 million, including the impact of the impairment in the amount of NIS 311 million, and a decrease of 37% compared with profit in 2011 before the impact of the impairment. Based on the weighted average number of shares outstanding during 2012, basic earnings per share or ADS, was NIS 3.07, an increase of 8% compared to NIS 2.85 in 2011.

Adjusted EBITDA. Annual Adjusted EBITDA totaled NIS 1,602 million in 2012, a decrease of 26% from NIS 2,178 million in 2011. Adjusted EBITDA for the cellular segment was NIS 1,314 million in 2012, decreasing by 31% from NIS 1,896 million in 2011, reflecting the impact of the reduction in service revenues and in gross profit from equipment revenues, partially offset by the reduction in operating expenses (including cost of service revenues, selling, marketing and administrative expenses and excluding depreciation and amortization), as described above. Adjusted EBITDA for the fixed-line segment in 2012 was NIS 288 million, an increase of 2% from NIS 282 million in 2011, reflecting the reduction in operating expenses and the impact of the full-year contribution of 012 Smile in 2012 compared with only ten months in 2011, partially offset by the reduction in service revenues.

Adjusted EBITDA as reviewed by the Chief Operating Decision Maker (“CODM”), represents earnings before interest (finance costs, net), taxes, depreciation, amortization (including amortization of intangible assets, deferred expenses-right of use, and share based compensation expenses) and impairment charges, as a measure of operating profit. Adjusted EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. Adjusted EBITDA may not be indicative of the Company’s historic operating results nor is it meant to be predictive of potential future results. We use the term “Adjusted EBITDA” to highlight the fact that amortization includes amortization of deferred expenses – right of use and employee share-based compensation expenses; it is fully comparable to EBITDA information which has been previously provided for prior periods. For a reconciliation of Adjusted EBITDA with our audited financial data, see Note 6 to the consolidated financial statements for 2013 included in this annual report.

5A.3a Cellular Services Business Segment

The impairment charge on fixed-line assets in 2011 did not have any impact on the results for the cellular segment.

Total Revenues, Total revenues for the cellular segment in 2012 were NIS 4,488 million, a decrease of 25% from NIS 5,996 million in 2011.

Revenues from services. Annual service revenues for the cellular segment were NIS 3,592 million in 2012, decreasing by 15% from NIS 4,248 million in 2011. The decrease was mainly a result of the intense price erosion of cellular services including voice and data services, following the entry of new competitors (MVNO’s and new operators) and the offering of “unlimited plans” in the first half of the year, as well as the continued decrease in revenues from roaming services. The decrease also reflected the lower post-paid cellular subscriber base, which decreased by approximately 4% on an average basis over the past year.

Pre-paid subscribers contributed service revenues in a total amount of approximately NIS 475 million in 2012, a decrease of 5% from approximately NIS 500 million in 2011, as a result of the price erosion and the decrease in the number of pre-paid subscribers.

Revenues from cellular data and content services excluding SMS in 2012 totaled NIS 559 million, a decrease of 16% compared with NIS 666 million in 2011. The decrease mainly reflected the price erosion of data and content services including browsing and other services, the lower post-paid subscriber base, and the impact of new consumer protection regulations in 2011 which led to a reduction in content service revenues.

SMS service revenues, on an allocated basis as explained below, totaled NIS 433 million in 2012, a decrease of 5% compared with NIS 456 million in 2011.

Since approximately two-thirds of outgoing airtime, content and data (including SMS) revenues is derived from customers who subscribe to bundled packages which include airtime, data and SMS, the separate reporting of data and content service revenues relies heavily on the allocation methodology and application of those revenues between the different services offered in the bundled packages. Furthermore, the proportion of customers with unlimited packages which offer unlimited use of voice and SMS, as well as certain browsing volumes, continues to rise, and this trend is expected to continue. The Company therefore concluded that the separate reporting of content and SMS revenues was no longer beneficial to understanding the Company's results of operation, and did not provide this breakdown in future discussions of its results.

Revenues from equipment. Revenues from cellular equipment sales in 2012 totaled NIS 896 million, decreasing by 49% from NIS 1,748 million in 2011. The decrease largely reflected a significant decrease of approximately 50% in the quantity of cellular equipment sold, reflecting increased competition from independent handset importers and distributors, the impact of the Company's strategy to require more stringent payment terms, a general decrease in market demand, and an end to the use of special discounts for customers with new handsets.

Gross profit from equipment. The gross profit from cellular equipment sales in 2012 was NIS 109 million, compared with NIS 369 million in 2011, a decrease of 70%. This was mainly due to the lower quantity of cellular equipment sales, as well as a decrease in the profit achieved per sale, reflecting the increased competition in the handset market.

Operating expenses. Operating expenses for the cellular segment (including cost of service revenues, selling, marketing and administrative expenses and excluding depreciation and amortization expenses) totaled NIS 2,497 million in 2012, a decrease of 12% or NIS 329 million from 2011. See also Note 22 to our consolidated financial statements. Including depreciation and amortization expenses, operating expenses decreased by 11%.

Cost of service revenues. The cost of service revenues (excluding inter-segment costs) decreased by 10% from NIS 2,601 million in 2011 to NIS 2,351 million in 2012, largely as a result of (i) the decrease in payroll and related expenses following the reduction in the level of workforce and other efficiency measures, (ii) lower royalty expenses due to the State (as a result of lower service revenues combined with the lower royalty rate of 1.3% for 2012, compared with 1.75% for 2011), and (iii) lower payments to content suppliers. See also Note 22 to our consolidated financial statements.

Selling, marketing, general and administration expenses. Selling, marketing, general and administration expenses for the cellular segment in 2012 amounted to NIS 584 million, decreasing by 18% from NIS 712 million in 2011. The decrease mainly reflected decreases in payroll and related expenses following the reduction in the level of workforce and other efficiency measures taken, lower selling commissions and a decrease in marketing and advertising expenses. See also Note 22 to our consolidated financial statements.

Operating profit. Overall, operating profit for the cellular segment in 2012 was NIS 742 million, decreasing by 42% compared with NIS 1,287 million in 2011, reflecting the impact of the reduction in service revenues and in gross profit from equipment revenues, partially offset by the reduction in operating expenses, as described above. The impairment recorded in 2011 did not impact the results of the cellular segment.

Adjusted EBITDA. Adjusted EBITDA for the cellular segment totaled NIS 1,314 million in 2012, a decrease of 31% from NIS 1,896 million in 2011, again reflecting the impact of the reduction in service revenues and in gross profit from equipment revenues, partially offset by the reduction in operating expenses, as described above. As a percentage of total cellular revenues, Adjusted EBITDA in 2012 was 29%, compared with 32% in 2011.

5A.3b Fixed-Line Services Business Segment

Total revenues. Total Revenues in 2012 for the fixed-line segment reached NIS 1,246 million, an increase of 8% compared with NIS 1,153 million in 2011.

Revenues from services. Service revenues for the fixed-line segment reached NIS 1,210 million in 2012, an increase of 7% compared with NIS 1,127 million in 2011. The increase largely reflects the contribution of 012 Smile to the Company's results for a full year in 2012, compared with only ten months in 2011 (from the date of acquisition in March 2011). The impact of 012 Smile's contribution was partially offset by price erosion in fixed-line services due to tougher competitive market conditions, and a gradual decrease in the average number of internet service subscribers over the period.

Revenues from equipment. Revenues from equipment sales in the fixed-line segment in 2012 totaled NIS 36 million, compared with NIS 26 million in 2011.

Operating expense. Operating expenses for the fixed-line segment (including cost of service revenues, selling, marketing and administrative expenses and excluding depreciation and amortization and impairment charges) totaled NIS 927 million in 2012, an increase of 10% or NIS 85 million from 2011. The increase was explained by the full-year contribution of 012 Smile in 2012 compared with only a 10 month contribution in 2011. See also Note 22 to our consolidated financial statements. Including depreciation and amortization expenses but excluding the impact of the impairment, operating expenses increased by 4%.

Cost of service revenue. The cost of service revenues (excluding inter-segment costs) for the fixed-line segment increased by 5% from NIS 821 million in 2011, before the impact of the impairment, to NIS 861 million in 2012. The increase was largely due to the full-year contribution of 012 Smile in 2012 compared with the ten-month contribution in 2011, and was partially offset by a decrease in depreciation and amortization expenses following the impairment, as well as lower infrastructure expenses. See also Note 22 to our consolidated financial statements.

Selling, marketing, general and administration expenses. Selling, marketing, general and administration expenses for the fixed-line segment in 2012 amounted to NIS 203 million, unchanged from 2011 before the impact of the impairment. This was despite the full-year contribution of 012 Smile in 2012 compared with the ten-month contribution in 2011, and mainly reflected lower payroll and related expenses. See also Note 22 to our consolidated financial statements.

Impairment loss for goodwill. In 2011, we recorded an impairment charge to goodwill related to the fixed-line segment in the amount of NIS 87 million.

Operating profit. Operating profit for the fixed-line segment was NIS 123 million in 2012, an increase of 73% compared to NIS 71 million in 2011, excluding the impact of the impairment (reported operating loss in 2011 was NIS 251 million and included the impact of impairment in the amount of NIS 322 million). The increase in operating profit, (excluding the impact of the impairment), reflected principally the impact of the efficiency measures which reduced operating expenses over the period, as well the impact of the full-year contribution of 012 Smile in 2012 compared with only ten months in 2011.

Adjusted EBITDA. Adjusted EBITDA for the fixed-line segment in 2012 was NIS 288 million, an increase of 2% from NIS 282 million in 2011, mainly reflecting the reduction in operating expenses, partially offset by the reduction in service revenues. The Adjusted EBITDA margin for the fixed-line segment in 2012 was 23% of total fixed-line segment revenues, compared with 24% in 2011.

5A.4 SEASONALITY

Our service revenues and profitability show some seasonal trends over the year, but the overall impact is not material. For cellular subscribers in plans which charge according to usage, airtime minutes and consequently airtime revenues are affected by the number of monthly work days and daylight hours in the day, which varies throughout the year. In addition, airtime revenues for such subscribers are lower in February, which is a shorter than average month.

However, due to the increased penetration of bundled plans which offer fixed or unlimited amounts of airtime SMS usage, the impact of such effects has significantly decreased over the last year. In addition, revenues from roaming services tend to fluctuate according to the timing of the Jewish holiday periods and season, with higher revenues generally recorded in the summer months as a result of roaming charges from increased travel abroad by subscribers and from foreign roamers using our network. There is no assurance that these trends will continue in the future.

NIS in millions	Three months ended			
	March 31	June 30	Sept. 30	Dec. 31
Service Revenues				
2011	1,212	1,360	1,366	1,286
2012	1,241	1,213	1,150	1,036
2013	961	950	951	922

5A.5 IMPACT OF EXCHANGE RATE FLUCTUATIONS AND INFLATION

Substantially all of our revenues and a majority of our operating expenses are denominated in shekels. However, in recent years, between one fifth and one quarter of our operating expenses (excluding depreciation), including a substantial majority of our handset purchases, were linked to non-shekel currencies, mainly the US dollar. These expenses related principally to the acquisition of handsets, where the price paid by us is based mainly on US dollars. In addition, a substantial amount of our capital expenditures (including with respect to our networks) are incurred in, or linked to, non-shekel currencies, mainly the US dollar. See “ ITEM 11 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK”.

Our Notes payable series B, C and our bank borrowings in a total principal amount of NIS 1,799 million as of December 31, 2013, are currently in shekels and are linked to the CPI. If the CPI increases, we may not be permitted to raise our tariffs in a manner that would fully compensate for any increase in our finance expenses. In 2013, the CPI increased 1.9 %, causing expenses of NIS 46 million in our finance costs, net, compared to a CPI increase of 1.4% in 2012, which caused finance expenses of NIS 35 million. The CPI for each month is published on the 15th day of the following month; references above to the annual change in CPI for a given year is the change from the CPI published on the 15th day of December of the preceding year to the CPI published on the 15th day of December of the relevant year, which for the purposes of this annual report, covers the twelve months beginning January 1 through December 31 of the year in question.

5B. Liquidity and Capital Resources

The discussion below first describes our financial indebtedness (Notes payable, long-term bank loans and total financial debt) and capital expenditures, then our dividend payments, and finally our main sources of liquidity.

5B.1 NOTES PAYABLE