

B Communications Ltd.

Update

Ratings

Long-Term IDR	B+
Senior secured	BB-

Outlooks

Foreign-Currency Long-Term IDR	Positive
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Financial Data

B Communications Ltd.

	31 Dec 15	31 Dec 14
Revenue (ILSm)	9,985	9,055
Revenue growth (%)	10.3	-5.3
EBITDA ^a (ILSm)	4,171	3,871
EBITDA margin (%)	41.8	42.8
Pass-through proportional net debt/EBITDA (x)	4.2	4.1

^a 2014 EBITDA excludes ILS 582m from the sale of Coral Tell Ltd

Key Rating Drivers

Liquidity, Buybacks Positive: B-Communications Ltd.'s liquidity is comfortable, following a sale of a 4.2% stake in Bezeq in early 2016, which offers protection against Bezeq's potentially volatile dividend flow.

The Positive Outlook reflects Fitch Ratings' expectation that a significant share of the proceeds from the sale of the Bezeq stake will be spent within the next 12-18 months on buying back senior secured bonds maturing in 2021. This would reduce B-Com's net interest payments and improve debt service coverage. Failure to achieve this within the next 12-18 months will probably result in the Outlook being changed back to Stable.

Control Over Bezeq Retained: Fitch views B-Com's reduced 26.3% stake in Bezeq as sufficient for full operational and management control over the telecoms operator. In our view, it is unlikely that the regulator would allow a further reduction in B-Com's stake in Bezeq to below 25%, which limits B-Com's flexibility to sell more shares in its subsidiary other than the 0.5% held separately from the controlling stake.

Dependence on Bezeq's Dividends: Both B-Com and its immediate parent Internet Gold (IG) have substantial debt with no recourse to Bezeq. Both entities ultimately depend on dividends from Bezeq as a key source of cash for servicing their debt obligations.

Bezeq's Strong Credit Profile: Bezeq's credit profile is consistent with the mid 'BBB' category, reflecting the company's strong position as the telecoms incumbent in Israel. The company has been able to defend and increase its market shares in key segments of broadband, pay-TV and mobile services. The prospect of further facilities-based competitive threats is remote. However, we view the regulatory and competitive environment in Israel as tough, with no signs of the pressures abating in the near future.

Improved Leverage, Low Cover: The sale of a 4.2% stake in Bezeq will improve B-Com's proportional net leverage, with pass-through proportional net debt/EBITDA estimated to drop to 3.6x by end-2016 from 4.2x at end-2015. Buying back debt would improve dividend interest cover, to above 2x in the medium term, as fewer bonds outstanding would reduce interest payments on a net basis. These estimates are based on the assumption that Bezeq will be able to maintain dividend distributions in the range of NIS1.4bn-1.5bn per annum.

No Parent-Subsidiary Linkage: Fitch views the parent-subsubsidiary linkage between B-Com and its ultimate shareholder Eurocom Group as weak due to the presence of an intermediary holding company IG between B-Com and Eurocom, and the fact that IG has its own debt. B-Com's ratings do not reflect any potential support from the parent.

Rating Sensitivities

Dividend-Based Coverage: A reduction in leverage to below 4.3x standalone net debt/dividends and pass-through proportional net leverage (including B-Com debt) to below 4x while improving normalised dividend interest coverage to above 2x may lead to an upgrade. A sustained deterioration in normalised dividend/interest coverage to below 1.75x may lead to a downgrade. Operating pressures and financial underperformance coupled with higher leverage at Bezeq may also be negative.

Related Research

Corporate Rating Methodology
(August 2015)

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Peer Group

Issuer	Country
BBB	
Vivendi SA	France
BB-	
Sistema Joint Stock Financial Corp.	Russian Federation
B+	
B Communications Ltd.	Israel

Issuer Rating History

Date	LT IDR (FC)	Outlook/ Watch
29 Mar 16	B+	Positive
30 Mar 15	B+	Stable
12 Nov 14	B+	Stable
18 Feb 14	B+	Stable
30 Jan 14	B+(EXP)	Stable

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

Holding companies' main activity is managing their equity stakes and other investment assets including cash. They are typically sensitive to operating risks only at the level of their cash-generating subsidiaries.

Financial Risks

Holding companies critically depend on dividends from their operating subsidiaries for debt service. Insufficient accounting net profit or asset write-downs may be hindrances for normal dividend upstreaming. Temporary disruptions in dividend payments may be mitigated through a lock-box mechanism conserving cash, or help-line credit facilities. Holding companies may operate as pass-through entities with all cash income less debt service slated for shareholder distributions. Without a strong ring-fence, they are typically exposed to the financial needs of their parent companies.

Peer Group Analysis

FY15	Vivendi SA BBB/Stable	Sistema BB-/Stable	DH Unrated	B-Com ^a B+/Stable
Revenue (USDm)	12,376	10,421	2,125	2,628
Revenue growth (%)	-1.6	7.2	7.0	-5.3
EBITDA margin (%)	12.4	24.9	5.8	41.8
Net debt/EBITDA (x)	n.m.	0.4	2.3	2.9

^a All metrics are on a consolidated basis
Source: Fitch, companies

Key Credit Characteristics

Traditional leverage metrics are not directly applicable for holding companies. Pass-through proportional leverage takes into account debt at both the holding- and operating-company levels on a proportional consolidation basis but ignores that fact that the holding company's debt is not recourse to the subsidiary. Coverage and leverage metrics based on dividends as a denominator tend to be volatile, but more sensitive to changes in debt at the holding company.

Overview of Companies

Vivendi SA (BBB/Stable) – is a diversified media conglomerate with assets comprising primarily music, pay-tv and until recently telecoms. In 2014 Vivendi sold its telecom assets, Maroc Telecom and GVT, followed by SFR, making the transition from asset heavy telecoms to a focus on media.

Sistema Joint Stock Financial Corp. (BB-/Stable) – is a diversified Russian holding company. Its largest asset is its 53% controlling stake in MTS, one of the largest CIS mobile operators. The company also has interests in telecoms, media, technology, tourism, banking, health care and retail. Its strategy is focused on the consumer services segment.

Doğan Sirketler Grubu Holding A.S. (Unrated) – is a diversified Turkish holding company with a dominant lead in the Turkish media and entertainment sector. The group also has interests in the energy, retail and industrial sectors.

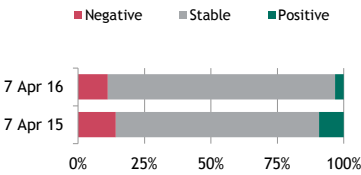
B Communications Ltd. (B+/Stable) – is a telecommunications-oriented holding company, with a controlling 26% stake in Bezeq, Israel's incumbent telecom provider.

Related Criteria

Corporate Rating Methodology (17 Aug 2015)

Distribution of Sector Outlooks

Directional Outlooks and Rating Watches



Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts.

They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

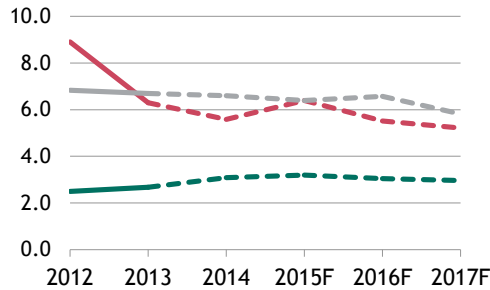
- increased fixed-line competition following the implementation of a wholesale market in Israel;
- persistent subscriber attrition and pricing pressure in mobile;
- some margin uplift after 2016 as structural separation is lifted;
- increased capex due to Yes acquisition and LTE and fibre investment;
- tax benefits to be realised after the removal of structural separation and Yes merger with Bezeq.

Definitions

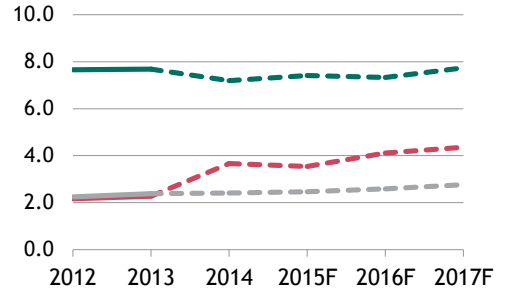
- **Leverage:** Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid minus interest received plus preferred dividends plus rental expense.
- **Interest cover:** FFO plus gross interest paid minus interest received plus preferred dividends divided by gross interest paid plus preferred dividends.
- **FFO profitability:** FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's "Interpreting the New EMEA and Asia-Pacific Corporates Credit Update Format" Special Report, dated 25 November 2009 and available at www.fitchratings.com.

B Communications Ltd. — Telecommunications Median — Developed B Cat Median —
Source: Company data; Fitch

Leverage including Fitch expectations



Interest Cover including Fitch expectations



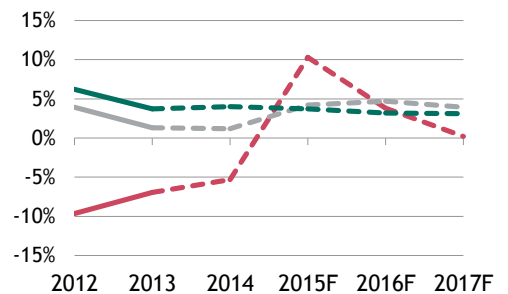
Debt Maturities and Liquidity at Dec 15^a

Debt maturities	(ILSm)
2016	217
2017	217
2018	217
2019	217
After 2019	2,085
Cash and equivalents^b	789

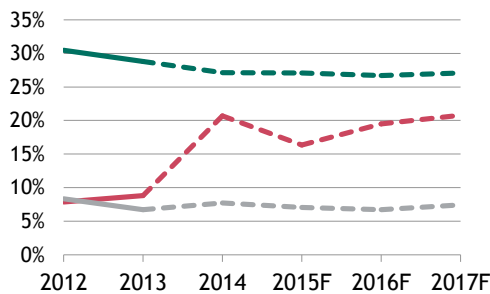
^a Unconsolidated future debt maturities (including amortising debt)

^b Excludes ILS 193m of restricted cash
Source: Fitch

Revenue Growth including Fitch expectations

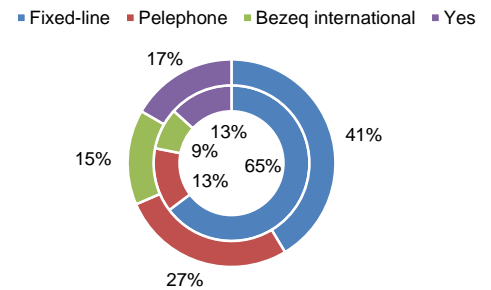


FFO Profitability including Fitch expectations

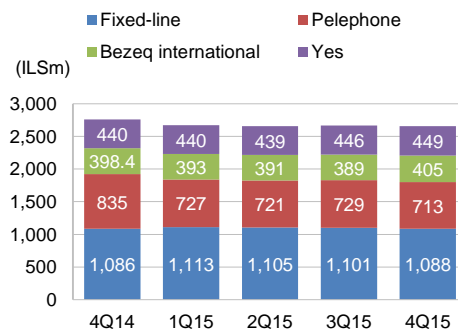


FY15 Segmental Split

Outer ring: Revenue
Inner ring: EBITDA

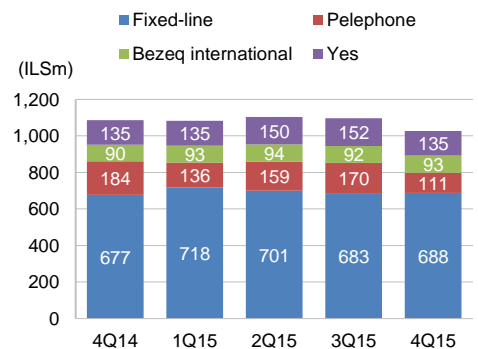


Bezeq Revenue by Division



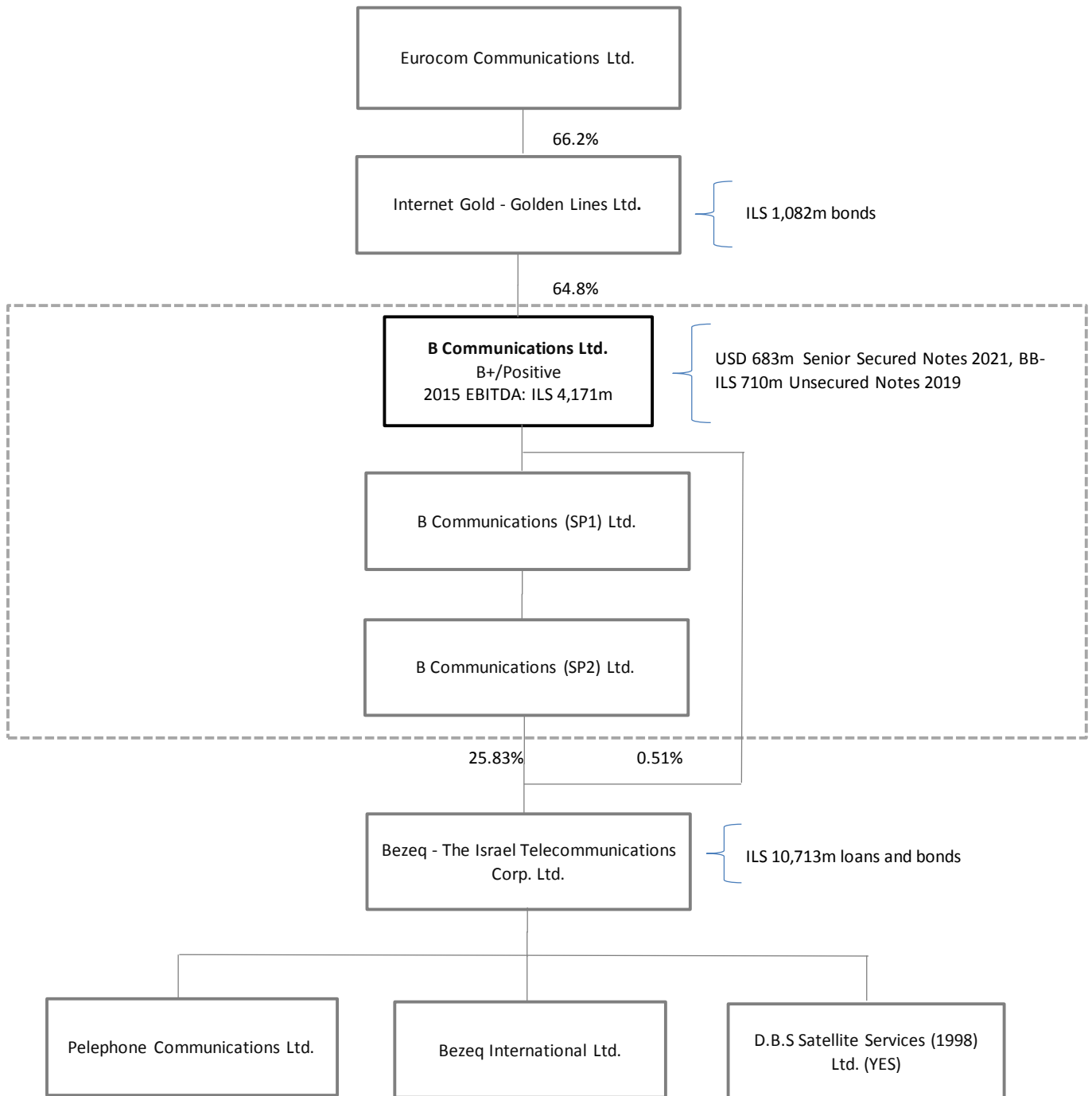
Source: Company reports

Bezeq EBITDA by Division



Source: Company reports

Figure 1
Simplified Group Structure Diagram: B Communications Ltd.^a



^a Borrowings outstanding at December 2015
 Source: Company reports

B Communications Ltd.

FINANCIAL SUMMARY

	31 Dec 2014	31 Dec 2013	31 Dec 2012	31 Dec 2011
	ILSm	ILSm	ILSm	ILSm
	Year End	Year End	Year End	Year End
Profitability				
Revenue	9,055	9,563	10,278	11,373
Revenue Growth (%)	(5.31)	(6.96)	(9.63)	31.37
Operating EBIT	2,579	2,035	1,949	1,500
Operating EBITDA	4,452	4,049	4,316	4,484
Operating EBITDA Margin (%)	49.17	42.34	41.99	39.43
FFO Return on Adjusted Capital (%)	10.43	8.76	8.79	n.a.
Free Cash Flow Margin (%)	(11.32)	0.55	(4.30)	(17.51)
Coverages (x)				
FFO Gross Interest Coverage	2.59	2.28	2.16	3.02
Operating EBITDA/Gross Interest Expense	6.32	6.13	6.19	6.91
FFO Fixed Charge Coverage (inc. Rents)	2.59	2.28	1.85	2.47
FCF Debt-Service Coverage	(0.14)	0.34	0.11	(0.73)
Cash Flow from Operations/Capital Expenditures	1.53	1.47	0.93	0.24
Debt Leverage of Cash Flow (x)				
Total Debt with Equity Credit/Operating EBITDA	3.12	3.28	3.15	3.12
Total Debt Less Unrestricted Cash/Operating EBITDA	2.26	2.68	2.63	2.53
Debt Leverage Including Rentals (x)				
Annual hire lease rent costs for long-term assets (reported and/or estimate)	0	0	247	247
Gross Lease Adjusted Debt/Operating EBITDAR	3.12	3.28	3.42	3.37
Gross Lease Adjusted Debt /FFO+Int+Rentals	7.61	8.81	8.90	7.22
FFO Adjusted Net Leverage	5.52	7.21	7.62	6.02
FCF/Lease Adjusted Debt (%)	(7.39)	0.40	(2.84)	(12.48)
Debt Leverage Including Leases and Pension Adjustment (x)				
Pension and Lease Adjusted Debt /EBITDAR + Pension Cost	3.12	3.28	3.42	3.35
Balance Sheet Summary				
Readily Available Cash	3,815	2,406	2,241	2,653
Restricted/Not Readily Available Cash	65	n.a.	n.a.	n.a.
Short-Term Debt	1,517	1,465	1,631	1,187
Long-Term Senior Debt	12,357	11,798	11,980	12,790
Subordinated debt	n.a.	n.a.	n.a.	n.a.
Equity Credit	n.a.	n.a.	n.a.	n.a.
Total Debt with Equity Credit	13,874	13,263	13,611	13,977
Off-Balance-Sheet Debt	n.a.	n.a.	1,976	1,976
Lease-Adjusted Debt	13,874	13,263	15,587	15,953
Fitch- identified Pension Deficit	n.a.	n.a.	n.a.	n.a.
Pension Adjusted Debt	13,874	13,263	15,587	15,953
Cash Flow Summary				
Operating EBITDA	4,452	4,049	4,316	4,484
Gross Cash Interest Expense	(704)	(660)	(697)	(649)
Cash Tax	(527)	(625)	(662)	(649)
Associate Dividends	(1,431)	(1,954)	(2,119)	(2,171)
Other Items before FFO (incl. interest receivable)	(672)	35	(31)	299
Funds from Operations	1,118	845	807	1,314
Change in Working Capital	536	686	373	(950)
Cash Flow from Operations	1,654	1,531	1,180	364
Total Non-Operating/Non-Recurring Cash Flow	(1,598)	(334)	(351)	(807)
Capital Expenditures	(1,081)	(1,042)	(1,271)	(1,548)
Dividends Paid	0	(102)	n.a.	n.a.
Free Cash Flow	(1,025)	53	(442)	(1,991)
Net (Acquisitions)/Divestitures	230	312	305	266
Net Equity Proceeds/(Buyback)	0	0	0	0
Other Cash Flow Items	1,593	148	91	(431)
Total Change in Net Debt	798	513	(46)	(2,156)
Working Capital				
Accounts Receivable Days	98	106	106	n.a.
Inventory Days	(21)	(22)	(25)	n.a.
Accounts Payable Days	(135)	(137)	(130)	n.a.

Figure 2

Reconciliation of Key Financial Metrics for B Communications Ltd.

(ILSm)	31 Dec 15	31 Dec 14
B-Com unconsolidated net debt		
Interest bearing loans and borrowings	3,428	3,524
- Cash and equivalents (unrestricted)	953	997
- Treasury bonds	117	0
+ Restricted cash	164	172
= Net debt (a)	2,522	2,699
Bezeq net debt		
Interest bearing loans and borrowings	10,713	10,087
- Cash and equivalents (unrestricted)	555	660
- Investments, including derivatives	762	2,223
= Net debt (b)	9,396	7,204
Bezeq EBITDA (c)^a	4,171	3,925
Pass-through proportional net debt/EBITDA (x)		
(B-Com net debt + (31%*Bezeq net debt))/(31%*Bezeq EBITDA)	4.20	4.05
(a+(b*0.31))/(c*0.31)		
Bezeq regular dividends (d)	1,777	1,632
B-Com interest payments (e)	279	273
Interest coverage (x)		
(31%*Bezeq regular dividends)/B-Com interest payments	1.97	1.85
(d*0.31)/e		
Leverage (x)		
B-Com net debt/(31%*Bezeq regular dividends)	4.58	5.33
a/(d*0.31)		

^a Excluding ILS582m from the sale of Coral Tell Ltd in 2014

Source: Fitch based on company reports

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