



31/10/2002

Partner Communications

Gloomy Future Results in Downgrade of Rating

Recommendation
downgraded to

Hold

Price at 30/10/2002

\$4.03

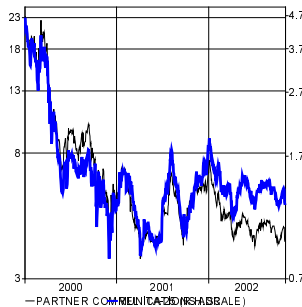
Target Price

\$4.46

Ticker/Code

PTNR

Price Performance (%)



Relative Performance

1m	1.6%
3m	-1.8%
12m	-16.6%

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YEnd	Revenue	EBIT	Net Profit	EPS (ILS)	% EPS	CEPS	P/E x	EV/EBDITA
31.12	(ILSm)	(ILSm)	(ILSm)		Growth			
2000	2,104	-541	-769	-4.30	-45.9	-1.57	-9.1	-177.5
2001	3,249	103	-303	-1.70	-60.5	2.0	-13.0	10.5
2002E	4,028	551	125	0.70	-141.2	4.0	27.2	6.2
2003E	4,321	690	360	2.0	188.3	5.4	9.4	5.3

Source: Deutsche Bank estimates and Company Data

Shares Outstanding (Million):	178.9	Average Daily Turnover, (\$m):	0.2
Market Cap (\$m):	717.2	Exchange Rate:	4.7
Free Float %:	24	Local Index (TA-25):	333.5

Following the recent release of Partner's Q3 2002 results and taking into account management's guidance for the Q4 2002 and 2003, we have revised our DCF model for the company. We have also updated our macroeconomic forecasts for Israel in our Partner model with the most recent Deutsche Bank projections. As a result, our revised DCF model suggests a new target price of \$4.46 per ADS, which is about 15% lower than our previous target of \$5.25 per ADS. The new target price offers only about 10% upside to the current market price. An international comparable valuation fully supports our DCF results. Given the low level of upside potential and taking into consideration the increased competition on the Israeli mobile market that is expected to come with further weakening of consumer sentiment, we have downgraded our Buy rating on Partner to Hold.

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2002-2003 forecast revisions

In the light of the recent release of Partner's Q3 2002 results and Deutsche Bank's new macroeconomic forecasts for Israel, we have updated certain assumptions in our DCF model:

- We have used new macroeconomic data for Israel as key inputs into our model, see Table 1.

Table 1: Israeli macroeconomic forecasts: revised versus previous

	2002E	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Previous									
NIS/\$	5.1	5.1	5.2	5.3	5.4	5.5	5.6	5.7	5.8
NIS inflation YE (%)	7.0	2.0	2.5	3.0	3.0	3.0	3.0	3.0	3.0
Real GDP growth (%)	-1.0	3.0	3.5	4.0	4.0	4.0	4.0	4.0	4.0
Revised									
NIS/\$	4.90	4.80	5.00	5.10	5.20	5.30	5.40	5.50	5.60
NIS inflation YE (%)	8.0	2.0	2.5	3.0	3.0	3.0	3.0	3.0	3.0
Real GDP growth (%)	-0.9	2.0	3.0	3.5	4.0	4.0	4.0	4.0	4.0

Source: Deutsche Bank Research estimates

- Partner under-performed our subscriber number estimates for Q3 2002 and an analysis of the operating statistics shows that the company has entered a period of tough competition, resulting from reinvigorated rivals coupled with a general weakening of consumer sentiment in Israel. All this has caused us to scale back our subscriber forecasts for Partner, as shown below.
- As far as ARPU is concerned, Partner has increased its tariff along with other market participants. Shekel-denominated ARPU also increased in Q3 2002 on the back of summer tariff increase initiatives. We believe that Partner and others, amid an environment of minimal subscriber growth, will try to "milk" more cash from the existing subscriber base in order to at least compensate for shekel depreciation against the dollar. All that has led us to upgrade our short-term NIS ARPU estimates. The reason for the higher dollar-denominated recomputed ARPU is the change in the NIS/\$ exchange rate, as shown above.
- We have also revised down Partner's revenues from 2003E following management guidance that the Israeli Communications Ministry will reduce interconnect rates on incoming calls by 10% from 1 January 2003.
- In addition, following management guidance on short-term EBITDA margin expectations, we have downgraded our EBITDA margin estimate for 2002 from 27% to 26%, leaving our long-term forecasts basically unchanged. Partner believes that in the long term, it should be able to generate around a 35% EBITDA margin.
- Partner's capex budget in shekel terms has not changed materially. We have kept our 13% capex/sales ratio estimate unchanged

Table 2: Key model variables: revised versus previous

	2002E	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Subscribers, '000s									
Previous	1,846	1,979	2,066	2,123	2,179	2,232	2,283	2,334	2,383
Revised	1,810	1,904	1,985	2,039	2,095	2,148	2,199	2,250	2,299
ARPU, (NIS)									
Previous	181	179	177	179	180	183	184	186	189
Revised	186	181	178	180	181	183	185	186	188
ARPU, (\$)									
Previous	38	35	34	34	34	34	33	33	33
Revised	40	37	36	36	35	35	34	34	34
EBITDA margin (%)									
Previous	27	30	32	33	34	35	36	36	37
Revised	26	30	32	33	34	35	36	36	36
Capex, (\$m)									
Previous	126	232	230	172	128	120	120	120	120
Revised	129	244	242	179	134	125	125	125	125
Capex/Sales ratio	15%	27%	27%	20%	15%	14%	13%	13%	13%
Capex, (NIS m)									
Previous	600	1,182	1,184	900	687	656	667	679	691
Revised	600	1,182	1,185	902	689	658	670	682	695

Source: Deutsche Bank Research estimates

Partner's 2002-2003 forecasts look as follows:

Table 3: 2002-2003 forecasts: revised versus previous

	2002E				2003E			
	Previous (NIS m)	Revised (NIS m)	Change (NIS m)	Change (%)	Previous (NIS m)	Revised (NIS m)	Change (NIS m)	Change (%)
Sales revenue	4,028	4,028	-1	0	4,425	4,321	-104	-2
EBITDA	1,087	1,065	-22	-2	1,328	1,283	-45	-3
EBITDA margin (%)	27.0	26.5		-0.5	30	30		0
Net profit/(loss)	72	125	53	74	313	360	48	15
Subscribers ('000s)	1,846	1,810	-36	-2	1,979	1,904	-75	-4
ARPU, (NIS)	181	186	5.1	2.8	179	181	1	1
ARPU, (\$)	38	40	1.9	5.0	35	37	2	6

Source: Deutsche Bank Research estimates

We have revised our Q4 2002 numbers for Partner following management guidance on anticipated reduction in revenues, EBITDA and net income.

Table 4: 2002 quarterly forecasts (NIS m)

	Q1 2002	Q2 2002	Q3 2002	Q4 2002E	2002E
Sales revenue	929	992	1,071	1,035	4,028
EBITDA	228	269	291	277	1,065
EBITDA margin (%)	25	27	27	27	26
Operating profit/(loss)	104	138	162	147	551
Operating margin (%)	11	14	15	14	14
Net profit/(loss)	-23	25	51	71	125
Subscribers, '000s	1,596	1,703	1,758	1,810	1,810
ARPU, (NIS)	184	185	189	185	186
ARPU, (\$)	39	39	38	40	40

Source: Deutsche Bank Research estimates and company data

Our long-term forecasts for Partner are presented in Table 5:

Table 5: Partner long-term forecasts (NIS m)									
	2002E	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Financials									
Sales revenue	4,028	4,321	4,446	4,596	4,713	4,858	4,982	5,112	5,260
EBITDA	1,065	1,283	1,403	1,499	1,583	1,682	1,769	1,818	1,875
EBITDA margin (%)	26	30	32	33	34	35	36	36	36
Net profit/(loss)	125	360	222	292	397	560	528	521	602
Operating statistics									
Subscribers, '000s	1,810	1,904	1,985	2,039	2,095	2,148	2,199	2,250	2,299
Prepaid as % of total	30	32	34	36	37	38	39	40	41
Voice ARPU, (\$)	37	33	31	29	27	26	24	23	22
Data ARPU, (\$)	3	4	5	7	8	9	10	11	12
Blended ARPU, (\$)	40	37	36	36	35	35	34	34	34
Mobile penetration – nominal (%)	95	97	99	100	101	102	103	104	105
Mobile penetration - adjusted (%)	83	84	86	87	88	89	90	91	92
Market share - Partner (%)	29	29	29	30	30	30	30	30	30

Source: Deutsche Bank Research estimates

Valuation

DCF

We have presented below our key DCF model assumptions:

Table 6: Cashflow table (NIS m)									
	2002E	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E
EBIT	551	690	690	725	794	891	965	1,001	1,045
Less: taxation	-	-	-	-	-	-	-174	-293	-339
Tax adjusted EBIT	551	690	690	725	794	891	791	708	707
Depreciation	507	585	705	767	789	791	804	817	830
Less: capex	-600	-1,182	-1,185	-902	-689	-658	-670	-682	-695
Change in working capital	-42	-42	-39	-39	-34	-34	-30	-34	-36
Unlevered free cashflow	416	50	172	550	860	990	895	808	805

Source: Deutsche Bank Research estimates

Table 7: WACC computation				2002E
Effective tax rate (%)			t	36.00
Beta		Fundamental Beta	B1	1.5
Net debt to equity (%)			D/E	40.0
Geared Beta		$B1*(1+(D/E*(1-t)))$	B2	1.83
Risk free rate (%)			Rf	5.10
Debt premium (%)			Dp	4.50
Equity risk prem (%)			Ep	5.50
Cost of equity (%)		$Rf+(B2*Ep)$	Ce	15.2
Cost of debt (%)		$(Rf+Dp)*(1-t)$	Cd	6.1
WACC (%)				11.6

Source: Deutsche Bank Research estimates

Using a WACC of 11.6% to discount the above cashflows and applying a 3.5% terminal growth rate, we have calculated a new target price for Partner of \$4.46 per ADS, which is about 15% lower than our previous target of \$5.25 per ADS. Our new target price offers about 10% upside from the current market level. Given the low level of upside potential and taking into consideration the increase in competition on the Israeli mobile

market that we expect to come with further weakening in consumer sentiment, we have downgraded our rating for Partner from Buy to Hold.

Table 8: DCF price computation with a 3.5% terminal growth rate

	NIS m
NPV	3,299
Discounted terminal value	3,866
Enterprise value	7,165
Net debt/(cash) YE 2002E	3,256
Market capitalisation	3,909
Number of ADS, (m)	178.9
Price per ADS, (NIS)	21.85
Price per ADS, (\$)	4.46
<i>Source: Deutsche Bank Research estimates</i>	

As DCF models are highly sensitive to the discount rates used and terminal growth rates applied, we have prepared a sensitivity table, as presented below:

Table 9: DCF price sensitivity table

Discount rate	Terminal growth rate					
	2.5%	3.0%	3.5%	4.0%	4.5%	5.0%
10.1%	5.55	5.95	6.41	6.94	7.58	8.34
10.6%	4.94	5.28	5.66	6.11	6.63	7.24
11.1%	4.41	4.70	5.02	5.39	5.82	6.32
11.6%	3.93	4.18	4.46	4.77	5.13	5.55
12.1%	3.51	3.73	3.96	4.23	4.54	4.88
12.6%	3.13	3.32	3.52	3.75	4.01	4.31
13.1%	2.79	2.95	3.13	3.33	3.55	3.80

Source: Deutsche Bank Research estimates

International comparable valuation

Our international comparable valuation, presented below, shows that on a major relative valuation matrix, Partner trades at a premium to the EEMEA group, by as much as more than 100% on an EV/Subscriber valuation. Compared to the major European mobile companies, Partner at various discounts on major valuation multiplies. We believe that such a valuation suggests very narrow upside to the current market price and fully supports our DCF analysis.

Table 10: International comparable valuation

	Ticker	Currency	Price 30/07/02	EV/Sales		EV/EBITDA		EV/EBITDA/CAGR	EV/Subscribers	
				2002E	2003E	2002E	2003E	2001E	2002E	2003E
M-Cell	MCEJ.J	ZAR	10.80	1.4	1.2	4.7	3.6	0.2	359	320
Mobinil	EMOB.CA	EGP	29.08	1.8	1.4	3.5	3.2	0.7	459	270
MTS	MBT.N	\$	31.49	2.6	1.9	5.1	4.2	0.3	539	348
Turkcell	TKC.N	\$	15.70	2.1	1.3	6.3	3.8	0.3	276	189
VimpelCom	VIP	\$	26.88	2.4	1.7	5.8	4.5	0.3	833	288
Average- EEMEA				2.0	1.5	6.1	5.1	0.4	493	283
Cosmote	COSr.AT	Euro	8.36	2.7	2.5	6.2	5.6	0.8	890	820
Elisa Communications	ELIAV.HE	Euro	5.41	1.0	1.0	4.3	3.6	0.4	1,163	1,123
Europolitan	EURO.ST	SEK	42.50	2.5	2.6	5.9	6.2	1.5	1,312	1,252
Libertel	LTEL.AS	Euro	7.76	2.2	2.0	5.9	5.4	1.3	921	827
Mobistar	MSTAR.BR	Euro	19.50	2.2	2.0	9.1	7.6	0.5	765	715
mmo2	OOM.L	GBp	50.25	1.1	1.1	6.8	5.1	0.3	465	459
Orange	ORA.PA	Euro	5.86	2.1	1.9	8.2	6.7	0.5	811	718
Panafon	PANr.AT	Euro	4.72	2.6	2.5	6.3	6.2	3.6	908	851
Sonera	SRA1V.HE	Euro	4.66	2.6	2.2	7.6	6.3	0.9	1,823	1,558
Stet Hellas	STHLY.O	\$	5.37	1.3	1.0	4.0	2.9	0.6	320	246
Telecel	TELN.IN	Euro	6.66	1.7	1.5	5.9	5.4	2.1	579	524
TIM	TIM.MI	Euro	4.82	4.4	4.1	9.5	9.0	1.7	1,318	1,115
TEM	TEM.MC	Euro	7.07	4.5	3.8	10.5	9.2	1.7	1,416	1,160
Vodafone Group	VOD.L	GBp	104.50	2.6	2.4	7.4	6.8	1.1	1,239	1,088
Average- developed markets				2.4	2.2	7.0	6.1	1.2	995	890
Partner	PTNR.O	\$	4.03	1.7	1.7	6.4	5.6	0.3	758	751
Premium/(discount) to EEMEA (%)				-17	9	6	9	-11	54	165
Premium/(discount) to pan Europe (%)				-29	-24	-8	-9	-74	-24	-16

Source: Deutsche Bank Research estimates, Reuters Input

Disclosures

Disclosure Checklist

Company	Ticker	Price	Disclosure
Cosmote	COSr.AT	Euro 8.36	2
Elisa Communications	ELIAV.HE	Euro 5.41	8
Europolitan	EURO.ST	42.50	
Libertel	LTEL.AS	Euro 7.76	
Mobistar	MSTAR.BR	Euro 19.50	
mmo2	OOM.L	£50.25	2,6,8,9
Orange	ORA.PA	Euro 5.86	2,7,8,9
Panafon	PANr.AT	Euro 4.72	2
Sonera	SRA1V.HE	Euro 4.66	6,7,8,9,10,11
Stet Hellas	STHLY.O	\$5.37	
Telecel	TELN.IN	Euro 6.66	
TIM	TIM.MI	Euro 4.82	
TEM	TEM.MC	Euro 7.07	
Vodafone Group	VOD.L	£104.50	2,5,7,8,9
M-Cell	MCEJ.J	ZAR10.80	8
Mobinil	EMOB.CA	EGP29.08	6
MTS	MBT.N	\$31.49	2,6
Turkcell	TKC.N	\$15.70	2
Vimpelcom	VIP	\$26.88	6
Partner	PTNR.O	\$4.03	2

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Hold: Total return expected to be between 10% to -10% over a 12 month period.

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