

June 06, 2005

**UNITED STATES**  
**Telecom Services**  
 Asia Telecom Services

## Partner Communications (US\$ 8.58) 1 - Overweight

Company Update

**NY W3 Conference - Asia Angle**

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### Investment Conclusion

- Partner Communications presented at Lehman's Worldwide Wireless & Wireline (W3) conference last Friday and updated investors on its strategy for 3G in Israel.

### Summary

- The company pointed out its superior revenue and profitability profile in the Israeli mobile market. While the company in the last two years has gained from superior subscriber churn into its own network, it is now beginning to target corporate users.
- The company intends to accelerate its 3G roll out, presently at 68% of population coverage. It expects faster take up over 2006 as handsets reach the sub-USD200 affordability mark.
- We reiterate our 1-OW rating on the US ADRs given the company's operational momentum, attractive deleverage over next 2 years and 3G lead.

FY Dec NIS	2004A	2005E		2006E		2007E	
	Actual	Old	New	Old	New	Old	New
EPS	2.59	3.02	3.02	3.72	3.72	3.93	3.93
Recurring EPS	2.79	3.31	3.31	3.72	3.72	3.93	3.93
Net Profit (m)	472	489	489	564	564	596	596
Recurring NP (m)	543	538	538	564	564	596	596
P/E	14.8		12.2		9.9		9.4
Recurring P/E	13.6		11.1		9.9		9.4
EV/EBITDA	5.8		4.9		4.6		4.2

### Market Data

Market Cap US\$ (m)	1,583
Shares Outstanding (m)	184.5
Dividend Yield (%)	-
Convertible	Yes
Share per ADR	1.00

### Financial Summary

3-Yr EPS Growth (%)	12%
3-Yr EBITDA Growth (%)	-2%
Current BVPS(ILS)	8.69
Debt-to-Equity (%)	29%
Gearing	22%
PEG Ratio	1.2

### Company Rating

Current: 1 - Overweight

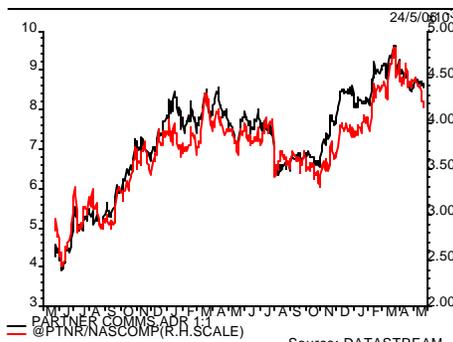
### Target (US\$)

Current: 10.50

### Sector View: 2 - Neutral

**Upside to Target %**
**22**

### Stock Overview



Reuters	PTNR.O
Bloomberg	PTNR US
ADR	-
NASDAQ	2,046.59
COMPOSITE	
<b>Performance</b>	<b>1M 3M 12M</b>
Absolute %	-0.2 -3.8 18.7
Rel. Market %	-5.8 -4.5 10.9
52 Week Range	9.60-6.36

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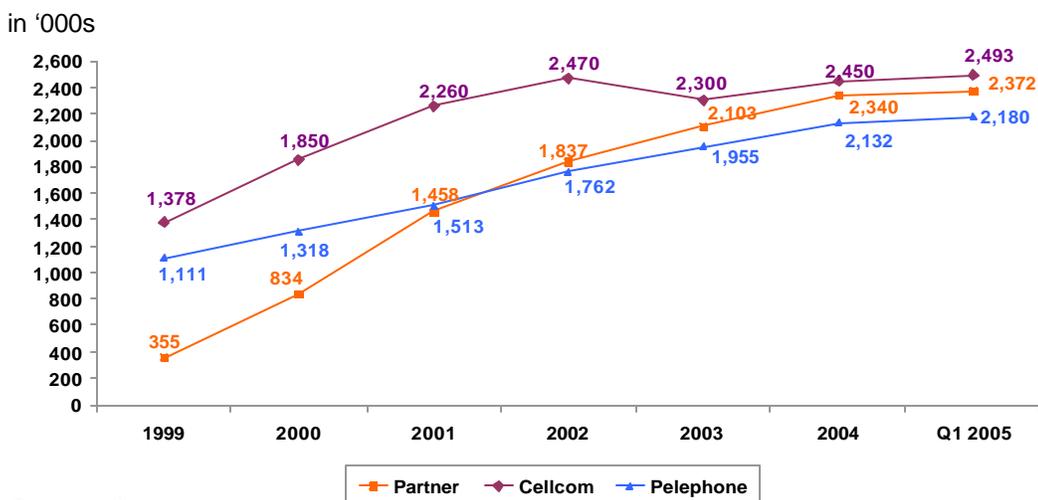
Investors should consider this report as only a single factor in making their investment decision.

**PLEASE SEE ANALYST(S) CERTIFICATION(S) ON PAGE 2 AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 3**

Partner Communications' CFO Alan Gelman presented at the Lehman Worldwide Wireless and Wireline (W3) conference last Friday. In its presentation, the company highlighted its superior customer profile in the Israeli market, strong brand and service perception, and 3G lead over market peers.

The company pointed out its superior revenue and profitability profile in the Israeli mobile market. While the company in the last two years has gained from superior subscriber churn into its own network, it is now beginning to target corporate users. Since the launch of services in 1999, Partner has been able to gain more than 50% of incremental subscriber growth in the market. The market has three strong players, and a smaller niche player. The company believes this superior churn-in into its own network is due to its ability to provide superior customer service and its brand advantage. The company's brand Orange is rated the best telecom brand and the second best overall brand in the country by Globes, July 2004. The company claims that a caller to its customer service center needs to wait for an average of only 30-45 seconds.

### Wireless Subscriber Growth Trends in Israel



Source: Company

The company intends to accelerate its 3G roll out, presently at 85% of population coverage. It expects faster take up over 2006 as handsets reach the sub-USD200 affordability mark. The company presently has slightly over 20k 3G subs, and expects similar incremental growth in data as witnessed during the GSM-GPRS transition. Meanwhile the company has done well in restricting its non-3G capex to less than 5-6% of its total revenues.

One common investor concern was Partner's lower than mature market EBITDA margins at 32%. The company attributed this to its accounting policy of recognizing revenues on a gross basis, and the more than 3% of revenues paid as royalties to the government.

### Valuation

We value Partner at US\$10.50 per share using DCF with a WACC of 8.3% and a 3.5x EV/EBITDA exit multiple.

We believe Partner's ability to dominate the 3G space, gain high-quality subscribers, steadily improve operational margins and cash flows, and aggressive deleverage should enable it to steadily outperform the general market over the coming quarters. We believe key risks remain external, such as worsening geo-political environment.

**Financials**

Year ended Dec 31 in NIS (mn)	2005E	2006E	2007E	Year ended Dec 31 in NIS (mn)	2005E	2006E	2007E
2G	4,524	3,988	3,634	Cash and equivalents	61	256	837
3G	131	456	818	Accounts receivable	691	657	651
Equipment	504	490	494	Inventories	103	99	94
<b>Total Revenue</b>	<b>5,160</b>	<b>4,935</b>	<b>4,945</b>	<b>Total Current Assets</b>	<b>855</b>	<b>1,012</b>	<b>1,583</b>
Cost of Services	(2,933)	(2,800)	(2,804)	PPE - net	1,930	1,973	1,959
Cost of Equipment	(701)	(682)	(687)	Intangible assets	1,268	1,190	1,114
Selling & Marketing	(351)	(331)	(326)	Deferred tax assets	97	-	-
G&A	(175)	(163)	(158)	<b>Total Non-Current Assets</b>	<b>3,295</b>	<b>3,163</b>	<b>3,073</b>
<b>Total Costs</b>	<b>(4,161)</b>	<b>(3,975)</b>	<b>(3,976)</b>	Investments & LT receivables	166	166	166
<b>EBIT</b>	<b>999</b>	<b>960</b>	<b>969</b>	<b>Total Assets</b>	<b>4,316</b>	<b>4,341</b>	<b>4,822</b>
<i>EBIT Margin</i>	<i>19%</i>	<i>19%</i>	<i>20%</i>	Creditors	541	505	494
Interest Expense	(258)	(130)	(118)	Borrowings + accrued interest	-	-	-
<b>Profit before Tax</b>	<b>741</b>	<b>829</b>	<b>851</b>	Other creditors	255	232	220
Income Tax	(252)	(265)	(255)	<b>Total Current Liabilities</b>	<b>796</b>	<b>737</b>	<b>714</b>
<b>Net Profit</b>	<b>489</b>	<b>564</b>	<b>596</b>	Borrowings	2,389	1,938	1,938
<i>EPS</i>	<i>3.02</i>	<i>3.72</i>	<i>3.93</i>	Notes Payable	-	-	-
<i>Recurring EPS</i>	<i>3.32</i>	<i>3.72</i>	<i>3.93</i>	Others	100	100	100
<i>DPS</i>	<i>-</i>	<i>0.37</i>	<i>0.78</i>	<b>Total Non-Current Liabilities</b>	<b>2,489</b>	<b>2,038</b>	<b>2,038</b>
<i>Payout ratio</i>	<i>0%</i>	<i>10%</i>	<i>20%</i>	Paid-up capital	2	2	2
EBITDA (EBIT + D&A)	1,600	1,582	1,615	Non-distributable reserves	1,290	1,317	1,345
<i>EBITDA margin</i>	<i>31%</i>	<i>32%</i>	<i>33%</i>	Reserve & Surplus	(261)	247	723
				<b>Shareholder's Equity</b>	<b>1,031</b>	<b>1,566</b>	<b>2,069</b>
				<b>Liabilities &amp; Shareholder's Equity</b>	<b>4,316</b>	<b>4,341</b>	<b>4,822</b>

Year ended Dec 31 in NIS (mn)	2005E	2006E	2007E	KPIs	2005E	2006E	2007E
Net Income	489	564	596	<b>Metrics</b>			
D&A	601	623	646	FCF yield	12%	11%	12%
Deferred Income Taxes	252	97	-	FCFE yield	11%	13%	12%
Change in Working Capital	(20)	(21)	(13)	Net Debt/EBITDA	1.5	1.1	0.7
<b>Cash flow from operations</b>	<b>1,322</b>	<b>1,263</b>	<b>1,229</b>	<b>Margin Analysis</b>			
Capital Expenditure	(600)	(578)	(556)	EBITDA Margin	30%	31%	32%
Spectrum Fees	(30)	(10)	-	Operating Margin	19%	19%	20%
Others	-	-	-	Net Margin	9%	11%	12%
<b>Cash flow from investing</b>	<b>(630)</b>	<b>(588)</b>	<b>(556)</b>	ROE (avg. equity)	37%	43%	33%
Dividends paid	-	(56)	(119)	<b>Drivers</b>			
Shares issued/(repurchase)	(1,045)	28	28	Market share	33%	33%	34%
Change in Debt	410	(451)	-	Revenue Growth YoY	0%	-4%	0%
<b>Cash flow from financing</b>	<b>(636)</b>	<b>(480)</b>	<b>(92)</b>	EBITDA Growth YoY	3%	-1%	2%
<b>Change in Cash</b>	<b>57</b>	<b>195</b>	<b>581</b>	PAT Growth YoY	4%	15%	6%

Source: Lehman Brothers Research

**Analyst Certification**

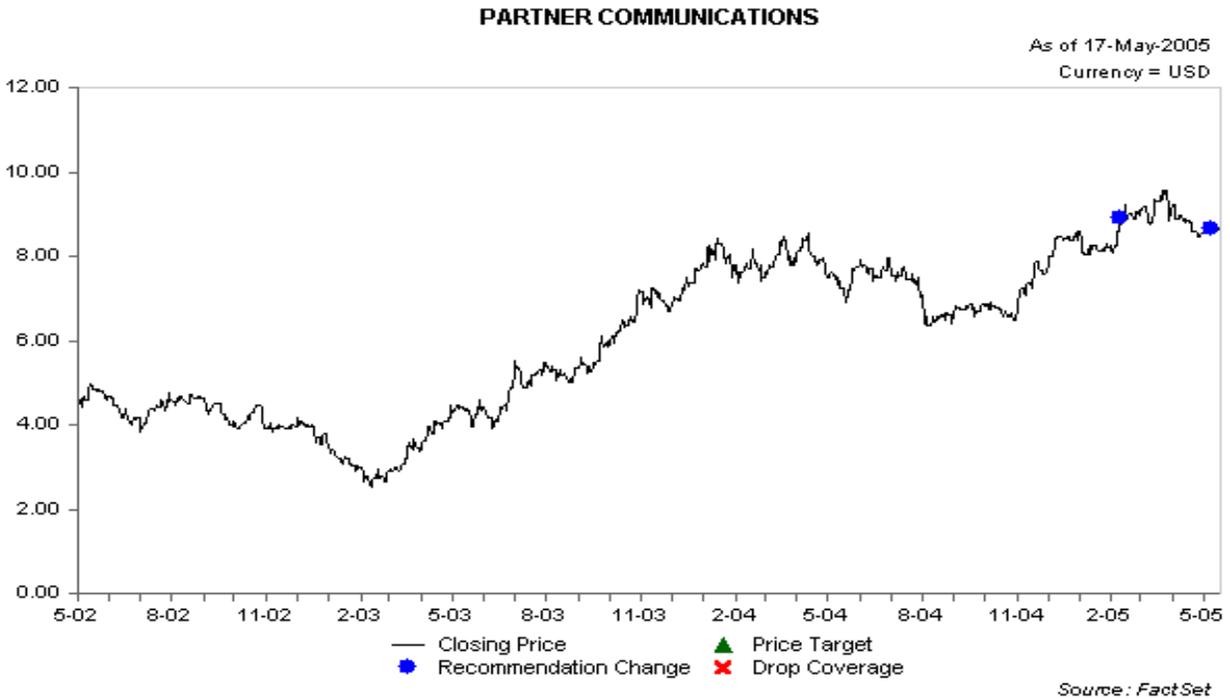
We, Sundeep Bihani and Alan Hellowell, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views contained in this report.

**Company description**

Partner is the 2nd biggest operator in Israel with USD1bn in revenues and 19% EBIT margins.

## Important Disclosures

### Rating and Price Target Chart: Partner Communications



### PARTNER COMMUNICATIONS

Currency = USD

Date	Closing Price	Recommendation Change	Date	Closing Price	Price Target
10-May-2005	8.65	1 - Overweight			
10-Feb-2005	8.90	RS - Rating Suspended			

-FOR EXPLANATION OF RATINGS PLEASE REFER TO THE STOCK RATING KEYS LOCATED AT THE END OF THIS DOCUMENT-

### Important Disclosures:

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Company Name	Disclosure(s)*	Reuters Ticker	Price(24/05/05)	Rating
Partner Communications	C,E,J,L	PTNR.O	(US\$ 8.58)	1 - Overweight

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**Risks Which May Impede the Achievement of the Price Target:** We believe the biggest risk to our valuation is the geopolitical situation in the region. The Middle-East remains largely unstable with relatively high security concerns and costs in Israel. While this will tend to have a limited impact on the operations of the company, this may keep the risk profile of the country high and the local stock market sentiment weak.

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#### Stock Rating

**1 - Overweight** - The stock is expected to outperform the unweighted expected total return of the relevant country index over a 12-month investment horizon.

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**RS - Rating Suspended** - The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Lehman Brothers is acting in an advisory capacity in a merger or strategic transaction involving the company.

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**1 - Positive** - sector coverage universe fundamentals/valuations are improving.

**2 - Neutral** - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

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#### Stock Ratings From February 2001 to August 5, 2002 (sector view did not exist)

This is a guide to expected total return (price performance plus dividend) relative to the total return of the stock's local market (i.e. the market where the stock primarily trades) over the next 12 months.

**1=Strong Buy** - expected to outperform the market by 15 or more percentage point.

**2=Buy** - expected to outperform the market by 5-15 percentage points

**3=Market Perform** - expected to perform in line with the market, plus or minus 5 percentage points

**4=Market Underperform** - expected to underperform the market by 5-15 percentage points

**5=Sell** - expected to underperform the market by 15 or more percentage points.

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