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Equity Research

INCREASE TARGET PRICE

Partner Communications

PTNR.OQ

Upgrade to cash flows, increasing target price

- **We are upgrading our estimates for Partner: We increase 2003 and 2004 EBITDA estimates by 4%, and cut 2004E capex to NIS 580m from previous NIS 700m. The main reasons behind the upgrade are a set of better than we expected Q2 results, what we consider less intense competitive pressures, and more visibility on investment spending going forward.**
- **The key change in our forecasts is better free cash flow generation. We expect PTNR to generate around US$ 50m of free cash this year and over US$ 100m of free cash flow in 2004.**
- **Given our more positive stance on cash flow generation, we forecast a marked improvement in Partner's balance sheet and credit ratios as well. Given the high leverage and above average duration of equity cash flows we expect these improvements to be equity valuation enhancing as well.**
- **With a 2004E P/E of 8x, EV/EBITDA of 4.9x and FCF yield of 11.4% (European small cap averages are 12.1x, 5.5x and 8.6% respectively) PTNR is trading at a discount on most traditional valuation multiples to European small cap mobile stocks.**
- **On the back of our near term cash flow upgrades we increase our 12m target price to US$ 6.5 and maintain our outperform rating on the stock.**

Partner is one of three mobile operators in Israel.

research team

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Rating	**OUTPERFORM* [V]**
Price (18 Aug 03)	**5.26 (US$)**
Target price (12 months)	**6.50 (US$)**
Market cap. (NIS m)	**4,246.81**
Enterprise value (NIS m)	**7,541.98**
Region/country	**European/Israel**
Sector	**Wireless Telecommunication Services**
Analyst's Coverage Universe	**Emerging Markets**
Weighting (vs. broad market)	
Date	**19 August 2003**

**** Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.***
[V] = Stock considered volatile (see Disclosure Section).

Price / price relative

The price relative chart measures performance against the isr_ta10 index.
On 18/08/03 the isr_ta10 index closed at 417.83.
On 18/08/03 the spot exchange rate was US$1.11/eu 1. - eu1.11/US$1.

Performance over	1mth	3mths	12mths
Absolute (%)	1.5	20.6	16.9
Relative (%)	4.8	20.3	-1.5

Year	12/01A	12/02A	12/03E	12/04E
Revenues (NIS m)	3,249.3	4,054.6	4,301.7	4,495.0
EBITDA (NIS m)	641.21	1,049.63	1,252.41	1,391.56
Net income (NIS m)	-303.4	84.2	356.0	536.7
CSFB adj. EPS (NIS)	-1.70	0.46	1.94	2.93
ROIC (%)	3.3	15.4	17.9	21.6
P/E (x)	-13.8	50.8	12.0	8.0
P/E rel (%)	—	—	—	—
EV/EBITDA (x)	11.4	4.0	6.0	4.9

Dividend 2002 (NIS)	—	Book value/share (12/02, NIS)	—
Dividend yield (%)	—	Free float (%)	24.0
IC (12/03E, NIS m)	3,598.25	Number of shares (m)	181.72
Net debt (12/03E, NIS m)	3,075	EV/IC (12/03E, x)	2.1
Net debt/equity (12/03E, %)	1,184.6	Current WACC (12/03E, %)	10.3

Source: FTI, Company data, Datastream, CSFB (EUROPE) LTD. Estimates.

Investment Summary

Changes to estimates – significant free cash flow upgrade

We are upgrading our estimates for Partner as set out in the table below. The main reasons behind the upgrade are a set of better than we expected Q2 results, what we consider less intense competitive pressures, and lower estimated investment spending going forward.

Figure 1: **Changes to estimates (NISm)**

	2003E new	2003E old	change	2004E new	2004E old	change
Revenues	4,302	4,110	5%	4,495	4,176	8%
EBITDA	1,252	1,209	4%	1,392	1,333	4%
Margin	29%	29%		31%	32%	
Net income	356	208	71%	537	274	96%
Capex	(600)	(600)		(580)	(700)	
Free cash flow	220	79		489	194	

Source: CSFB estimates.

Changes to key income statement items such as revenues and EBITDA are relatively modest – 2003 and 2004 EBITDA estimates are up by 4% for both year. The earnings changes are a result of both operating and financial leverage – the key change in our forecasts is better free cash flow generation in 2003, and particularly in 2004., on new estimates investment spend of about NIS 580m in that year compared to previous NIS 700m.

Overall, we expect PTNR to generate around US$ 50m of free cash this year and over US$ 100m of free cash flow in 2004.

In a way, these changes are a modelling internalisation of the flexibility Partner has had on investment spend. PTNR's 3G plans have, in the past, limited visibility on future capex's spend. PTNR's Q2 conference call has shed some more light on this issue.

There are still significant question markets over the future commercial success of 3G. We believe that PTNR has the necessary flexibility in terms of 3G spending to assess the financial operating performance of recent 3G start ups in Europe, and down- or upscale investment requirements accordingly. Thus, should PTNR end up with higher than forecast capex, we believe this will also have revenue and profitability implications. On the other hand, should 3G prove a less attractive commercial proposition, we see further potential for capex reductions.

In our view, PTNR has become less of a technological platform story (as opposed to the late nineties when it entered a market which at that time already had 3 standards). We believe the technological capabilities in terms of product offerings etc are getting increasingly similar for all the market participants in Israel. Therefore we would regard 3G spending in Israel just as much a commercial issue as for any other European market, since we see limited need for product differentiation with uncertain profitability for marketing purposes only.

Financial and valuation implications of our forecast change

Given our more positive stance on cash flow generation, we forecast a marked improvement in Partner's balance sheet and credit ratios as well. Given the high leverage and above average duration of equity cash flows we expect these improvements to be equity valuation enhancing as well. We believe that PTNR's announcement that it sees no need for further funding for its current business plan is supportive of these forecasts above.

We expect PTNR's net debt to EBITDA to fall below 2x next year and 1.5x in 2005, which should also go hand in hand with further improvements in return on capital and equity.

Figure 2: **Cash flow, balance sheet, returns**

NIS in millions, unless otherwise stated

	2002	2003E	2004E	2005E
Cash earnings	682	927	1,106	1,259
Investing cash flow	(816)	(707)	(617)	(620)
Cash flow before financing	(134)	220	489	640
Net Debt	3,295	3,075	2,586	1,947
Net Debt/Equity	n/m	1185%	325%	132%
Net debt/Total capital	103%	92%	76%	57%
Net debt/EBITDA	2.6	2.2	1.7	1.3
EBITDA/Interest	2.3	4.4	5.5	7.3
ROE	-87%	137%	67%	46%
ROA	2%	8%	11%	12%
ROCE	17%	19%	23%	26%

Source: Company data, CSFB estimates.

Risks to forecasts – demand and competition

The key risk to our forecast remains the uncertain operating environment. The weak Israeli economy and the uncertain security situation have been a potential valuation negative for all Israeli assets.

From a bottom up perspective, we believe PTNR did benefit from a less intense competitive situation in the Israeli mobile market, as all operators have been stressing cost and capex discipline in our view. Pricing erosion was limited (as reflected in stable ARPUs, and also the fact the operators have been increasing nominal tariffs earlier this year). Competitive dynamics has also been changing over the past few quarter we think. Relative market shares have, by now, been stabilised, with similar total net adds for all three operators over the last 6 months. (See table 3). We do not expect a marked change in this over the next few quarters as we believe all operators will emphasise cash flow generation and margin protection , but would note that in the past, the Israeli cellular market did suffer periodically from bouts of intense competitive pressures.

Figure 3: Subscribers, net adds, ARPUs

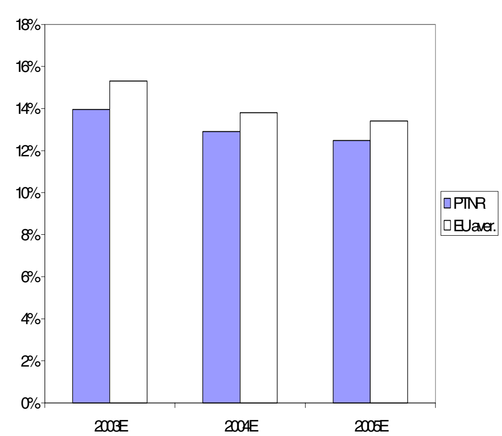
	2003 Q2 ('000)	net adds for Q2 03 ('000)	net adds for Q1 02 ('000)
Pelephone	1,865	71	33
Cellcom	2,551	37	71
Partner	1,949	55	57
ARPUs (NIS/month)	2003 Q2	2003 Q1	
Pelephone	163	158	
Partner	171	164	

Source: Company data

Valuations – at a discount to small cap mobile stocks; absolute valuations imply NIS 31 TP

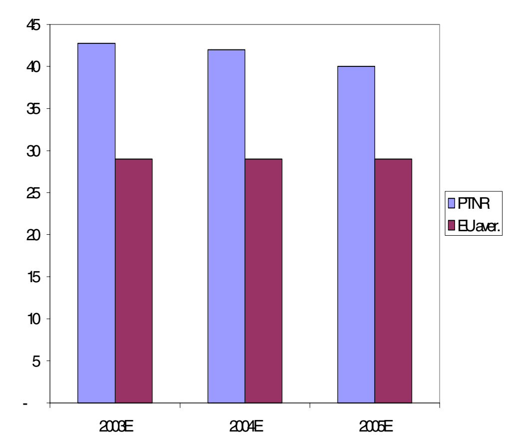
Our investment view on PTNR is one of delevering and execution capability. In this sense, PTNR is different to most of the (listed) emerging market mobile stories where the overriding investment argument is essentially secular growth (subscribers and/or income). With over 6 million reported subscribers, the Israeli cellular market is one of the most mature in the world. ARPU's of around euro 40 per month are around 30% above our generic European ARPU models, and usage is what we consider high with MoUs of around 300 minutes per month. Given a relatively defensive pricing structure with about 14 eurocents of ARPM, a comprehensive product portfolio and branding are key factors in revenue generation.

Figure 4: Capex to sales



Source: CSFB estimates.

Figure 5: ARPU



Source: CSFB estimates.

Valuations against its most comparable peers in Europe are relatively undemanding in our view. PTNR trades about a 20-30% discount on both 2003 and 2004 estimates to European small cap stocks on five out of six traditional valuation metrics (P/E, EV/EBITDA, equity FCF yield) – the only exception being 2003E FCF.

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Figure 6: Comparative valuations

Company	RIC	Price/ value per share	Target price	CSFB rating	EV/ EBITDA 2003E x	EV/ EBITDA 2004E x	EV/ EBITDA 2005E x	EBITDA CAGR 02-05E	PE ratio 2003E x	PE ratio 2004E x	PE ratio 2005E x	FCF Yield 2003E	FCF Yield 2004E	FCF Yield 2005E
Vodafone	VOD.L	118p	135p	OUT-PFM	7.4	6.5	5.8	10.6%	15.7	14.6	13.5	7.4%	8.6%	9.1%
TIM	TIM.MI	Eu4.08	Eu4.35	UNDER-PFM	7.0	6.6	6.2	4.3%	20.4	17.7	15.1	5.8%	7.3%	8.5%
Orange	ORA.PA	Eu8.28	Eu7.50	NEUTRAL	6.9	5.9	5.1	8.9%	23.8	20.8	17.8	5.7%	7.6%	8.3%
TEM	TEM.MC	Eu6.95	Eu6.70	UNDER-PFM	8.2	6.9	6.2	9.3%	19.1	16.5	14.9	6.1%	7.4%	8.5%
mmO2	OOM.L	54p	59p	NEUTRAL	4.9	3.9	3.3	25.5%	2,629.1	(124.7)	(159.3)	-3.8%	2.0%	8.3%
Bouygues	BOUY.PA	Eu23.05	Eu23.00	NEUTRAL	0.4	-0.1	-0.6	12.3%	23.6	18.6	14.7	0.7%	7.0%	9.3%
Tele2	TEL2b.ST	310 kr	330 kr	OUT-PFM	8.0	6.4	5.4	18.4%	14.4	11.4	9.7	8.3%	8.9%	10.6%
COSMOTE	COSr.AT	Eu10.18	Eu10.50	NEUTRAL	6.1	5.0	4.2	14.8%	13.3	11.4	9.9	5.9%	7.9%	9.6%
Mobistar	MSTAR.BR	Eu40.35	Eu40.00	OUT-PFM	7.4	6.1	5.2	14.8%	12.0	11.3	12.7	9.8%	10.0%	8.1%
Panafon	PANr.AT	Eu5.84	Eu6.50	OUT-PFM	6.2	5.2	4.5	12.1%	13.0	11.3	10.3	6.8%	8.0%	8.6%
STET Hellas	STHLY.O	$9.85	$6.70	NEUTRAL (V)	4.0	3.4	3.0	9.3%	9.9	8.8	8.1	8.0%	9.9%	9.0%
Partner	**PTNR.O**	**US$ 5.3**	**US$ 6.5**	**Outperform**	**5.9**	**4.9**	**4.2**	**13.1%**	**12.1**	**8.0**	**6.3**	**5.1%**	**11.4%**	**14.9%**
Average (big cap: PE, FCF yield ex mmO2)					6.9	6.0	5.3	11.7%	19.8	17.4	15.3	6.2%	7.7%	8.6%
Average (small cap, EV/ EBITDA ex Bouygues, PE, FCF yield ex SonaeCom)					6.6	5.5	4.7	14.0%	14.4	12.1	10.9	6.6%	8.6%	9.2%
Average (PE ex mmO2, EV/ EBITDA ex Bouygues, PE, FCF yield ex SonaeCom)					6.7	5.7	5.0	13.1%	16.5	14.2	12.7	6.5%	8.3%	8.9%

Our sector weighting on the European mobile sector is Neutral

V – Volatility indicator, see disclosure

Source: Company data, CSFB estimates.

Our DCF valuation (WACC of 10.3%, Cost of equity 12%) implies fair value of NIS 29 YE2003, yielding a 12m price target of NIS 31 (at current exchange rates US$ 7 per share). Comparative valuations (using European small cap average) imply fair value of between US$7 (on 2004E FCF) and US$8 (2004E P/E) US$8 per share.

An important valuation consideration is PTNR's technicals – it is what we regard a small and illiquid stock, which calls in our view for some valuation discount. Taking a somewhat arbitrary 15% discount on the average of the implied fair values of DCF and comparative valuations translates into a fair value of US$ 6.5 per share. Therefore we increase our target price to US$ 6.5 and maintain our outperform rating in the stock.

Figure 7: Summary forecasts

NIS in millions, unless otherwise stated

Profit & Loss (Shk m)	2001	2002	2003E	2004E	2005E	2005E
Revenues	3,249	4,055	4,302	4,495	4,646	4,812
EBITDA	641	1,050	1,252	1,392	1,487	1,520
Depreciation	538	516	610	600	601	612
EBIT	103	533	643	791	886	907
Other income/(loss)						
Financial income/(loss)	(406)	(449)	(287)	(255)	(204)	(155)
Profit before tax	(303)	84	356	537	682	752
Tax	0	0	0	0	0	(271)
Profit after tax	(303)	84	356	537	682	481
Minorities	0	0	0	0	0	1
Net profit	(303)	84	356	537	682	481
Cash flow (Shk m)	2001	2002	2003E	2004E	2005E	2005E
EBITDA	641	1,050	1,252	1,392	1,487	1,520
Change in working capital	90	(57)	(39)	(30)	(24)	(26)
Other non cash items	50	48	0	0	0	0
Operating cash flow	781	1,041	1,214	1,361	1,463	1,494
Cash interest paid	(358)	(358)	(287)	(255)	(204)	(155)
Cash tax paid	0	0	0	0	0	(271)
Cash earnings	423	682	927	1,106	1,259	1,068
Investment in PP&E	(685)	(600)	(600)	(580)	(580)	(580)
Investments other	56	(216)	(107)	(37)	(40)	(35)
Dividends	0	0	0	0	0	0
Cash-flow before financing	(207)	(134)	220	489	640	453
New equity	0	4	0	0	0	0
Net change in debt	211	126	0	0	0	0
Extraordinary items						
Change in cash	4	(4)	220	489	640	453
Balance sheet (Shk m)	2001	2002	2003E	2004E	2005E	2005E
Fixed assets	1,749	1,865	1,915	1,959	2,004	2,041
Working capital	121	174	213	243	267	293
Other net assets/(liabilities)	1,005	1,160	1,207	1,181	1,154	1,119
Net operating assets	2,876	3,199	3,335	3,383	3,425	3,453
Net debt/(cash)	3,070	3,295	3,075	2,586	1,947	1,494
Provisions	0	0	0	0	0	0
Minorities	0	0	0	0	0	0
Shareholders funds	(194)	(96)	260	796	1,478	1,959
Capital employed	2,876	3,199	3,335	3,383	3,425	3,453

Source: Company data, CSFB estimates.

Companies Mentioned *(Price as of 30 Jul 03)*

Partner Communications (PTNR.OQ, $5.5, OUTPERFORM [V], TP $6)

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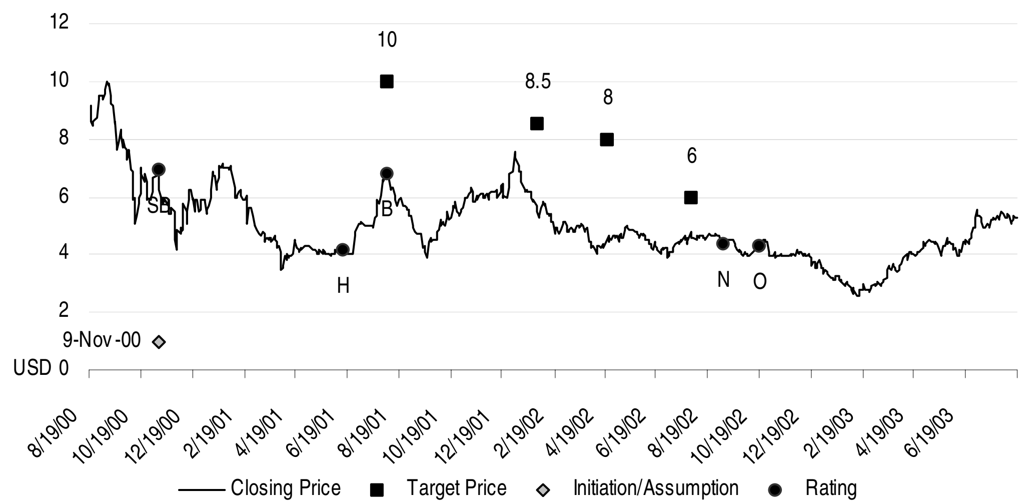
3-Year Price, Target Price and Rating Change History Chart for PTNR.OQ



Current: O=Outperform; N=Neutral; U=Underperform; R=Restricted; NR=Not Rated

Prior to 9-Sep-02: SB=Strong Buy; B=Buy; H=Hold; S=Sell; R=Restricted; NR=Not Rated

PTNR.OQ Date	Closing Price ($)	Target Price ($)	Rating	Initiation/ Assumption
11/9/00	6.94		STRONG BUY	X
6/14/01	4.17		HOLD	
8/6/01	6.8	10	BUY	
1/30/02	5.45	8.5		
4/22/02	4.511	8		
7/29/02	4.77	6		
9/6/02	4.371		NEUTRAL	
10/17/02	4.27		OUTPERFORM	

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Outperform: The stock's total return is expected to exceed the industry average* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.

Neutral: The stock's total return is expected to be in line with the industry average* (range of ±10%) over the next 12 months.

Underperform:** The stock's total return is expected to underperform the industry average* by 10-15% or more over the next 12 months.

**The industry average refers to the average total return of the analyst's industry coverage universe (except with respect to Asia/Pacific, Latin America and Emerging Markets, where stock ratings are relative to the relevant country index).*

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Neutral	43%	(36% banking clients)
Underperform	20%	(32% banking clients)
Restricted	3%	

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Price Target: (12 months) for (PTNR.OQ)
Method: DCF, comparative
Risks: macro, competition

As of the date of this report, CSFBLLC makes a market in the securities of the subject company (PTNR.OQ).

Disclosures continue on next page.

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