Global Equity Research

Israel

Wireless Communications

UBS

UBS Investment Research

Partner Communications

Rating	**Neutral 2**
	Prior: Buy 2
Price target	**US$8.90/NIS40.00**
	Prior:US$10.02/NIS45.00
Price	**US$8.36 (ADR)/NIS37.15**

RIC: PTNR.O BBG: PTNR US

16 March 2004

Matav deal raises risk profile

■ Partner announces intention to buy controlling Matav stake

Partner has announced that it intends to inject US$137m into Matav Cable in return for a 40% stake (and voting control) in the company. This potentially paves the way for Partner to drive consolidation in the cable TV sector and emerge as the main competitor to Bezeq across a range of telecom and entertainment services.

■ A good use of cash flow?

Facing an increasing mature core wireless business (albeit with some growth potential from the 3g rollout), Partner has elected to pursue growth through acquisition rather than further degearing and cash returns to shareholders. We are concerned that the cable and fixed line businesses may require further capital, with returns uncertain.

■ Investors should demand a higher risk premium

Given management's excellent record of execution to date, we are loathe to dismiss this as a value-destructive deal. However, returns from this investment are far from certain, in our view, and this, together with our view that Partner's debt levels will rise as a result, implies that investors should demand a higher return for holding Partner's shares.

■ Valuation: Downgrade to Neutral 2 (from Buy 2)

Until we are able to analyse this deal in more detail, we feel it is appropriate to attach a risk discount to Partner's fair value. We reduce our target price from NIS45 to NIS40, after applying a 10% risk discount to our DCF-based valuation. We apply a predictability level of 2 because of the uncertainty of timing of 3G capex payments, the exposure to exchange rate movements and the level of an appropriate discount rate--in addition to the uncertainty we see being added by the Matav deal.

Highlights (US$m)	12/02	12/03	12/04E	12/05E	12/06E
Revenues	856	984	1,063	1,102	1,137
EBIT	113	188	208	219	243
Net income (UBS)	18	256	88	103	134
EPS (UBS, US$(ADR))	0.10	1.41	0.49	0.57	0.74
Net DPS (UBS, US$(ADR))	0.00	0.00	0.00	0.18	0.34

Profitability & Valuation	5-yr hist. av.	12/03	12/04E	12/05E	12/06E
EBIT margin %	-	19.1	19.6	19.9	21.4
ROIC (EBIT) %	-	29.0	30.4	32.8	37.2
EV/EBITDA x	-	4.9	5.8	5.3	4.7
PE (UBS) x	-	3.5	17.2	14.7	11.3
Net dividend yield %	-	0.0	0.0	2.2	4.0

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 US$8.36 on 15 Mar 2004

Trading data (US$(ADR)/local)	
52-wk. range	US$8.41-3.21/NIS37.15-15.39
Market cap.	US$1.52bn/NIS6.74bn
Shares o/s	181m (ADR)/181m (ORD)
ADR ratio	1 ADR :1 ORD
Free float	-
Avg. daily volume ('000)	120/367
Avg. daily value (US$m)	0.9/12.8

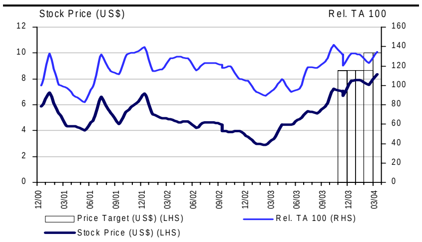
Balance sheet data 12/04E	
Shareholders' equity	US$0.24bn
P/BV (UBS)	6.3x
Net cash (debt)	(US$0.43bn)

Forecast returns	
Forecast price appreciation	+6.5%/+7.7%
Forecast dividend yield	0.0%
Forecast stock return	+6.5%/+7.7%
Market return assumption	6.5%/9.4%
Forecast excess return	+0.0%/-1.7%

EPS (UBS, US$)

	12/03	12/04E	Cons.	Prior
Q1	0.04	0.12	-	-
Q2	0.19	0.12	-	-
Q3	0.21	0.12	-	-
Q4	0.99	0.12	-	-
FY	1.45	0.49	*0.48*	-

Performance (US$)



Source: UBS

www.ubs.com/investmentresearch

Alex Wright
alexander.wright@ubs.com
+44-20-7568 3240

Stephen Levey
stephen.levey@ubs.com
+972 3 693 0904

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5

Matav deal transformational but high risk

Partner has announced that it intends to invest US$137m in Matav Cable in return for a controlling 40% stake in the company. While we have yet to make a firm judgement on the merits of this deal, and have not made any revisions to our forecasts, we believe that the company's risk profile is substantially higher as a result, and, as we do not immediately assume any value creation as a result of the deal, downgrade our rating from Buy 2 to Neutral 2.

We have been highly impressed over the last year with Partner's delivery of rapid margin improvement, strong cash flow generation and degearing of the balance sheet. When we upgraded our rating on the shares from Neutral 2 to Buy 2 on September 19th last year, our report was titled '*Showing us the money*'. Our view was that shareholders should benefit from the improvement in cash flow, which, in the short term, contributed to a rapidly declining cost of capital and, in the longer term, the prospect of healthy dividend payments.

However, the planned US$137m equity injection in Matav accounts for over 90% of our current free cash flow forecast for Partner. As a result, although we have not yet revised our forecasts, net debt is likely to be significantly higher at YE 2004 than we currently forecast, and Partner's strong cash flow is being invested into a business where the short- and even long-term returns are far from certain.

What is the strategic logic?

At this stage, the company has not made public the specific reasons for the deal, nor have we been able to speak to management about it. However, we assume that the main reasons are a combination of some or all of the following:

- A purchase of Matav because Partner believes the cable TV business itself is undervalued.

- The potential for further consolidation in the cable business – Partner's capital injection into Matav would enable the combined group to be the driving force behind a merger with Tevel and Golden Channels, potentially leading to synergies as a result.

- Enhancements to Partner's existing business. These are hard to identify at present, in our view, given the lack of precedent in a wireless company entering the cable TV business.

- The cable networks would potentially provide a platform for Partner to compete with Bezeq across a whole range of wireless, fixed line voice and data services.

It is hard to draw firm conclusions on this strategic move at this point, particularly as we do not yet know management's exact intentions. However, we believe it is fair to say that Partner's management will face an increasingly complicated set of challenges – not just the running of the existing business and the rollout of the 3g network, but the implementation of this acquisition and the execution of the combined business plan, which will ask completely new questions of Partner's management.

Will Matav require more capital?

We believe this depends very much on what Partner's plans for the business are beyond the initial acquisition. Matav currently has a high level of gearing, although this will be resolved in the short term by Partner's injection of new capital. If Matav is to go on to acquire the other cable companies, we believe that it will have to at least pay partly in cash, as well as assuming the considerable debt of Tevel, which is currently in bankruptcy. Beyond this, if the cable TV companies are to compete with Bezeq across a range of telecom services, it is likely that further substantial investments in the cable networks will be required. Furthermore, we believe that competing for market share in some of Bezeq's core fixed line businesses is likely to be a tough prospect with highly uncertain returns.

At this point, we believe there is a reasonable probability that Partner's investment in Matav will not be limited to the initial amount of US$137m; that further capital injections into Matav are possible; that consolidated net debt may rise further (particularly if Matav is to be fully consolidated, given Partner's voting control); and that there is likely to be prolonged uncertainty over the long-term profitability of this investment. As a result, until we are able to analyse this potential transaction in more detail and review our forecasts and valuation accordingly, we apply a 10% risk discount to our existing DCF valuation, leading to a reduction in our target price from NIS45 to NIS40 per share. This implies a reduction in NPV of some US$160m, which seems conservative relative to the size of the investment.

Implications for the Israeli telecom sector

There are likely to be many of these and so for now we just highlight some of the main implications:

- We view this as being marginally negative for Bezeq, in that the consolidation of the cable business should now be driven by a well capitalised, cash generative group with a top class cellular operation at its core.

- This deal, and any ensuing consolidation of the cable sector, may hasten Bezeq's purchase of the remaining shares in Yes, the satellite television company.

- Cellcom may be viewed as a loser from this transaction, in our view, given that most had expected it to be the driving force in a new fixed line competitor to Bezeq. However, given that Partner's management will now have much more demand on its time outside of the core wireless business, Cellcom may be able to turn this to its own competitive advantage for a while.

Impact on IDB Holdings

Only three short years ago, Cellcom and Tevel made up almost 20% of IDB's total net asset value. The general view was that if a grouping was to be formed which would eventually compete in the local loop versus Bezeq, then it would come from the IDB stable.

This story started to unwind with the bankruptcy of Tevel, and IDB have spent the past three years trying to extricate themselves from this holding, to the extent that today IDB no longer has an interest in the CATV business. Nonetheless, the view remained that a telecom grouping could be formed around Cellcom and the CATV companies to compete with Bezeq.

The aggressive move by Partner to take control of Matav and then potentially eventually of Tevel and Golden Channels leaves any such plan in shreds (indeed one of the conditions of Partner’s deal with Matav is that Matav make a significant addition by purchase t its subscriber base). One could argue that this is no bad thing for Cellcom and therefore IDB. If Partner take their eyes of the ball in the cellular market and botch up their 3G launch, Cellcom will be ready to pounce. Nonetheless, it does go to show that the ongoing negotiations between Cellcom's shareholders regarding possible stake sales or purchases has had an impact on the decision making processes, and allowed Partner to steal a march on its competitor.

It is far too early to call Cellcom and therefore IDB a loser from this transaction, as we are far from certain at this point whether this transaction makes sense in the first place. Nonetheless, we expect the upshot of the deal to be a speeding up of any negotiations over the ownership structure of Cellcom. We continue to believe that in 2004, IDB will take control of Cellcom, increasing its stake from its current 25%.

■ Partner Communications

Partner Communications is a GSM mobile operator in Israel. The company commenced commercial operations in January 1999 under the Orange brand name. It had a customer base of almost 2 million subscribers as of June 2003, and an estimated 29% market share. Partner Communications is in final negotiations with suppliers of 3G infrastructure, and expects to launch commercial services in 2004.

■ Statement of Risk

Partner's announced plan to buy a 40% stake in Matav Cable significantly raises the risk profile of the company, in our view. Not only will the deal result in a significant increase in consolidated debt, we believe there is a reasonable probability that more capital will be required to complete the consolidation of the cable businesses and potentially invest in fixed line telephony.

Partner remains exposed to macro sensitivities such as GDP growth and the NIS/US$ exchange rate. In the short term, our cash flow forecasts could be significantly impacted by the timing of large capital expenditures, such as those planned on a 3g network.

■ 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

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Global 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**	38%	35%
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**	51%	32%
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%	26%

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 2003.

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.
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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[10a]	BEZQ.TA	Neutral 1	NIS4.66
IDB Holdings	IDBH.TA	Buy 1	NIS87.40
Partner[1,3a,3b,10a,10b]	PTNR.O	Neutral 2	US$8.36

Price(s) as of 15 March 2004. Source: UBS.

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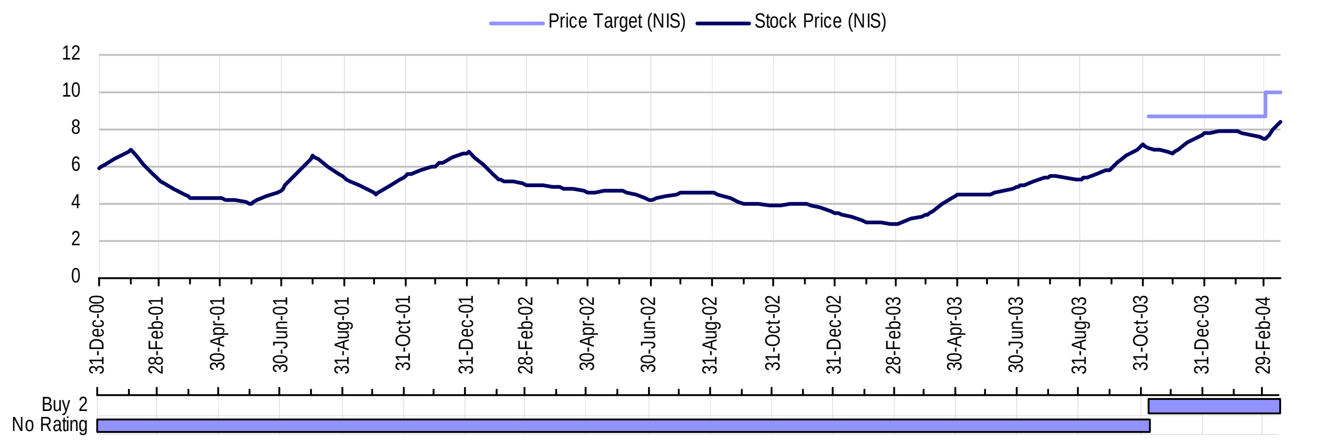
Partner Communications (US$)



Source: UBS; as of 15 March 2004.

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Head Office: UBS Limited, 1 Finsbury Avenue, London, EC2M 2PP, UK Phone: +44-20-7567 8000

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UBS

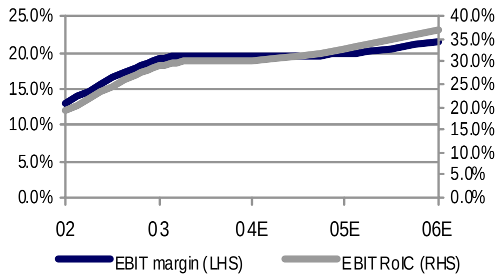
Partner Communications

Per share (NIS)	12/02	12/03	12/04E	12/05E	12/06E
EPS	0.5	6.4	2.2	2.6	3.3
CEPS	3.3	9.4	5.5	5.9	6.6
Net DPS	0.0	0.0	0.0	0.8	1.5
BVPS	(2.3)	3.5	5.9	8.1	10.2
Profit & loss (NIS m)					
Sales	4,055	4,468	4,770	4,950	5,107
EBITDA	1,050	1,392	1,529	1,590	1,686
EBIT	533	855	934	984	1,094
Pre-tax profit	84	530	618	724	942
Net income (UBS adj.)	84	1,163	396	464	603
Cash flow (NIS m)					
EBIT	533	855	934	984	1,094
Depreciation & amortisation	516	537	594	606	593
Change in NWC	96	(53)	(43)	49	(12)
Other (operating)	113	(674)	269	298	170
Operational cash flow	1,258	664	1,755	1,937	1,845
Tax paid	0	633	(223)	(261)	(339)
Capital expenditure	(807)	(472)	(616)	(577)	(486)
Net interest	(445)	(322)	(311)	(255)	(147)
Dividends paid	0	0	0	(228)	(425)
Net (acquisitions) / disposals	6	12	0	0	0
Other items	(237)	209	22	(145)	(23)
Change in net debt	(226)	726	627	471	425
Operating free cash flow (OpFCF) (NIS m)					
Core EBITDA	1,052	1,380	1,529	1,590	1,686
Less: Maintenance capex	(600)	(350)	(586)	(547)	(455)
Less: Maintenance NWC	(31)	6	49	(12)	(12)
OpFCF	421	1,035	991	1,032	1,219
Balance sheet (NIS m)					
Net tangible fixed assets	1,749	1,865	1,695	1,798	1,850
Net intangible fixed assets	1,113	1,269	1,326	1,201	1,089
Net working capital	(81)	(28)	15	(34)	(22)
Total invested capital (IC)	2,781	3,106	3,036	2,965	2,917
Financial & other fixed assets	137	154	59	76	93
Net cash / (debt)	(3,295)	(2,570)	(1,942)	(1,472)	(1,046)
Provisions	(42)	(61)	(77)	(97)	(117)
Minority interests	0	0	0	0	0
Shareholders' funds	(419)	629	1,075	1,472	1,847
Profitability					
EBITDA margin	25.9%	31.2%	32.1%	32.1%	33.0%
EBIT margin	13.2%	19.1%	19.6%	19.9%	21.4%
EBIT RoIC	19.1%	29.0%	30.4%	32.8%	37.2%
Net RoE	NM	>100.0%	46.4%	36.4%	36.3%
Interest cover (EBIT)	1.2x	2.7x	3.0x	3.9x	7.4x
Dividend cover (net)	NA	NA	NA	3.1x	2.2x
Productivity					
Labour % sales	0.0%	0.0%	0.0%	0.0%	0.0%
Depreciation % sales	12.7%	12.0%	12.5%	12.2%	11.6%
Capex % sales	19.9%	10.6%	12.9%	11.7%	9.5%
Invested capital turnover	1.4x	1.5x	1.6x	1.6x	1.7x
Tax rate	NM	NM	36.0%	36.0%	36.0%
Net debt / total equity	Neg. Ass.	408.4%	180.6%	100.0%	56.6%
Momentum					
Sales growth	+24.8%	+10.2%	+6.8%	+3.8%	+3.2%
EBIT growth	>+200%	+60.3%	+9.3%	+5.4%	+11.1%
Net earnings growth	NM	>+200%	-66.0%	+17.1%	+30.0%
Dividend growth	NM	NM	NM	NM	+86.2%
Value*					
Market capitalisation (NIS m)	3,957	4,050	6,738	6,738	6,738
Plus: Core net debt / (cash)	3,295	2,570	1,942	1,472	1,046
Plus: Pension provisions	61	77	97	117	137
Plus: Buy out of minorities	-	-	-	-	-
Less: Non-core assets	-	-	-	-	-
Enterprise value (EV, avg)	7,313	6,696	8,777	8,326	7,921
EV/Sales (core)	1.80x	1.50x	1.84x	1.68x	1.55x
EV/EBITDA (core)	7.0x	4.9x	5.7x	5.2x	4.7x
EV/EBIT (core)	13.7x	7.8x	9.4x	8.5x	7.2x
EV/OpFCF	17.4x	6.5x	8.9x	8.1x	6.5x
EV/Invested capital	2.6x	2.3x	2.9x	2.8x	2.7x
P/CE	6.7x	2.4x	6.8x	6.3x	5.6x
P/E	47.9x	3.5x	17.0x	14.6x	11.2x
Dividend yield (net)	0.0%	0.0%	0.0%	2.2%	4.1%
P/BV (average)	NM	6.4x	6.3x	4.6x	3.7x

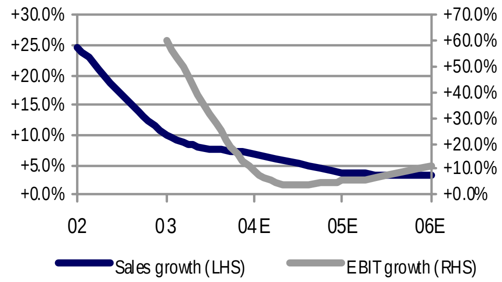
Source: UBS estimates, * Historical valuations are based on an 'average for the year' share price. Current & future valuations are based on a share price of NIS37.2 on 15/03/2004

Partner Communications is a GSM mobile operator in Israel. The company commenced commercial operations in January 1999 under the Orange brand name. It had a customer base of almost 2 million subscribers as of June 2003, and an estimated 29% market share. Partner Communications is in final negotiations with suppliers of 3G infrastructure, and expects to launch commercial services in 2004.

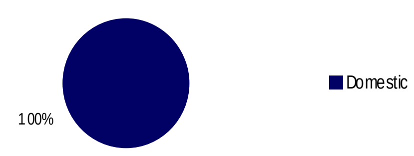
Profitability (EBIT margins & RoIC)



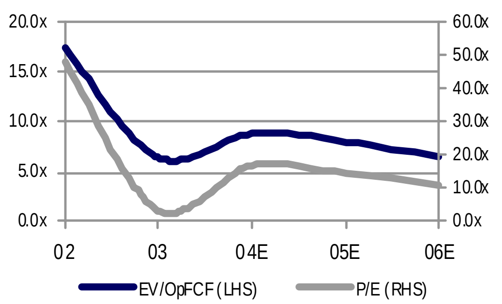
Momentum (Sales & EBIT growth)



Geographic exposure (Sales)



Value (EV/OpFCF & P/E)



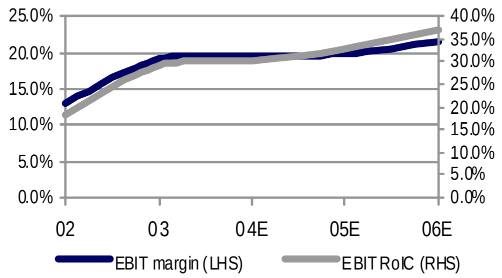
Partner Communications ADR

Per ADR (US$)	12/02	12/03	12/04E	12/05E	12/06E
EPS	0.10	1.41	0.49	0.57	0.74
CEPS	0.69	2.06	1.22	1.31	1.46
Net DPS	0.00	0.00	0.00	0.18	0.34
BVPS	(0.48)	0.79	1.32	1.80	2.26
Profit & loss (US$ m)					
Sales	856	984	1,063	1,102	1,137
EBITDA	222	306	341	354	375
EBIT	113	188	208	219	243
Pre-tax profit	18	117	138	161	210
Net income (UBS adj.)	18	256	88	103	134
Cash flow (US$ m)					
EBIT	113	188	208	219	243
Depreciation & amortisation	109	118	133	135	132
Change in NWC	20	(12)	(10)	11	(3)
Other (operating)	24	(148)	60	66	38
Operational cash flow	266	146	391	431	411
Tax paid	0	139	(50)	(58)	(75)
Capital expenditure	(170)	(104)	(137)	(128)	(108)
Net interest	(94)	(71)	(69)	(57)	(33)
Dividends paid	0	0	0	(51)	(95)
Net (acquisitions) / disposals	1	3	0	0	0
Other items	(50)	51	5	(32)	(5)
Change in net debt	(48)	165	140	105	95
Operating free cash flow (OpFCF) (US$ m)					
Core EBITDA	222	304	341	354	375
Less: Maintenance capex	(127)	(77)	(131)	(122)	(101)
Less: Maintenance NWC	(7)	1	11	(3)	(3)
OpFCF	89	228	221	230	271
Balance sheet (US$ m)					
Net tangible fixed assets	368	424	377	400	412
Net intangible fixed assets	234	289	295	267	242
Net working capital	(17)	(6)	3	(8)	(5)
Total invested capital (IC)	586	707	676	660	649
Financial & other fixed assets	29	35	13	17	21
Net cash / (debt)	(694)	(585)	(432)	(328)	(233)
Provisions	(9)	(14)	(17)	(21)	(26)
Minority interests	0	0	0	0	0
Shareholders' funds	(88)	143	239	328	411
Profitability					
EBITDA margin	25.9%	31.2%	32.1%	32.1%	33.0%
EBIT margin	13.2%	19.1%	19.6%	19.9%	21.4%
EBIT RoIC	18.4%	29.1%	30.1%	32.8%	37.2%
Net RoE	NM	932.8%	46.1%	36.4%	36.3%
Interest cover (EBIT)	1.2x	2.7x	3.0x	3.9x	7.4x
Dividend cover (net)	NA	NA	NA	3.1x	2.2x
Productivity					
Labour % sales	0.0%	0.0%	0.0%	0.0%	0.0%
Depreciation % sales	12.7%	12.0%	12.5%	12.2%	11.6%
Capex % sales	19.9%	10.6%	12.9%	11.7%	9.5%
Invested capital turnover	1.4x	1.5x	1.5x	1.6x	1.7x
Tax rate	NM	NM	36.0%	36.0%	36.0%
Net debt / total equity	Neg. Ass.	408.4%	180.6%	100.0%	56.6%
Momentum					
Sales growth	+10.8%	+14.9%	+8.1%	+3.6%	+3.2%
EBIT growth	>+200%	+67.1%	+10.7%	+5.2%	+11.1%
Net earnings growth	NM	>+200%	-65.5%	+16.9%	+30.0%
Dividend growth	NM	NM	NM	NM	+86.2%
Value*					
Market capitalisation (US$ m)	829	892	1,516	1,516	1,516
Plus: Core net debt / (cash)	696	566	433	328	233
Plus: Pension provisions	13	17	22	26	30
Plus: Buy out of minorities	-	-	-	-	-
Less: Non-core assets	-	-	-	-	-
Enterprise value (EV, avg)	1,537	1,475	1,971	1,870	1,779
EV/Sales (core)	1.80x	1.50x	1.85x	1.70x	1.57x
EV/EBITDA (core)	6.9x	4.9x	5.8x	5.3x	4.7x
EV/EBIT (core)	13.6x	7.8x	9.5x	8.5x	7.3x
EV/OpFCF	17.3x	6.5x	8.9x	8.1x	6.6x
EV/Invested capital	2.5x	2.3x	2.9x	2.8x	2.7x
P/CE	6.7x	2.4x	6.9x	6.4x	5.7x
P/E	47.4x	3.5x	17.2x	14.7x	11.3x
Dividend yield (net)	0.00%	0.00%	0.00%	2.16%	4.02%
P/BV (average)	NM	6.2x	6.3x	4.6x	3.7x

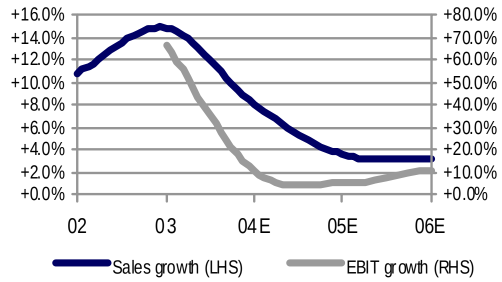
Source: UBS estimates, * Historical valuations are based on an `average for the year' share price. Current & future valuations are based on a share price of US$8.36 on 15/03/2004

Partner Communications is a GSM mobile operator in Israel. The company commenced commercial operations in January 1999 under the Orange brand name. It had a customer base of almost 2 million subscribers as of June 2003, and an estimated 29% market share. Partner Communications is in final negotiations with suppliers of 3G infrastructure, and expects to launch commercial services in 2004.

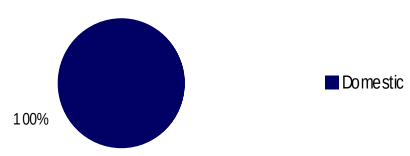
Profitability (EBIT margins & RoIC)



Momentum (Sales & EBIT growth)



Geographic exposure (Sales)



Value (EV/OpFCF & P/E)