UBS

UBS Investment Research

Bezeq

Global Equity Research

Israel

Fixed-Line Communications

Rating	Buy 2
	Unchanged
Price target	NIS6.30/US$1.44
	Prior:NIS5.00/US$1.15
Price	NIS4.97/US$1.14

RIC: BEZQ.TA BBG: BEZQ IT

17 January 2005

Privatisation - the long home straight

■ After many false dawns, we may be getting there

Investors who have followed Bezeq for many years may have tired of believing in full privatisation. But the evidence of the last two years is that many steps have been taken firmly in that direction. Although completion may be many months away, there is little reason to believe now that the process should falter. All parties - banks, GCA and bidders - are committed, in our view.

■ Share price recovery illustrates the progress

A sign of the commitment to the sale of a 30% controlling stake is that, unlike in the past, the government has not taken advantage of the share price recovery to sell shares into the market, as some speculated it would. There are now a total of eight groups (although some of these are merging) that are genuinely considering a bid for the stake.

■ Forecasts changed to reflect full consolidation of Pelephone

We had previously indicated in our research that the Pelephone acquisition should be value enhancing. Our new forecasts and valuation fully capture that transaction. We have not assumed any significant restructuring that may follow on the back of privatisation.

■ Valuation: Price target raised to NIS6.30 from NIS5.00

Our new DCF based price target of NIS6.30 is the equivalent of NIS5.80 in today's money. This implies 2006E EV/EBITDA of 5.2x, EFCF yield of 8.3% and a dividend yield of 5.3%.

Highlights (NISm)	12/02	12/03	12/04E	12/05E	12/06E
Revenues	8,235	7,981	9,088	9,946	9,837
EBIT	1,037	1,093	1,535	1,716	1,720
Net income (UBS)	(927)	545	671	866	907
EPS (UBS, NIS)	(0.39)	(0.18)	0.30	0.29	0.31
Net DPS (UBS, NIS)	0.00	0.00	0.00	0.00	0.31

Profitability & Valuation	5-yr hist. av.	12/03	12/04E	12/05E	12/06E
EBIT margin %	-	13.7	16.9	17.3	17.5
ROIC (EBIT) %	-	10.3	14.0	14.5	15.1
EV/EBITDA x	-	4.6	5.6	5.1	4.9
PE (UBS) x	1.6	-26.8	16.8	16.9	16.1
Net dividend yield %	0.0	0.0	0.0	0.0	6.2

Source: Company accounts, Thomson Financial, UBS estimates. UBS EPS is stated before goodwill, exceptionals and other special items.
Valuations: based on an average share price that year, (E): based on a share price of NIS4.97 on 13 Jan 2005

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Trading data (local/US$)	
52-wk. range	NIS5.36-4.14/US$1.21-0.93
Market cap.	NIS12.9bn/US$2.97bn
Shares o/s	2,605m (ORD)
Free float	36%
Avg. daily volume ('000)	4,607
Avg. daily value (NISm)	21.7

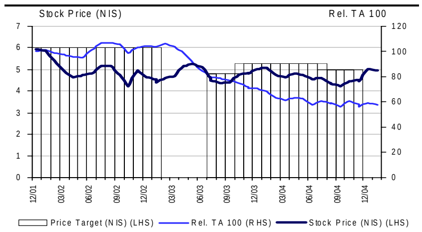
Balance sheet data 12/04E	
Shareholders' equity	NIS5.35bn
P/BV (UBS)	1.7x
Net cash (debt)	(NIS5.90bn)

Forecast returns	
Forecast price appreciation	+26.8%
Forecast dividend yield	0.0%
Forecast stock return	+26.8%
Market return assumption	9.1%
Forecast excess return	+17.7%

EPS (UBS, NIS)

	12/04E			12/03
	From	To	Cons.	Actual
Q1	0.06	0.07	-	(0.04)
Q2	0.06	0.07	-	(0.04)
Q3E	0.06	0.07	-	(0.04)
Q4E	0.06	0.07	-	(0.04)
12/04E	0.24	0.30	*0.26*	
12/05E	0.26	0.29	*0.29*	

Performance (NIS)



Source: UBS

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 6

The privatisation progresses

In our view, all signs currently indicate that all the relevant parties are committed towards completion of the privatisation process. The eight groups that have so far proclaimed their interest in the 30% stake in Bezeq are currently in the process of completing their due diligence, and in some cases are merging with each other in order to better position themselves in the run up to the tender. Regarding the option on the additional 10.7% stake that the buyer would acquire, the government seems prepared to allow a six year period in which to exercise, which we believe is designed to reduce the financial commitment of the successful bidder. Meanwhile, the banks holding the 17% stake appear to continue to co-operate with each other in the interest, in our opinion, of holding out for the best possible valuation for their stake.

Table 1:The potential bidders

Potential bidders for privatisation	Background
IDB	Holding company
Markstone	Private equity
Maariv / Gusinsky	Media
Apax & Saban (two groups merged)	Private equity
David Azrieli	Real estate
Rothschild & Polar & Pegasus	Private equity
Benny Alagem	Packard Bell founder

Source: Various press reports including Globes and The Marker

A sign of the progress is that as little as six months ago, most market participants believed the government would turn a piecemeal seller into the market again if the share price approached NIS5.00.

The timetable from here

Based on progress to date as reported in the local press (including Globes and The Marker), we expect the timeline to proceed as follows:

- Currently most of the groups are taking it in turns to receive access to the company's data room. This part of the due diligence process should be completed by the end of January.
- Meetings with management and the GCA (Government Companies Authority) should then take place in February and March.
- By this time, full year financials should be published, at which point the official tender process should be opened. There is no firm date for completion, but we believe that in an optimistic scenario, the 30% stake may have changed hands by the end of 2005. We would caution that it may take longer than this, however.

Changes to forecasts and valuation – price target increased from NIS5.00 to NIS6.30

We have made a number of changes to our model, the most important being to reflect the full consolidation of Pelephone into our forecasts. The transaction was actually completed at the end of August 2004, so Q3 results partially reflected the full consolidation. To recap, Bezeq paid Shamrock US$60m, at the same time repaying a loan of US$392m to Bank Hapoalim. Bezeq had also some time ago written off a convertible loan which it had extended to Shamrock which gave it the right to acquire 80% of the holding company. Through the eventual acquisition, it therefore effectively acquired a 50% stake in Pelephone for a total consideration of US$452m (in addition to the convertible). As detailed in previous research, (see *'Loosening the shackles'*, November 2003), this added some US$200m to our valuation of Bezeq, or around NIS0.35 per share.

We have detailed the full changes to our key forecasts below.

Table 2: Revisions to key forecasts (largely reflecting full Pelephone consolidation)

		2004E	2005E	2006E	2007E
Revenue	New	9,088	9,946	9,837	9,723
	Old	7,991	7,925	7,790	7,650
	% change	13.7%	25.5%	26.3%	27.1%
EBITDA	New	3,602	3,653	3,522	3,423
	Old	3,341	3,198	3,104	2,995
	% change	7.8%	14.3%	13.5%	14.3%
Capex	New	1,565	1,407	1,269	1,250
	Old	1,379	1,142	1,051	1,028
	% change	13.5%	23.2%	20.8%	21.6%
OpFCF	New	2,037	2,246	2,253	2,173
	Old	1,962	2,055	2,053	1,967
	% change	3.8%	9.3%	9.7%	10.5%
FCF	New	958	1,363	1,534	1,594
	Old	1,524	1,332	1,402	1,430
	% change	-37.1%	2.4%	9.4%	11.5%
EPS	New	0.30	0.29	0.31	0.34
	Old	0.24	0.26	0.31	0.35
	% change	21.4%	14.3%	-1.7%	-3.9%

Source: UBS estimates

The corollary of these P&L and cash flow upgrades is, of course, a higher level of net debt due to the payment for the Pelephone stake, and the full consolidation of Pelephone's net debt. Our 2005E net debt forecast has risen by some NIC5.2bn to NIS4.6bn, equivalent to 36% of total capital or 1.3x EBITDA.

It is worth noting that our consolidated margin forecasts are significantly lower than previously due to the lower level of profitability of Pelephone compared to the parent company. This explains the dip in consolidated margins in 2005 in the summary table below.

Table 3:Breakdown of revenues and EBITDA as reported

	NISm	2003	2004E	2005E	2006E	2007E
Revenue	Parent	5,231	4,969	4,671	4,391	4,127
	Pelephone	2,027	2,973	4,014	4,094	4,176
	Bezeq International	703	830	930	1,004	1,054
	Group	7,981	9,088	9,946	9,837	9,723
EBITDA	Parent	2,683	2,534	2,335	2,151	1,981
	Pelephone	490	803	1,124	1,146	1,169
	Bezeq International	190	257	260	251	264
	Group	3,253	3,602	3,653	3,522	3,423
Consolidated EBITDA margin		40.8%	39.6%	36.7%	35.8%	35.2%

Source: UBS estimates

Apart from fully consolidating Pelephone into our forecasts, we have not made any significant changes to the underlying assumptions – merely tinkered on a smaller scale. Later in this report we address the potential upside to valuations that may be achieved through operational and financial restructuring post privatisation.

DCF valuation raised to NIS6.30 on a 12 month view

We have not made any changes to our WACC or perpetual growth assumptions. However, by making the highlighted changes to our forecasts, and rolling our DCF valuation forward by six months, our DCF valuation is now approximately NIS6.30 per share on a 12 month view (up from just over NIS5), or equivalent to NIS5.80 in today’s terms. Our DCF is based on a WACC of 7.5%, which employs a risk free rate of 5.5%. Israel is fairly unique among the EMEA markets in terms of its steep yield curve – rising from 3.7% at the short end to around 7.0% at the long end.

We have decided to stick with our DCF valuation as our target price, although this is not a key driver for the stock price over the coming months. Rather, we would highlight ongoing progress on privatisation (in which case the market may look at restructuring potential and possible cash returns to shareholders).

Restructuring potential

We believe, given our comments on the possible timing of privatisation above, that it is far too early to factor in major changes to our forecasts based on the potential restructuring that should follow privatisation. However, we would highlight the following as areas that may come increasingly into focus:

- Operational cost reductions. Although Bezeq has continued to reduce its fixed line workforce (by about 2% y/y in Q3 04, a reduction of some 176 employees), the company is no longer such an epitome of efficiency relative to its peers as it was some years ago. Its line/employee ratio currently stands at 361; the central European incumbents, by contrast, are now targeting levels of 450-500 lines per employee over the coming two years. Labour now accounts for some 23% of parent company revenues, so any improvement here could be significant in terms of margin improvement or protection.

- Capex could also stand to be trimmed. At, we estimate, some 15% of sales for the wireline business in 2004E and 23% for Pelephone, there should be some cash flow improvements equating to perhaps 2% of consolidated sales.

- The DBS satellite business continues, for now, to consume part of Bezeq's free cash flow – although the capital contribution should be relatively small, at up to NIS82m, in 2005. If Bezeq moves to majority control, as seems possible, of this business, we believe the management will be able to take a fresh look at improving margins and ROIC in this business – especially as there appears to be no white knight for the beleaguered cable industry.

With net debt to EBITDA of 1.6x at the end of 2004E, we believe Bezeq should restrict further deleveraging from this level. Accounting rules in Israel make it impossible to pay out a dividend in 2005 though, and subsequent dividends are likely to be restricted by the level of distributable reserves on the balance sheet. However, with strong cash flow relative to its gearing level, we believe private owners should find a way out of this impasse, perhaps by reclassifying reserves, in order to increase dividend payouts. Nonetheless, we forecast a dividend yield of up to 6% in 2006E, based on a 100% payout ratio.

■ Bezeq

Bezeq is Israel's fixed-line incumbent, with 3 million lines in service. Bezeq currently owns 50% of Pelephone, a CDMA mobile operator with 1.8 million subscribers, and, until February 2005, it has an option to buy the remaining 50% via a third-party arrangement. Bezeq also owns 100% of Bezeq International, one of the country's three international operators, with an estimated market share of 36%, and a 49% stake in DBS, a satellite TV provider with 410,000 subscribers.

■ Statement of Risk

Our rating is partly based on further progress in the privatisation process. Lack of progress would limit the extent of potentially value creative restructuring in the business. Our forecasts and valuations are subject to the usual vagaries in terms of competitive and regulatory developments, uncertainty over the macro economic environment and so forth.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

Required Disclosures

This report has been prepared by UBS Limited, an affiliate of UBS AG (UBS).

UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage[1]	IB services[2]
Buy 1	FSR is > 10% above the MRA, higher degree of predictability	**Buy 2**	FSR is > 10% above the MRA, lower degree of predictability	**Buy**	36%	32%
Neutral 1	FSR is between -10% and 10% of the MRA, higher degree of predictability	**Neutral 2**	FSR is between -10% and 10% of the MRA, lower degree of predictability	**Hold/Neutral**	53%	35%
Reduce 1	FSR is > 10% below the MRA, higher degree of predictability	**Reduce 2**	FSR is > 10% below the MRA, lower degree of predictability	**Sell**	11%	29%

1: Percentage of companies under coverage globally within this rating category.
2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 31 December 2004.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.
Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).
Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.
Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.
Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.
UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.
Core Banding Exceptions (CBE): Exceptions to the standard +/-10% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned table in the relevant research piece.

Companies mentioned

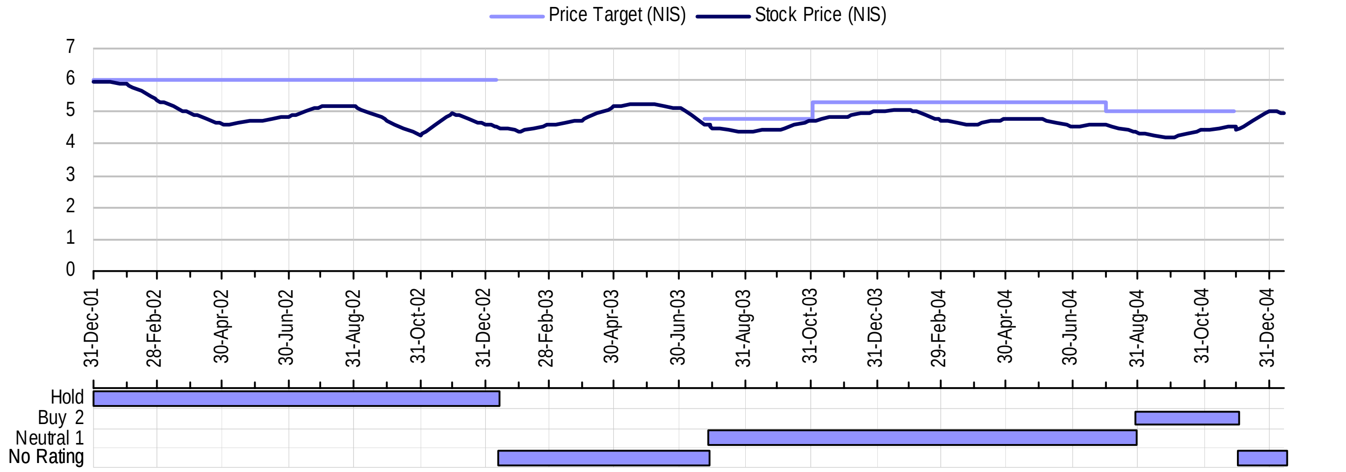
Company Name	Reuters	Rating	Price
Bezeq[4,5]	BEZQ.TA	Buy 2	NIS4.97

Price(s) as of 13 January 2005. Source: UBS.

4. Within the past 12 months, UBS AG, its affiliates or subsidiaries has received compensation for investment banking services from this company.
5. UBS AG, its affiliates or subsidiaries expect to receive or intend to seek compensation for investment banking services from this company within the next three months.

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Bezeq (NIS)



Source: UBS; as of 13 January 2005.

Note: On October 13, 2003, UBS adopted new definition criteria for its rating system. (See 'UBS Investment Research: Global Equity Ratings Definitions and Allocations' table for details.) Between January 11 and October 12, 2003, the UBS ratings and their definitions were: Buy 1: Excess return potential > 15%, smaller range around price target; Buy 2: Excess return potential > 15%, larger range around price target; Neutral 1: Excess return potential between -15% and 15%, smaller range around price target; Neutral 2: Excess return potential between -15% and 15%, larger range around price target; Reduce 1: Excess return potential < -15%, smaller range around price target; Reduce 2: Excess return potential < -15%, larger range around price target. Prior to January 11, 2003, the UBS ratings and definitions were: Strong Buy: Greater than 20% excess return potential, high degree of confidence; Buy: Positive excess return potential; Hold: Low excess return potential, low degree of confidence; Reduce: Negative excess return potential; Sell: Greater than 20% negative excess return potential, high degree of confidence. Under both ratings systems, excess return is defined as the difference between the FSR and the one-year local market interest rate.

Global Disclaimer

Bezeq

Per share (US$)	12/02	12/03	12/04E	12/05E	12/06E
EPS	(0.08)	(0.04)	0.07	0.07	0.07
CEPS	0.21	0.16	0.23	0.23	0.22
Net DPS	0.00	0.00	0.00	0.00	0.07
BVPS	0.59	0.62	0.68	0.74	0.74
Profit & loss (US$ m)					
Sales	1,739	1,757	2,029	2,280	2,256
EBITDA	708	716	804	838	808
Operating income (EBIT)	219	241	343	393	395
Pre-tax profit	(79)	206	313	345	335
Net income (UBS adj.)	(196)	120	150	199	208
Cash flow (US$ m)					
Operating income (EBIT)	219	241	343	393	395
Depreciation & amortisation	490	476	461	444	413
Net change in working capital	(17)	39	(97)	(36)	3
Other (operating)	205	13	(22)	(23)	(23)
Operational cash flow	896	769	685	779	788
Tax paid	(45)	(11)	(117)	(110)	(100)
Capital expenditure	(291)	(311)	(402)	(320)	(288)
Net interest	(36)	(35)	(29)	(48)	(59)
Dividends paid	0	(41)	0	0	0
Net (acquisitions) / disposals	(77)	(42)	(33)	(23)	0
Other items	(347)	74	(957)	12	11
Increase (decrease) in net debt	101	403	(853)	290	352
Operating free cash flow (OpFCF) (US$ m)					
EBITDA (core)	708	716	804	838	808
Less maintenance capital expenditure	(316)	(323)	(349)	(323)	(291)
Less maintenance net working capital	(17)	39	(97)	(36)	3
OpFCF	375	432	358	479	520
Balance sheet (US$ m)					
Net tangible fixed assets	2,099	1,980	2,395	2,271	2,146
Net intangible fixed assets	0	0	0	0	0
Net working capital	295	270	375	407	404
Total invested capital (IC)	2,395	2,251	2,770	2,678	2,550
Financial & other fixed assets	388	404	411	407	407
Net cash / (debt)	(839)	(504)	(1,365)	(1,063)	(711)
Provisions	(285)	(313)	(295)	(269)	(246)
Minority interests	(0)	(0)	3	0	0
Shareholders' funds	1,414	1,558	1,238	1,471	1,718
Profitability					
EBITDA margin	40.7%	40.8%	39.6%	36.7%	35.8%
EBIT margin	12.6%	13.7%	16.9%	17.3%	17.5%
EBIT RoIC	8.8%	10.4%	13.6%	14.4%	15.1%
Net RoE	NM	8.1%	10.7%	14.7%	13.0%
Interest cover (EBIT)	6.2x	6.9x	11.7x	8.1x	6.6x
Dividend cover (net)	NA	NA	NA	NA	1.0x
Productivity					
Labour % sales	24.5%	24.5%	24.0%	23.5%	23.5%
Depreciation % sales	28.2%	27.1%	22.7%	19.5%	18.3%
Capex % sales	16.8%	17.7%	19.8%	14.0%	12.8%
Invested capital turnover	0.7x	0.8x	0.8x	0.8x	0.9x
Tax rate	NM	5.1%	37.5%	31.7%	29.8%
Net debt / total equity	59.3%	32.3%	110.5%	72.2%	41.4%
Momentum					
Sales growth	-10.3%	+1.1%	+15.4%	+12.4%	-1.1%
EBIT growth	+12.7%	+10.0%	+42.3%	+14.8%	+0.3%
Net earnings growth	NM	NM	+24.7%	+32.6%	+4.7%
Dividend growth	NM	NM	NM	NM	NM
Value*					
Market capitalisation (US$ m)	2,580	2,517	2,973	2,973	2,973
Plus: Core net debt / (cash)	841	487	1,317	1,063	711
Plus: Pension provisions	286	302	284	269	246
Plus: Buy out of minorities	-	-	-	-	-
Less: Non-core assets	-	-	-	-	-
Enterprise value (EV, avg)	3,706	3,306	4,573	4,304	3,930
EV/Sales (core)	2.13x	1.88x	2.25x	1.89x	1.74x
EV/EBITDA (core)	5.2x	4.6x	5.7x	5.1x	4.9x
EV/EBIT (core)	16.9x	13.7x	13.3x	10.9x	10.0x
EV/OpFCF	9.9x	7.6x	12.8x	9.0x	7.6x
EV/Invested capital	1.5x	1.4x	1.8x	1.6x	1.5x
P/CE	5.2x	6.6x	4.9x	5.0x	5.2x
P/E	NM	NM	17.3x	16.9x	16.1x
Dividend yield (net)	0.00%	0.00%	0.00%	0.00%	6.22%
P/BV (average)	1.8x	1.7x	1.7x	1.5x	1.5x

Source: UBS estimates, * Historical valuations are based on an `average for the year' share price. Current & future valuations are based on a share price of NIS4.98 on 13/01/2005

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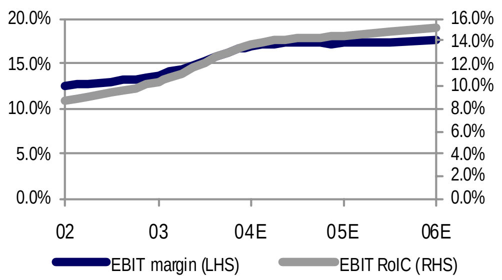
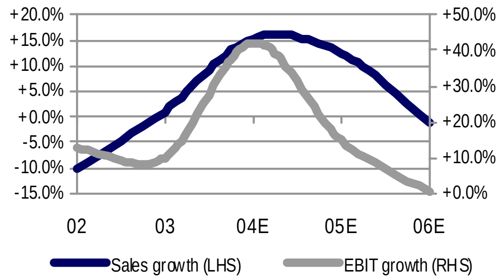
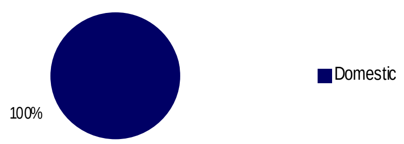
Profitability (EBIT margins & RoIC)



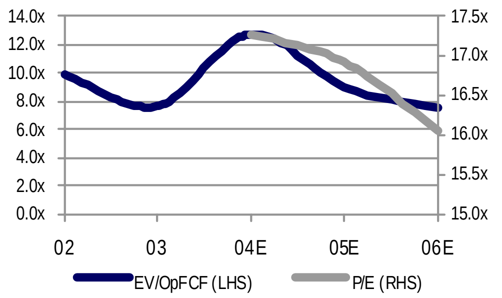
Momentum (Sales & EBIT growth)



Geographic exposure (Sales)



Value (EV/OpFCF & P/E)



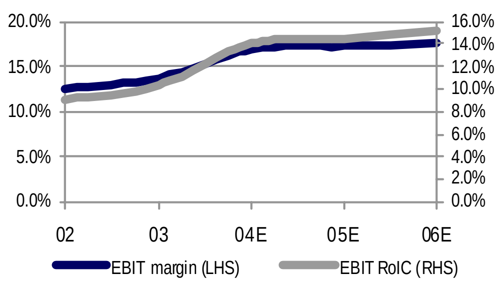
Bezeq

Per share (NIS)	12/02	12/03	12/04E	12/05E	12/06E
EPS	(0.39)	(0.18)	0.30	0.29	0.31
CEPS	0.98	0.71	1.05	1.00	0.96
Net DPS	0.00	0.00	0.00	0.00	0.31
BVPS	2.79	2.74	2.92	3.22	3.22
Profit & loss (NIS m)					
Sales	8,235	7,981	9,088	9,946	9,837
EBITDA	3,355	3,253	3,602	3,653	3,522
Operating income (EBIT)	1,037	1,093	1,535	1,716	1,720
Pre-tax profit	(375)	936	1,403	1,505	1,461
Net income (UBS adj.)	(927)	545	671	866	907
Cash flow (NIS m)					
Operating income (EBIT)	1,037	1,093	1,535	1,716	1,720
Depreciation & amortisation	2,318	2,160	2,067	1,937	1,802
Net change in working capital	(80)	177	(432)	(156)	14
Other (operating)	970	61	(100)	(100)	(100)
Operational cash flow	4,245	3,491	3,070	3,397	3,436
Tax paid	(211)	(48)	(526)	(478)	(436)
Capital expenditure	(1,380)	(1,414)	(1,801)	(1,395)	(1,257)
Net interest	(168)	(158)	(132)	(211)	(259)
Dividends paid	0	(185)	0	0	0
Net (acquisitions) / disposals	(366)	(190)	(148)	(99)	0
Other items	(1,641)	275	(4,149)	50	50
Increase (decrease) in net debt	478	1,771	(3,686)	1,265	1,534
Operating free cash flow (OpFCF) (NIS m)					
EBITDA (core)	3,355	3,253	3,602	3,653	3,522
Less maintenance capital expenditure	(1,497)	(1,466)	(1,565)	(1,407)	(1,269)
Less maintenance net working capital	(80)	177	(432)	(156)	14
OpFCF	1,778	1,964	1,605	2,090	2,267
Balance sheet (NIS m)					
Net tangible fixed assets	9,970	8,699	10,344	9,901	9,356
Net intangible fixed assets	0	0	0	0	0
Net working capital	1,403	1,188	1,621	1,777	1,763
Total invested capital (IC)	11,373	9,887	11,965	11,678	11,119
Financial & other fixed assets	1,844	1,776	1,776	1,776	1,776
Net cash / (debt)	(3,984)	(2,213)	(5,899)	(4,634)	(3,100)
Provisions	(1,352)	(1,373)	(1,273)	(1,173)	(1,073)
Minority interests	(1)	(0)	12	0	0
Shareholders' funds	6,717	6,845	5,349	6,414	7,490
Profitability					
EBITDA margin	40.7%	40.8%	39.6%	36.7%	35.8%
EBIT margin	12.6%	13.7%	16.9%	17.3%	17.5%
EBIT RoIC	9.1%	10.3%	14.0%	14.5%	15.1%
Net RoE	NM	8.0%	11.0%	14.7%	13.0%
Interest cover (EBIT)	6.2x	6.9x	11.7x	8.1x	6.6x
Dividend cover (net)	NA	NA	NA	NA	1.0x
Productivity					
Labour % sales	24.5%	24.5%	24.0%	23.5%	23.5%
Depreciation % sales	28.2%	27.1%	22.7%	19.5%	18.3%
Capex % sales	16.8%	17.7%	19.8%	14.0%	12.8%
Invested capital turnover	0.7x	0.8x	0.8x	0.8x	0.9x
Tax rate	NM	5.1%	37.5%	31.7%	29.8%
Net debt / total equity	59.3%	32.3%	110.5%	72.2%	41.4%
Momentum					
Sales growth	+1.0%	-3.1%	+13.9%	+9.4%	-1.1%
EBIT growth	+26.8%	+5.5%	+40.4%	+11.8%	+0.2%
Net earnings growth	NM	NM	+23.0%	+29.1%	+4.7%
Dividend growth	NM	NM	NM	NM	NM
Value*					
Market capitalisation (NIS m)	12,193	11,415	12,947	12,947	12,947
Plus: Core net debt / (cash)	3,984	2,213	5,899	4,634	3,100
Plus: Pension provisions	1,352	1,373	1,273	1,173	1,073
Plus: Buy out of minorities	-	-	-	-	-
Less: Non-core assets	-	-	-	-	-
Enterprise value (EV, avg)	17,530	15,001	20,119	18,755	17,120
EV/Sales (core)	2.13x	1.88x	2.21x	1.89x	1.74x
EV/EBITDA (core)	5.2x	4.6x	5.6x	5.1x	4.9x
EV/EBIT (core)	16.9x	13.7x	13.1x	10.9x	10.0x
EV/OpFCF	9.9x	7.6x	12.5x	9.0x	7.6x
EV/Invested capital	1.5x	1.4x	1.8x	1.6x	1.5x
P/CE	5.2x	6.6x	4.7x	5.0x	5.2x
P/E	NM	NM	16.8x	16.9x	16.0x
Dividend yield (net)	0.00%	0.00%	0.00%	0.00%	6.23%
P/BV (average)	1.8x	1.7x	1.7x	1.5x	1.5x

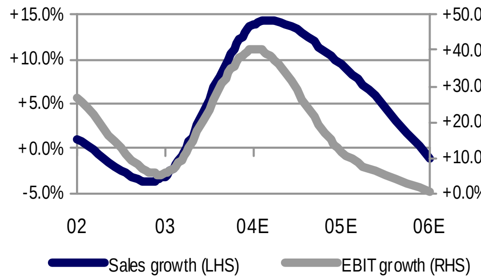
Source: UBS estimates, * Historical valuations are based on an `average for the year' share price. Current & future valuations are based on a share price of NIS4.97 on 13/01/2005

Bezeq is Israel's fixed-line incumbent, with 3 million lines in service. Bezeq currently owns 50% of Pelephone, a CDMA mobile operator with 1.8 million subscribers, and, until February 2005, it has an option to buy the remaining 50% via a third-party arrangement. Bezeq also owns 100% of Bezeq International, one of the country's three international operators, with an estimated market share of 36%, and a 49% stake in DBS, a satellite TV provider with 410,000 subscribers.

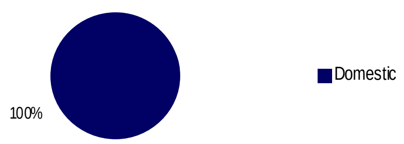
Profitability (EBIT margins & RoIC)



Momentum (Sales & EBIT growth)



Geographic exposure (Sales)



Value (EV/OpFCF & P/E)