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Israeli Telecoms

High dividend yields sustainable despite challenges

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Industry Update

Top picks	
Bezeq (BEZQ.TA),ILS10.44	Buy
Partner Communications (PTNR.TA),ILS67.50	Buy

Companies featured			
Bezeq (BEZQ.TA),ILS10.44			**Buy**
	2010A	2011E	2012E
EV/EBITDA (x)	5.6	6.7	6.3
P/E (x)	10.0	12.8	11.6
DB EPS (ILS)	0.94	0.82	0.90
Cellcom (CEL.TA),ILS116.30			**Hold**
	2010A	2011E	2012E
EV/EBITDA (x)	5.7	6.3	6.2
P/E (x)	8.8	10.2	10.4
DB EPS (ILS)	13.12	11.35	11.17
Partner Communications (PTNR.TA),ILS67.50			**Buy**
	2010A	2011E	2012E
EV/EBITDA (x)	5.4	6.0	5.5
P/E (x)	9.0	9.5	9.0
DB EPS (ILS)	8.01	7.08	7.48

Bezeq and Partner are our top picks

We believe Bezeq will be a net beneficiary of upcoming regulation; with a 2011e dividend yield of 11.5%, we maintain our Buy recommendation and ILS 11.4 TP. Efficiency measures should help Partner maintain profitability, and with a dividend yield of 10.7%, we maintain our Buy and ILS 80 TP. While Cellcom's 2011e dividend yield is attractive, it is the lowest in the sector, and in our view the company is the most vulnerable to MVNOs. Hold maintained.

Tariff cuts likely to have far greater impact than MVNOs

We expect the MVNOs to gain about 3% market share annually over the first three years, with the launch beginning in 2H11. That said, we view the MVNOs as a threat primarily in the prepaid voice market. As this is the lower end of the market, we view the impact on the profitability of the existing providers as subdued. In our view, the greater impact will come from regulatory measures that drastically cut MTRs and contract cancellation penalties. MTR cuts will have a significant impact on revenues and profitability; elimination of cancellation penalties should have only a modest impact on revenues, but will likely increase marketing costs due to higher churn and lower net subscriber growth.

But high dividend yields should be sustainable

We view the sector's high dividend yields as attractive in the current uncertain environment. Nevertheless, the regulatory tariff cuts and MVNOs will make this a difficult year, particularly for the mobile operators. That said, we expect the sector to offset much of the impact through tariff changes, efficiencies, and a greater emphasis on smartphones and data revenues. While these measures may not immediately mitigate the full impact of the tariff cuts, we expect the net decline in 2011e net income to be modest (10-13%), with subsequent years showing stable earnings at Cellcom and modest gains at Partner. Dividend payouts should remain at c100%, leading to continued high dividend yields.

Easing of structural separation and tariff restrictions should benefit Bezeq

We believe Bezeq will be a net beneficiary of new regulatory measures to be recommended by the Hayak Committee. While Bezeq may be forced to offer wholesaling of its fixed-line infrastructure, in exchange it would receive benefits that are potentially more valuable: the lifting of tariff supervision on its fixed-line business and the easing of structural separation within the group, allowing for further cost cutting and the benefit of cross marketing.

Efficiency potential at Partner

We see Partner as having high potential for rationalization. We note that customer service employees have been growing at a faster rate than subscribers. In 2007, there were 1,085 subscribers per customer service employee, while in 2010, this fell to only 782. The addition of 012 Smile should allow for more efficient utilization of customer service, as well as cross marketing of services.

Price targets based on DCF valuation models

We value the companies via DCF, deriving a WACC (8.1% for Bezeq, 8.3% for Cellcom and 8.8% for Partner) and a TGR of 0%. WACC is based on a rfr of 5.5%, an ERP of 4.75%, a beta (0.75 for Bezeq, 0.80 for Cellcom and 0.90 for Partner). Our TGR reflects market saturation and potential for new competition. Key risks: regulatory actions and new competition from MVNOs and other providers.

Bezeq could gain from regulatory changes; Partner a potential turnaround story

Bezeq likely a net gainer if structural separation is eased; renewed focus on mobile could revitalize Partner

New regulatory measures are likely to make for a challenging environment in 2011. MTR cuts, the elimination of penalties for mobile contract termination and the launch of MVNOs will make this a difficult year, particularly for the mobile operators. Impacts are likely to be seen on revenue and profitability, as well as subscriber growth. That said, Bezeq could be a net beneficiary of new regulatory measures. While Bezeq may be forced to offer wholesaling of its fixed-line infrastructure, in exchange it would receive benefits that are potentially more valuable: the lifting of tariff supervision on its fixed-line business and the easing of structural separation within the group. As a potential net beneficiary of new regulatory measures, and with a 2011e dividend yield of 11.5%, we maintain our Buy recommendation. While Partner will be under pressure from the mandatory tariff cuts, we see the new management implementing efficiency measures that would have been necessary even without the tariff cuts. We believe Partner's previous management had been too focused on launching the company's VoB and ISP services, while allowing market share erosion in its core mobile business. The acquisition of 012 Smile provides a turnkey operator of these services, and will allow management to return its focus to the mobile sector. With a 2011e dividend yield of 10.7%, we maintain our Buy recommendation on Partner. With the highest percentage of prepaid subscribers in the sector, Cellcom will be most vulnerable to the launch of MVNOs. While its 2011e dividend yield is an attractive 9.4%, it is the lowest in the sector, and we reiterate our Hold recommendation.

Regulatory changes and new competition set to impact 2011

Several key developments are set to take place in 2011 that are likely to change the landscape of the Israeli telecom sector. These developments include regulatory measures designed to increase competition, particularly in the mobile sector, as well as the launch of new competition. These developments include:

- MTR cuts
- Elimination of early cancellation penalties for mobile subscribers
- Launch of MVNOs
- Possibility of the licensing of an additional mobile operator
- Wholesaling of fixed-lines
- Relaxing structural separation for Bezeq
- Elimination of Bezeq fixed-line tariff constraints

While all of these measures are likely to have significant impact on the profitability of the sector in the near to medium term, we believe the MTR cuts and the elimination of cancellation penalties that will have the greatest near-term impact.

Regulator-mandated tariff cuts likely to have greater impact than competition

If MVNOs are just a nuisance to the operators, regulatory actions are likely to be more troublesome. The greatest impact will come from the sharp 73% cut in MTRs effective 1 January 2011, which were designed to level the playing field for MVNOs. As mobile out of network calls are roughly equally divided amongst the three providers, the cuts will have little impact in this segment. However, the cuts will have significant impact from calls originating from fixed-line. Both Partner and Cellcom estimate that the cuts would have a negative impact of about ILS 300m on annual net income. The providers are taking measures such as tariff hikes and cost cutting to offset the revenue loss; however, the MTR cuts were immediate and the measures taken will have only a gradual impact. The other significant regulatory action is the sharp reduction in penalties for subscribers switching providers before the expiration of their contract. We expect this to result in reduced revenues in penalties, a higher churn rate which in turn should lead to higher subscriber retention and acquisition costs.

Figure 1: MTR cuts (ILS)

	Voice MTR	% cut	SMS MTR	% cut
Previous tariff	0.251	n/a	0.0285	n/a
Effective 1 January 2011	0.0687	-73%	0.0016	-94%
Effective 1 January 2012	0.0634	-8%	0.0015	-6%
Effective 1 January 2013	0.0591	-7%	0.0014	-7%
Effective 1 January 2014	0.055	-7%	0.0013	-7%

Source: MoC, Deutsche Bank

Bezeq could be a net gainer of regulatory measures

While some of the regulatory measures will have negative implications for Bezeq, the company could end up with net gains when the dust settles. While MTR cuts will have some negative impact on Pelephone, the lower cost of fixed-line to mobile calls could at least theoretically increase call volume. The elimination or easing of tariff supervision and structural supervision could easily offset the negative impact of fixed-line wholesaling.

Hayak committee could have more upside than downside for Bezeq fixed-line

That Hayak committee, assigned to review Bezeq's current fixed-line structure, released its initial recommendations in March. As expected, the recommendations included the requirement for Bezeq and Hot to allow wholesaling of its fixed-line infrastructure, allowing other telecoms to lease these lines and resell them to their customers. However, under the proposals Bezeq would be compensated through the partial lifting of tariff regulations, thus allowing Bezeq to cut tariffs to be more competitive. Perhaps more importantly, the committee recommended the lifting of structural separation, a move that would allow Bezeq fixed-line to work with its sister companies – thus allowing cross marketing and elimination of duplication of costs. Structural separation would only be lifted upon tangible progress in fixed-line wholesaling, and would not be applicable to subscriber TV services. The latter would have structural separation lifted upon the launch of IPTV.

MVNOs likely to have subdued impact

While the launch of the first MVNOs is expected in 2H11, the new competition is likely to be more of a nuisance than a real threat to the mobile operators. We believe MVNOs will only be able to compete effectively on voice, a segment which has already seen tariff erosion over several years, thus narrowing any potential price benefit to consumers from MVNOs. Since MVNOs are buying airtime from the mobile providers, the latter could always undercut prices, preventing the MVNOs from gaining any substantial market share. MVNOs will be at a disadvantage with data, as access to affordable content will be limited due to their smaller sizes. The providers are moving towards packaged plans of data and voice minutes, narrowing and also blurring the pricing differences with MVNOs. An obstacle to entering the post-paid market would be the need to establish a billing system, and we therefore expect most MVNOs to be limited to the pre-paid market. While the pre-paid segment will be the area in which they will be the most competitive, it is also the segment with the lowest ARPUs. While there have been several applications for MVNO licenses, we believe that due to these difficulties it is likely that some applicants will decide not to make use of a license. Indeed, HaMashbir, Israel's largest department store chain, decided to forego its MVNO license and instead will become a distributor for Pelephone.

A challenging year ahead for the mobile sector

2011 will likely be the most challenging period the mobile sector has faced in years. Regulatory tariff cuts to MTRs, the elimination of heavy subscriber cancellation penalties and the launch of MVNOs could lead to declining profitability. Subscriber growth at the existing providers is likely to be greatly reduced, as subscribers are likely to begin shopping around for the lowest price, moving between the existing providers and MVNOs. The latter could put additional pressure on voice tariffs, which have fallen for the last several years, offset by increases in MoU.

But recent trends should help to compensate

While the mobile operators could see declining voice and other revenues due to regulatory action and new competition, other trends should help at least partially compensate. Sales of smartphones have ballooned, and account for nearly half of all handsets sold. These more expensive handsets, combined with cuts in handset subsidies, have led to gross profit on equipments sales for the last several quarters following years of losses due to lower priced handsets and high handset subsidies. More importantly, smartphones substantially increase data usage, and data has been the main growth driver for the mobile operators over the last few years. The growth in smartphones will likely accelerate this trend.

High dividend yields are sustainable

While profitability will likely be under pressure in 2011, we expect the impact on net income to be somewhat muted. With effective dividend payouts of 95% and higher, we expect that the key investment case for these stocks – high dividend yields – will continue. Bezeq will supplement its 100% dividend payout with a capital reduction of ILS 1bn annually for 2011-2013, leading to a 2011e dividend yield of 11.5%, the highest in the sector. Partner's 2011e dividend yield is the next highest at 10.7%, which is also the highest ordinary dividend yield in the sector. Cellcom trails the sector with a 9.4% 2011e dividend yield.

Figure 2: Dividend yields

			2011e Dividend Yield		
	Current policy	Effective recent payouts	Ordinary	Special	Total
Bezeq	100%	100%	7.8%	3.7%	11.5%
Cellcom	75%	95%	9.4%	0.0%	9.4%
Partner	80%	95%-100%	10.7%	0.0%	10.7%

Source: Company, Deutsche Bank

Comparative valuations

On a comparative basis, the Israeli telcos are trading at higher EV/EBITDA multiples than their global peers, but are trading below their peers on a PER comparison. That said, what sets the Israeli telco sector apart is their dividend yields, with an average of 10.5% compared to 6.1% at European peers and 4.4% at CEEMEA peers.

Figure 3: Comparative valuations

						EPS growth (%)		EV/EBITDA		P/E ratio (x)		FCF Yield (%)		Div yield (%)	
Europe:	Ticker	Rec	TP	Price	52 week	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011
Telefonica	TEF.MC	Buy	19.7	17.95	14.875 - 19.595	29	(11)	5.3	5.7	7.2	8.4	11.8	10.9	8.1	8.9
Vodafone Group Plc	VOD.L	Buy	215	179.1	129.45 - 182.75	(6)	5	4.4	5.8	8.2	10.6	10.4	6.8	6.3	5.0
France Telecom	FTE.PA	Hold	16.8	15.885	14.145 - 17.72	1	7	5.8	5.1	9.9	9.0	15.9	16.5	8.6	8.8
Telecom Italia	TLIT.MI	Buy	1.45	1.088	0.8865 - 1.144	5	1	4.0	3.7	8.2	8.2	17.6	16.7	5.3	6.1
TeliaSonera	TLSN.ST	Hold	48.5	54.3	44.76 - 56.7	12	3	6.3	6.6	11.5	11.2	5.3	6.4	5.1	5.2
KPN	KPN.AS	Hold	13.3	12.01	10.16 - 12.055	30	6	5.4	5.4	9.6	9.6	11.8	12.2	7.1	7.1
Swisscom	SCMN.VX	Hold	423	416	358 - 433.5	(6)	1	6.6	6.5	11.9	11.7	8.0	7.2	5.0	5.3
BT Group PLC	BT.L	Hold	175	188.2	109.9 - 191.1	876	16	4.0	4.6	7.2	9.6	14.9	9.1	5.7	3.8
Belgacom	BCOM.BR	Hold	23.1	27.47	24.31 - 29.11	(2)	(12)	4.5	5.7	9.9	11.5	12.0	8.8	8.1	7.8
Portugal Telecom	PTC.LS	Hold	9.5	8.278	6.48 - 10.7	839	(94)	6.7	5.9	1.3	19.4	nm	9.1	7.4	7.9
OTE	OTEr.AT	Hold	6.5	7.71	5.2 - 8.96	(49)	33	4.6	4.5	18.5	14.9	10.4	13.2	1.4	2.6
Telekom Austria	TELA.VI	Hold	9.9	10.28	8.93 - 11.335	(4)	(8)	5.2	5.5	13.3	14.6	23.6	14.5	7.5	7.4
C&W Communications	CW.L	Buy	210	148.3	0 - 0	(46)	1	5.3	5.0	12.2	9.9	4.1	8.8	11.5	10.8
Iliad Group	ILD.PA	Buy	95	85.36	62.08 - 85.82	36	3	5.9	6.6	16.5	18.2	8.1	0.4	0.5	0.5
Mobistar	MSTAR.BR	Buy	51	49.59	40.04 - 49.59	1	(7)	5.4	6.0	10.2	12.2	10.1	8.2	9.6	7.9
United Internet	UTDI.DE	Buy	15	12.71	8.631 - 13.32	(33)	29	6.9	7.6	17.3	15.7	9.8	7.4	1.8	1.7
Elisa Corporation	ELI1V.HE	Hold	15	15.68	12.89 - 17.38	1	5	6.6	6.4	13.4	13.0	8.0	9.0	8.4	9.6
Telenet Group	TNET.BR	Hold	27	33.545	19.97 - 33.545	(21)	61	7.4	8.8	30.9	27.2	9.7	6.7	19.0	14.4
Colt Group S.A.	COLT.L	Buy	185	150	109 - 156.2	(14)	43	3.4	3.0	13.0	10.4	3.7	6.7	-	-
Freenet AG	FNTG.DE	Buy	13.5	8.237	7.251 - 9.6	30	(10)	5.4	5.3	5.6	6.0	14.2	15.5	9.3	9.7
Versatel	VTWGn.DE	Hold	5.9	6.75	3.959 - 7.98	4	(1)	4.2	4.7	nm	nm	33.5	11.8	-	-
QSC AG	QSCG.DE	Buy	4	2.71	1.3 - 3.648	406	(1)	2.5	3.4	8.4	13.7	7.1	8.9	-	3.7
Average						**90.8**	**2.6**	**5.3**	**5.5**	**11.7**	**12.8**	**11.8**	**9.9**	**6.2**	**6.1**
Median						**1.2**	**1.4**	**5.4**	**5.5**	**10.8**	**11.6**	**10.3**	**9.0**	**7.1**	**6.3**
CEEMEA:															
MTS ADR	MBT.N	Buy	24	21.54	18.43 - 23.552	52	(7)	5.5	5.5	13.3	14.3	6.4	6.7	4.9	4.7
Turkcell	TCELL.IS	Buy	11.8	9.5	7.8 - 11.15	4	(1)	6.0	5.3	12.0	11.9	3.1	5.5	4.1	4.6
Turk Telekom	TTKOM.IS	Hold	7.2	7.94	4.86 - 7.94	37	3	6.6	6.2	11.1	10.7	7.8	9.1	5.7	7.8
Vodacom	VODJ.J	Hold	75	79	53.39 - 79.95	22	23	4.8	6.1	10.9	12.6	10.6	6.6	5.1	4.8
Telekomunikacja Polska	TPSA.WA	Hold	16.5	17.9	14.1 - 18.65	(91)	899	4.4	5.2	200.6	22.0	11.5	10.1	9.2	8.4
AFK Sistema	SSAq.L	Hold	27.1	30.19	21 - 30.99	(43)	43	3.8	3.6	15.6	10.8	4.1	4.1	0.1	0.6
Telkom	TKGJ.J	Hold	37.5	37.65	32.85 - 39.1	755	(94)	0.9	2.9	0.5	9.1	17.4	nm	7.4	3.6
Average						**82.4**	**93.3**	**4.6**	**4.8**	**32.2**	**14.4**	**9.3**	**8.2**	**4.7**	**4.4**
Median						**22.2**	**3.2**	**4.6**	**5.2**	**12.0**	**11.9**	**9.2**	**7.8**	**5.1**	**4.7**
Israel:															
Bezeq	BEZQ.TA	Buy	11.4	10.32	8.255 - 10.95	20.1	(13.3)	5.6	6.6	10.0	12.6	9.1	6.8	10.0	11.5
Partner Communications	PTNR.TA	Buy	80	66.16	59 - 84.07	9.1	(11.6)	5.4	5.9	9.0	9.3	13.2	nm	10.6	10.7
Cellcom	CEL.TA	Hold	120	114.2	97 - 128.5	9.1	(13.5)	5.7	6.2	8.8	10.1	15.4	11.3	10.8	9.4
Average						**12.8**	**(12.8)**	**5.6**	**6.2**	**9.3**	**10.7**	**12.6**	**9.1**	**10.5**	**10.5**
Median						**9.1**	**(13.3)**	**5.6**	**6.2**	**9.0**	**10.1**	**13.2**	**9.1**	**10.6**	**10.7**

Source: Deutsche Bank

The trend towards multi-service providers continues

The Israeli telecom sector is accelerating the consolidation of smaller, narrowly focused service providers to multi-service providers. While Bezeq for years has offered multiple telecom services in the form of fixed-line, mobile, broadband, ISP, ILD and subscriber television, regulatory restrictions have prevented these divisions from operating as a single unit. Hot has been offering subscriber television and broadband, and its new owners have acquired MIRS, a small mobile operator with about a 5% subscriber market share. Hot has also added an ISP service, meaning that the owner of Hot & MIRS can offer the same services as the Bezeq group, and at a lower cost when subscribing to Hot's triple play service of fixed-line via cable, subscriber television and broadband. At the same time, Partner has acquired 012 Smile and Cellcom is in merger negotiations with its sister company, Netvision. At the end of the process we believe there will be four or five multi service telecom providers in Israel.

Acquisition 012 Smile will make Partner a true multi-service provider

Earlier this month, Partner announced that it closed the deal for the acquisition of 012 Smile. Partner paid ILS 1.49bn (ILS 650m in cash, ILS 800m in assumed debt and ILS 40m in assigned receivables) for 012 Smile, a provider of ISP, VoB and ILD services. Partner noted that the regulators required structural separation between Partner and 012 Smile for a limited period of time, due to 012 Smile's ILD services. Up until now, no cellular provider has been licensed to provide ILD services, but the MoC is making changes to allow that. We note that Partner previously stated that in the medium term it expects the acquisition to add ILS 350m to EBITDA annually (including EBITDA from Partner's attempt at these services). Partner had attempted to launch ISP and VoB services on its own, but after disappointing subscriber acquisition, the company decided to acquire a "turnkey" business. In 012 Smile, Partner will acquire about 600k ISP subscribers, and the company will now become a major ISP provider in Israel. 012 Smile also adds 200k VoB subscribers to Partner's relatively small subscriber base. We view the Israeli telecom sector as moving to 4-5 large telco groups offering various telecom services, and Partner has been looking to add other services to its core mobile business. Partner's new management will now be able to renew focus on its core mobile business, which will be needed to deal with new competition and more onerous regulatory measures.

Cellcom and Netvision are in merger negotiations

Earlier this month, Cellcom announced that it made a merger proposal to Netvision, whereby Cellcom would acquire all of Netvision's shares for ILS 1.5bn (10% above its market valuation), and Netvision would become a wholly owned subsidiary of Cellcom. Both Cellcom and Netvision are controlled by the IDB group, and a merger possibility had been discussed for some time, so the announcement was not surprising. Netvision provides ISP, ILD and VoB services, and would complement Cellcom's cellular services, and reported net income of ILS 82m on ILS 1.3bn in revenues in 2010. With Partner's acquisition of 012 Smile, the likely relaxation of structural separation at Bezeq, and the common ownership of Hot and Mirs, Cellcom will need to add additional services to its product portfolio. The move would be in line with our expectation of the consolidation of the Israeli telecom market.

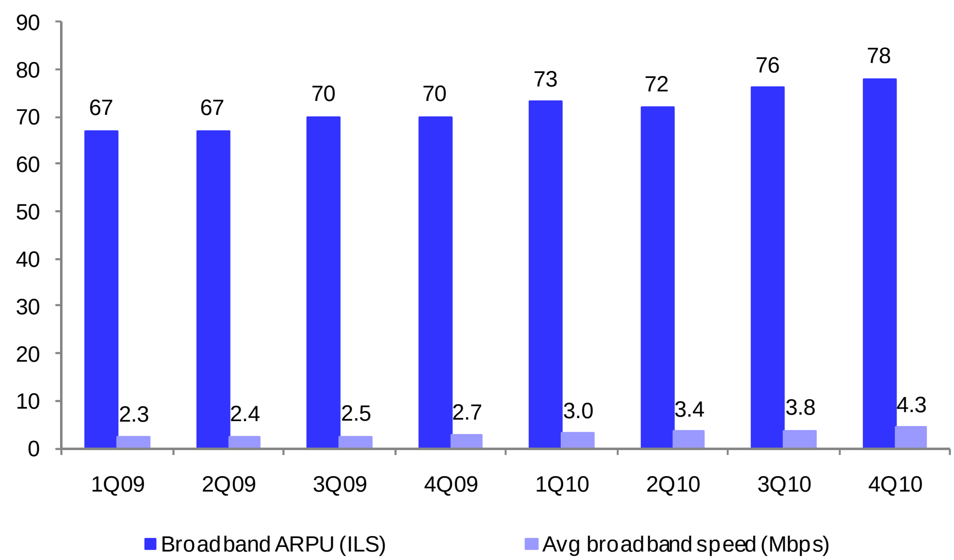
Bezeq: Upgrades spurring margin expansion

Bezeq growth to come from upgrades in fixed-line and broadband

In recent years Bezeq's group top-line growth has been flat to low single-digit. At the same time, profitability has gone up markedly. Initially this was accomplished through rationalization measures, but more recently the margin expansion derived from upward internal migration of existing subscribers in both fixed-line and mobile, as follows:

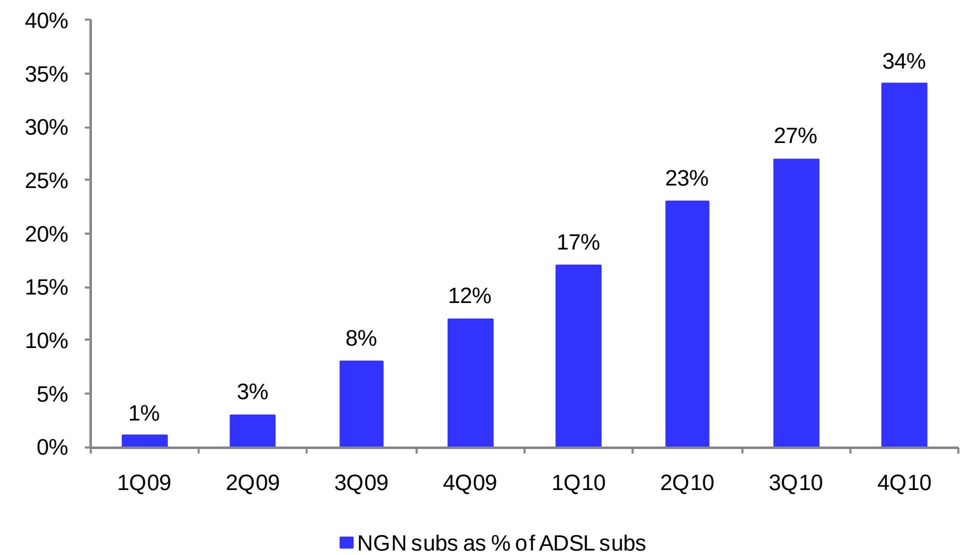
- Broadband: Bezeq's investment in NGN has resulted in increased broadband ARPU. The higher speeds attainable with NGN have led to an increase in the average speed per customer, from 2.3 Mbps in 1Q09 to 4.3 Mbps in 4Q10, and hence higher ARPU, from ILS 67 in 1Q09 to ILS 78 in 4Q10. With only about half of Bezeq's fixed-line subscribers currently connected to NGN and with a target of 85% by year end, we expect to see further increases in average speed and ARPU.

Figure 4: Broadband ARPU and broadband speed



Source: Company, Deutsche Bank

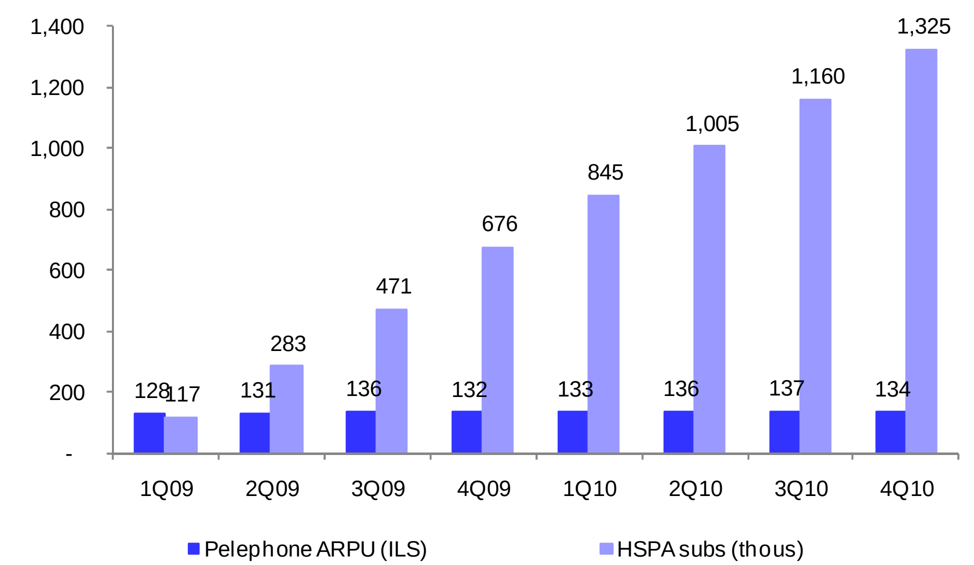
Figure 5: NGN share of ADSL subscribers



Source: Company, Deutsche Bank

- Mobile: Pelephone upgraded its CDMA network to HSPA in January 2009. While the company's subscriber market share has not increased, ARPU and EBITDA margins have increased markedly. With only 46% of Pelephone's subscriber base on HSPA, we anticipate additional significant migration in 2011, which should help to boost ARPU and margins. This positions Pelephone in a stronger position than its competitors, who are in a more mature stage of migration in their older 3G networks.

Figure 6: Pelephone: ARPU and HSPA subscribers



Source: Company, Deutsche Bank

4Q10: broadband continues to offset erosion of fixed-line voice revenues

Bezeq's 4Q10 net income was ILS 575m, in line with our ILS 570m forecast, and was significantly higher than the ILS 366m recorded in 4Q09, which was impacted by one-offs and seasonality. Revenues rose 4% YoY to ILS 3,058m, higher than our ILS 2,976 estimate, while EBITDA was 1,269m, slightly ahead of our ILS 1,254m forecast. The company will pay a dividend of ILS 1,163m, or 0.43/share, representing a 100% payout of 2H10 net income.

The dividend will be payable on May 19th to holders of record on May 4th. Management expects 2011 EBITDA (before one-time charges of ILS 402m) to be similar to that of the ILS 5.2bn recorded 2010. The company also said that capex would be 5%-10% higher than in 2010 due to the cable being deployed by Bezeq International, and could rise a further 5%-10% if the company decides to purchase real estate for its headquarters and replace properties currently leased.

- Fixed line: Revenues rose 1% YoY to ILS 1,329m, as broadband and data revenues offset the continued erosion of voice revenues. ARPL rose 1% to ILS 83, while ADSL ARPU rose 11% YoY to ILS 78, as subscribers upgrade speed with the deployment of NGN. EBITDA margin on fixed-line was 50.6%. Total subscribers fell 5% YoY to 2,365 thousand, continuing a long-term trend.
- Mobile: Pelephone recorded EBITDA of ILS 497m, up 21% YoY, as revenues rose 5% YoY to ILS 1,468m EBITDA margin was 33.9% compared to 29.4% in 4Q09, as ARPU rose 2% YoY to ILS 134. We note that most of the improvement in Pelephone is coming on the back of internal migration of Pelephone's subscribers to the new HSPA network. This is being reflected in financial results, as Pelephone is narrowing the gap with its competitors with strongest EBITDA and ARPU growth in the sector.

Figure 7: 4Q10 mobile comparison (ILSm)

	Cellcom		Partner		Pelephone	
	4Q10a	YoY%	4Q10a	YoY%	4Q10a	YoY%
Revenues	1,662	1.4%	1,761	11.6%	1,468	5.4%
EBIT	448	6.9%	459	6.3%	343	36.7%
EBIT margin	27.0%		26.1%		23.4%	
EBITDA	631	3.4%	664	9.2%	497	21.2%
EBITDA margin (reported)	38.0%		37.7%		33.9%	
EBITDA (adjusted)	682	11.8%	664	9.2%	497	21.2%
EBITDA margin (adjusted)	41.0%		37.7%		33.9%	
Net profit	319	17.7%	304	3.4%	268	48.1%
Net margin	19.2%		17.3%		18.3%	
Subs (k)	3,394	3.1%	3,160	3.9%	2,857	3.3%
Net adds during quarter (k)	18	-45.5%	27	-20.6%	32	-28.9%
3G Subs (k)	1,140	14.3%	1,549	21.1%	1,325	96.0%
% of 3G subs	33.6%	n/a	49.0%		46.4%	
% of serv revenues from data	21.3%	n/a	22.1%		25.0%	
ARPU (ILS)	144	0.7%	147	-1.3%	134	1.5%

Source: Companies, Deutsche Bank

Figure 8: Bezeq 4Q10 results analysis (ILSm)

	4Q10a	4Q09A	% delta YoY	3Q10a	% delta QoQ
Revenues:					
Fixed Line	1,329	1,316	1.0%	1,323	0.5%
Mobile	1,468	1,393	5.4%	1,442	1.8%
International and Internet	319	335	-4.8%	347	-8.1%
YES DBS	-	-	n/a	-	n/a
Other	74	21	252.4%	71	4.2%
Consolidation adjustments	(132)	(133)	-0.8%	(150)	-12.0%
Total Revenues	3,058	2,932	4.3%	3,033	0.8%
Operating Income:					
Fixed Line	505	161	213.7%	556	-9.2%
Mobile	343	251	36.7%	356	-3.7%
International and Internet	58	67	-13.4%	70	-17.1%
YES DBS	-	-	n/a	-	n/a
Other	(5)	1	-600.0%	(3)	n/a
Consolidation adjustments	-	-	n/a	-	n/a
Operating Income	901	480	87.7%	979	n/a
Operating margin					
Fixed Line	38.0%	12.2%		42.0%	
Mobile	23.4%	18.0%		24.7%	
International and Internet	18.2%	20.0%		20.2%	
YES DBS	n/a	n/a		n/a	
Other	-6.8%	4.8%		-4.2%	
Consolidation adjustments	0.0%	0.0%		0.0%	
Operating margin	29.5%	16.4%		32.3%	
EBITDA:	4Q10a	4Q09A	% delta YoY	3Q10a	% delta QoQ
Fixed Line	672	355	89.3%	727	-7.6%
Mobile	497	410	21.2%	505	-1.6%
International and Internet	80	89	-10.4%	93	-14.2%
YES DBS	-	-	n/a	-	n/a
Other	20	(1)	-2100.0%	1	1900.0%
Consolidation adjustments	-	-	n/a	-	n/a
EBITDA	1,269	853	48.7%	1,326	-4.3%
EBITDA Margins:					
Fixed Line	50.6%	27.0%		55.0%	
Mobile	33.9%	29.4%		35.0%	
International and Internet	25.0%	26.6%		26.8%	
YES DBS	n/a	n/a		n/a	
Other	27.0%	-4.8%		1.4%	
Consolidation adjustments	0.0%	0.0%		0.0%	
Total	41.5%	29.1%		43.7%	

Source: Company, Deutsche Bank

Bezeq: Investment thesis

Outlook

While fixed-line telephony revenues are likely to decline in the coming years due to the increased competition, we see group revenues as stable with growing broadband, cellular, data and subscription television revenues helping to offset fixed-line erosion. An efficiency program that surrounds headcount cuts at the parent (fixed-line) company will reduce operating costs, contributing to fixed-line EBITDA margin expansion, while Pelephone's new HSPA network should improve ARPU and market share. We expect the margin expansion will contribute to high cash generation that supports high dividend payouts. NGN should allow for additional efficiencies that will allow for further margin expansion. Buy

Valuation

We value Bezeq using a DCF model that assumes a WACC of 8.1% and a terminal growth rate of 0%. Our WACC is based on a risk free rate of 5.5%, an equity risk premium of 4.75%, a beta of 0.75, a pre-tax cost of debt of 7% and a long term debt/capital ratio of 30%. Our terminal growth rate reflects market saturation and the potential for new competition. We use a DCF valuation methodology as we view the company as a single entity, rather than a sum of its individual parts. The expected regulatory relaxation regarding structural separation reinforces the case for using DCF.

Risks

Risks to our long-term model come from further unfavorable regulation, irrational business models at competitors, and the adoption of new disruptive technologies (such as IPTV, Wimax, and MVNO).

Partner – acquisition should renew focus on core business

Attempting to regain momentum

For years Partner was the clear leading mobile operator in Israel. Until Cellcom launched its GSM platform in 2007, Partner was the sole GSM provider in Israel since its inception in 1998, and the company took full advantage of its roaming and data advantages. This began to change when Cellcom launched its GSM platform in 2007, and was further accelerated when Partner launched new telecom services, which ultimately proved to be a failure. Cellcom has slowly gained market share on Partner, particularly in data, where Cellcom now leads Partner despite a lower penetration of 3G handsets. We believe this happened in part due to the previous management's loss of focus on its core mobile business in an attempt to launch new services. We believe addressing this deterioration will be the key focus of the new management team. Further, with the acquisition of 012 Smile, we expect to see the company implement tariff restructuring, content enhancement, and efficiency measures that we believe should result in a recovery for the company.

Efficiency potential: customer service

One example of potential efficiency measures is in customer service. We note that the number of customer service employees has been growing at a faster rate than subscribers. To illustrate, in 2007 there were 1,085 subscribers per customer service employee. At the end of 2010, there were only 782 subscribers per customer service employee. With the acquisition of 012 Smile, customer service employees from the combined companies should be able to eventually handle customers from both Partner's core cellular business and from 012 Smile's service offerings. This should allow not only for a reduction in total customer service employees, but also cross selling of services.

Figure 9: Partner customer service data

	2007	2008	2009	2010
Subscribers (thous)	2,860	2,898	3,042	3,160
Customer Service employees	2,635	2,902	3,750	4,041
Subscribers per customer service employee	1,085	999	811	782
Subscriber growth YoY	n/a	1.3%	5.0%	3.9%
Customer service employee growth YoY	n/a	10.1%	29.2%	7.8%

Source: Deutsche Bank, company data

4Q10 trends: equipment drives revenue growth

4Q10 EBITDA of ILS 664m (+16% YoY) was slightly ahead of our ILS 649m forecast, while revenues of ILS 1,761m (+12% YoY) easily beat our ILS 1,644m forecast. We note that part of the revenue growth was due to seasonal factors, as the Jewish holiday season (which tends to reduce MoU due to fewer work days) occurred in 3Q10 vs 4Q09. While data and SMS grew YoY at 12% and 24% respectively, growth slowed from the FY10 average, as data and SMS made up nearly 21% of service revenues. Growth was also triggered by higher-than-expected equipment revenues of ILS 329m, an increase of 65% YoY, due to strong sales of smartphones and 3G handsets. We note that while the average revenue per device sold rose sharply, the number of handsets sold fell. The company added 27k new subs during the quarter, for a total subscriber base of 3.16m. Nearly half of subscriber base is represented by 3G handsets. The higher weighting of equipment sales in total revenues led to lower-than-expected EBITDA margin of 37.7% compared to our 39.4% estimate; however, this was still higher than the 36.1% EBITDA margin achieved in 4Q09. Net profit rose 3% YoY to ILS 304m, slightly below our ILS 315m estimate, due to higher-than-expected income taxes. FCF rose 31% YoY to ILS 343m, mostly due to higher profitability. The company declared a dividend of ILS 300m, a 99% payout, to holders of record on March 16th, paid on March 28th. No specific guidance was given, but management said that the MTR cuts should be moderated by efficiency and other measures.

Figure 10: Partner 4Q10 results analysis

ILSm (except EPS)	4Q10a	4Q09a	D (%)
Voice revenues	1,048	1,074	-2.4%
Data and content revenues ex SMS	162	145	11.7%
SMS	134	108	24.1%
Total Revenue from cellular services	1,344	1,327	1.3%
Fixed-line revenues	88	52	69.2%
Total service revenues	1,432	1,379	3.8%
Revenue from Equipment	329	199	65.3%
Total Revenues	1,761	1,578	11.6%
Cost of Revenues from Services	863	821	5.1%
Cost of Revenues from Equipment	257	176	46.0%
Total Cost of Revenues	1,120	997	12.3%
Gross Profit from Services	569	558	2.0%
Gross Profit from Equipment	72	23	213.0%
Total Gross Profit	641	581	10.3%
Gross Margin from Services	42.3%	42.0%	
Gross Margin from Equipment	21.9%	11.6%	
Overall Gross Margin	36.4%	36.8%	
SG&A	206	163	26.4%
Selling and marketing as % of revenues	11.7%	10.3%	
Other income	24	14	71.4%
Operating Profit:	459	432	6.3%
Operating Margin:	26.1%	27.4%	
EBITDA	664	608	9.2%
EBITDA margin	37.7%	38.5%	
Financial Expenses, net	45	41	9.8%
Profit Before Tax	414	391	5.9%
Income Taxes	110	97	13.4%
Income Tax Rate	26.6%	24.8%	
Net Profit	304	294	3.4%
Net margin	17.3%	18.6%	
EPS (fully diluted)	1.99	1.93	3.1%

Source: Company, Deutsche Bank

Figure 11: Partner: 4Q10 key operating data

	4Q10a	4Q09a	D (%)
Post Paid Subscribers (thous)	2,290	2,231	2.6%
Prepaid Subscribers	870	811	7.3%
Total Subscribers (thous)	3,160	3,042	3.9%
Net adds during period (k)	27	34	-20.6%
3G Subscribers (thous)	1,549	1,279	21.1%
3G Subs as % of Subscriber base	49.0%	42.0%	
SMS as % of service revenues	12.1%	10.9%	
Content & Data as % of service revenues	10.0%	8.1%	
Churn	5.4%	4.4%	
MOU (Avg. per subscriber)	375	366	2.5%
ARPU (ILS)	147	149	-1.3%
Fixed line and ISP subs (thous)	115	63	82.5%

Source: Deutsche Bank, company data

Figure 12: Partner subscriber breakdown

	2007			2008			2009			2010		
	Subs (thous)	% of total	% chg YoY	Subs (thous)	% of total	% chg YoY	Subs (thous)	% of total	% chg YoY	Subs (thous)	% of total	% chg YoY
Pre-paid subscribers	792	27.7%	1.4%	745	25.7%	-5.9%	811	26.7%	8.9%	870	27.5%	7.3%
Post-paid subscribers	2,068	72.3%	9.6%	2,153	74.3%	4.1%	2,231	73.3%	3.6%	2,290	72.5%	2.6%
Total	2,860	100.0%	7.2%	2,898	100.0%	1.3%	3,042	100.0%	5.0%	3,160	100.0%	3.9%

Source: Company, Deutsche Bank

Partner: Investment thesis

Outlook

New management and a new owner should help Partner refocus on its core mobile market, helping to offset the challenges of new competition. The acquisition of 012 Smile would provide the company with an established customer base, as well as the infrastructure for the new services that Partner had been trying to launch on its own, with very limited success. While in our view a new owner, new management and a new acquisition increase the risk, it also increases the reward potential. Buy.

Valuation

We base our price target on a DCF model that assumes a WACC of 8.8% and a terminal growth rate of 0%. Potential upside to our estimates is limited due to the regulatory environment and market saturation. Our WACC assumptions include a risk free rate 5.5%, equity risk premium 4.75%, beta 0.90; and a terminal growth rate of 0%, consistent with that used by DB analysts for wireless operators in developed European markets.

Risks

We see the key risks as intense competition, both from established providers and MVNOs, and the increasingly challenging Regulatory environment that threatens both revenue growth and profitability. Other risks include the inability to absorb the 012 Smile acquisition and potential disruption from the change in ownership and management.

Cellcom – the most vulnerable to MVNOs

Attractive dividend yield, but will be most exposed to MVNOs

Like its competitors, Cellcom will have to deal with MTR cuts, the elimination of contract cancellation penalties and the launch of MVNOs. However, prepaid revenues accounted for over 10% of Cellcom's revenues, is the highest exposure in the sector. With MVNOs expected to target the prepaid sector, we view Cellcom as the most vulnerable to the new competition.

Figure 13: Cellcom revenue breakdown (individual vs business)

	2008		2009			2010		
	Revenues	% of total	Revenues	% of total	% chg YoY	Revenues	% of total	% chg YoY
Individual	4,626	72.1%	4,775	73.7%	3.2%	4,917	73.8%	3.0%
Business	1,654	25.8%	1,622	25.0%	-1.9%	1,649	24.8%	1.7%
Other	137	2.1%	86	1.3%	-37.2%	96	1.4%	11.6%
Total	6,417	100.0%	6,483	100.0%	1.0%	6,662	100.0%	2.8%

Source: Company, Deutsche Bank

Figure 14: Cellcom revenue breakdown (prepaid vs postpaid)

	2008		2009			2010		
	Revenues	% of total	Revenues	% of total	% chg YoY	Revenues	% of total	% chg YoY
Pre-paid	696	10.8%	657	10.1%	-5.6%	675	10.1%	2.7%
Post-paid	5,584	87.0%	5,740	88.5%	2.8%	5,891	88.4%	2.6%
Other	137	2.1%	86	1.3%	-37.2%	96	1.4%	11.6%
	6,417	100.0%	6,483	100.0%	1.0%	6,662	100.0%	2.8%

Source: Company, Deutsche Bank

4Q10: one-offs impact results

Cellcom's 4Q10 net income of ILS 319m (+17% YoY) easily beat our ILS 253m forecast on the back of slightly better-than-expected operating results and one-time financial income. EBITDA was ILS 631m (+3% YoY; margin of 38.0%), ahead of our ILS 606m estimate, as revenues of ILS 1,662m (+1% YoY) were slightly ahead of our ILS 1.632m forecast. We note that results and our forecasts include lost revenues of ILS 66m following the network outage in December, whereby the company compensated subscribers with one week's worth of free voice and text for the week prior to the outage. The company declared a dividend of ILS 303m, representing a 95% payout, in line with previous payouts.

Figure 15: Cellcom 4Q10 results analysis

ILSm (except EPS)	4Q10	4Q09	D (%)
Revenue from voice and other non-data services	1,132	1,204	-6.0%
Revenues from content and value added services	306	242	26.4%
Revenue from Equipment	224	193	16.1%
Total Revenues	1,662	1,639	1.4%
Cost of Revenues	845	847	-0.2%
Gross Profit	817	792	3.2%
Gross Margin	49.2%	48.3%	
Selling and marketing	202	247	-18.2%
Selling and marketing as % of revenues	12.2%	15.1%	
G&A and other income (expense)	167	126	32.5%
Selling and marketing as % of revenues	10.0%	7.7%	
Total Operating Expenses	369	373	-1.1%
OPEX as % of revenues	22.2%	22.8%	
Operating Profit:	448	419	6.9%
Operating Margin:	27.0%	25.6%	
EBITDA	631	610	3.4%
EBITDA margin	38.0%	37.2%	
Financial Expenses (Income)	45	58	-22.4%
Profit Before Tax	403	361	11.6%
Income Taxes	84	90	-6.7%
Income Tax Rate	20.8%	24.9%	
Net Profit	319	271	17.7%
Net margin	19.2%	16.5%	
EPS (ILS, fully diluted)	3.22	2.75	17.1%

Source: Company, Deutsche Bank

Figure 16: Cellcom $q10 operating data

	4Q10	4Q09	D (%)
Total Subscribers (thous)	3,394	3,292	3.1%
Net adds (k), QoQ	18	33	-45.5%
3G Subscribers (thous)	1,140	997	14.3%
3G Subs as % of Subscriber base	33.6%	30.3%	
Content & Data as % of Service Revenues	21.3%	16.7%	
MoU	342	333	2.7%
ARPU	144	143	0.7%
Churn	5.3%	4.8%	

Source: Company, Deutsche Bank

Cellcom: Investment thesis

Outlook

Over the past few years, Cellcom has managed to increase revenues and expand margins despite a saturated market and intense competition and a tough regulatory environment. Despite these conditions Cellcom has managed to achieve margin expansion, and we expect earnings stability in 2010. We believe Cellcom has a slightly greater medium-term growth potential than Partner, its key competitor, due to Cellcom's relatively late entry into HSDPA. Nevertheless, the share price appears fairly valued. Hold.

Valuation

Our price target is derived from a DCF model that uses an 8.3% WACC and assumes terminal growth of 0%. The WACC is based on a risk-free rate of 5.5% (Israeli long bond), an equity risk premium of 4.75% (standard for the Israeli market), and a beta of 0.80 (vs TA-25 index). Our terminal growth rate reflects market saturation and the potential for new competition.

Risks

We see the main downside risks coming from Pelephone, with the 2009 launch of its HSPA platform that will challenge Cellcom in the business market, and from the Regulator, in the form of further tariff cuts, the potential introduction of an MVNO and/or WiMax, and any other regulation that increases competition and puts further pressure on prices. Upside risks include better-than-expected data growth and subscriber growth.

Model updated:03 April 2011

Running the numbers

Emerging Europe

Israel

Telecoms

Bezeq

Reuters: BEZQ.TA Bloomberg: BEZQ IT

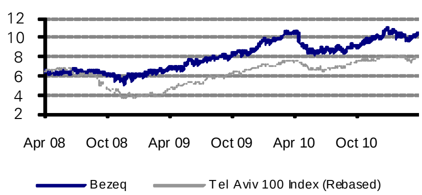
Buy

Price (3 Apr 11)	ILS 10.44
Target price	ILS 11.40
52-week Range	ILS 8.26 - 10.95
Market Cap (m)	ILSm 28,065 USDm 8,076

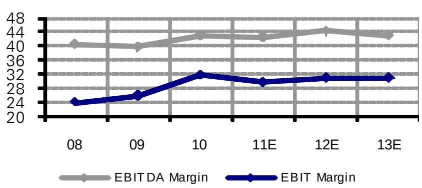
Company Profile

Bezeq is the former state-owned local fixed line monopoly. In late 2005, the state sold a 30% controlling share plus a 10.7% option to a consortium of Apax Partners, Haim Saban and Mori Arkin, which in 2010 sold the 30% controlling stake to B Communications, controlled by Shaul Elovitch. Main subsidiaries include Pelephone (100%), the third largest local cellular operator; YES DBS (50%), one of two MCTV providers; and Bezeq International (100%), an ISP/ILD provider. As a former monopoly, Bezeq faces a harsh regulatory environment as well as the entry of new players into the fixed line market.

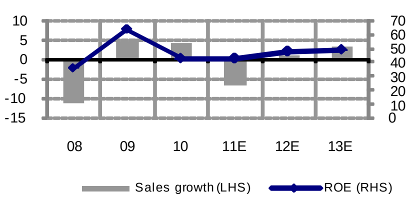
Price Performance



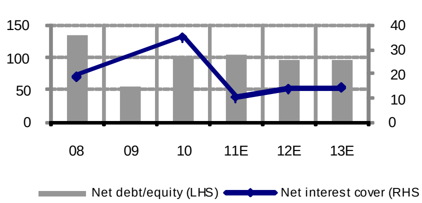
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Dec	2008	2009	2010	2011E	2012E	2013E
Financial Summary						
DB EPS (ILS)	0.61	0.78	0.94	0.82	0.90	0.94
Reported EPS (ILS)	0.61	1.35	0.94	0.82	0.90	0.94
DPS (ILS)	0.57	1.35	0.94	1.19	1.27	1.31
BVPS (ILS)	1.8	2.5	2.0	1.9	1.9	1.9
Weighted average shares (m)	2,649	2,649	2,649	2,688	2,688	2,688
Average market cap (ILSm)	16,984	19,792	24,844	28,065	28,065	28,065
Enterprise value (ILSm)	21,970	21,839	29,019	31,780	31,439	31,477
Valuation Metrics						
P/E (DB) (x)	10.4	9.5	10.0	12.8	11.6	11.2
P/E (Reported) (x)	10.4	5.6	10.0	12.8	11.6	11.2
P/BV (x)	3.48	3.88	5.38	5.57	5.44	5.40
FCF Yield (%)	11.9	11.7	9.1	6.7	8.6	8.0
Dividend Yield (%)	8.9	18.0	10.0	11.4	12.2	12.5
EV/Sales (x)	2.0	1.9	2.4	2.8	2.8	2.7
EV/EBITDA (x)	4.9	4.8	5.6	6.7	6.3	6.2
EV/EBIT (x)	8.3	7.3	7.6	9.6	9.0	8.8
Income Statement (ILSm)						
Sales revenue	**11,015**	**11,519**	**11,987**	**11,192**	**11,305**	**11,668**
Gross profit	**11,015**	**11,519**	**11,987**	**11,192**	**11,305**	**11,668**
EBITDA	**4,468**	**4,581**	**5,181**	**4,762**	**5,003**	**5,042**
Depreciation	1,519	1,343	1,114	1,188	1,275	1,196
Amortisation	309	266	269	250	250	250
EBIT	**2,640**	**2,972**	**3,798**	**3,324**	**3,479**	**3,596**
Net interest income(expense)	-140	31	-109	-320	-250	-250
Associates/affiliates	-154	1,370	-261	-114	-79	-78
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	**2,346**	**4,373**	**3,428**	**2,890**	**3,149**	**3,268**
Income tax expense	719	807	932	694	724	752
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**1,627**	**3,566**	**2,496**	**2,196**	**2,425**	**2,516**
DB adjustments (including dilution)	0	-1,488	0	0	0	0
DB Net profit	**1,627**	**2,078**	**2,496**	**2,196**	**2,425**	**2,516**
Cash Flow (ILSm)						
Cash flow from operations	**3,642**	**3,942**	**3,750**	**3,540**	**3,865**	**3,706**
Net Capex	-1,622	-1,622	-1,480	-1,648	-1,465	-1,465
Free cash flow	**2,020**	**2,320**	**2,270**	**1,892**	**2,400**	**2,241**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-1,514	-3,566	-2,496	-3,196	-3,425	-3,516
Net inc/(dec) in borrowings	-862	-391	1,525	431	434	434
Other investing/financing cash flows	176	-168	-223	71	-434	-527
Net cash flow	**-180**	**-1,805**	**1,076**	**-803**	**-1,025**	**-1,368**
Change in working capital	*0*	*0*	*0*	*0*	*0*	*0*
Balance Sheet (ILSm)						
Cash and other liquid assets	786	580	365	440	695	585
Tangible fixed assets	6,036	5,428	5,610	5,770	5,742	5,793
Goodwill/intangible assets	2,927	1,885	2,248	2,298	2,266	2,234
Associates/investments	252	1,503	1,220	1,602	1,638	1,682
Other assets	4,310	4,545	4,795	4,915	4,978	5,112
Total assets	**14,311**	**13,941**	**14,238**	**15,025**	**15,318**	**15,407**
Interest bearing debt	6,495	4,136	5,717	5,714	5,663	5,636
Other liabilities	3,564	3,267	3,151	4,227	4,457	4,527
Total liabilities	**10,059**	**7,403**	**8,868**	**9,941**	**10,120**	**10,162**
Shareholders' equity	4,723	6,544	5,327	5,041	5,156	5,201
Minorities	-471	-6	43	43	43	43
Total shareholders' equity	**4,252**	**6,538**	**5,370**	**5,084**	**5,199**	**5,244**
Net debt	*5,709*	*3,556*	*5,352*	*5,274*	*4,968*	*5,051*
Key Company Metrics						
Sales growth (%)	-11.2	4.6	4.1	-6.6	1.0	3.2
DB EPS growth (%)	20.3	27.7	20.1	-13.3	10.4	3.8
EBITDA Margin (%)	40.6	39.8	43.2	42.5	44.3	43.2
EBIT Margin (%)	24.0	25.8	31.7	29.7	30.8	30.8
Payout ratio (%)	93.1	100.0	100.0	145.5	141.2	139.7
ROE (%)	35.1	63.3	42.0	42.4	47.6	48.6
Capex/sales (%)	16.1	14.9	13.4	16.1	14.3	13.9
Capex/depreciation (x)	1.0	1.1	1.2	1.3	1.1	1.1
Net debt/equity (%)	134.3	54.4	99.7	103.7	95.6	96.3
Net interest cover (x)	18.9	nm	34.8	10.4	13.9	14.4

Source: Company data, Deutsche Bank estimates

Model updated:28 March 2011

Running the numbers

Emerging Europe

Israel

Telecoms

Partner Communications

Reuters: PTNR.TA Bloomberg: PTNR IT

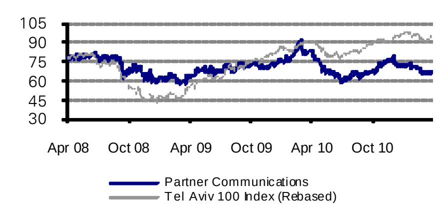
Buy

Price (3 Apr 11)	ILS 67.50
Target price	ILS 80.00
52-week Range	ILS 59.00 - 84.07
Market Cap (m)	ILSm 10,519 USDm 3,027

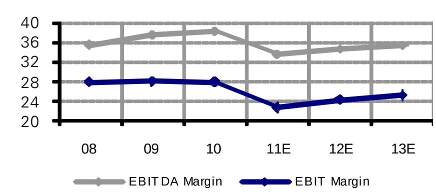
Company Profile

Partner Communications is an Israeli cellular operator under the Orange brand name. The company was established in 1999, and now has a 32% market share. Partner operates a GSM network that allows for international roaming and 3G capabilities. Scailex is the controlling shareholder with a c45% stake.

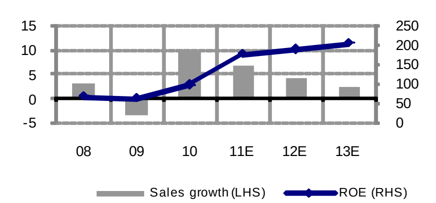
Price Performance



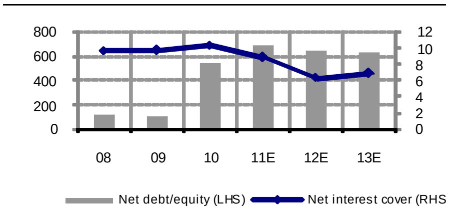
Margin Trends



Growth & Profitability



Solvency



Richard Gussow

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Fiscal year end 31-Dec	2008	2009	2010	2011E	2012E	2013E
Financial Summary						
DB EPS (ILS)	7.21	7.34	8.01	7.08	7.48	8.17
Reported EPS (ILS)	7.21	7.34	8.01	7.08	7.48	8.17
DPS (ILS)	5.92	15.87	7.62	7.08	7.48	8.17
BVPS (ILS)	11.1	12.7	4.0	4.0	4.0	4.0
Weighted average shares (m)	157	155	155	156	156	156
Average market cap (ILSm)	11,723	10,553	11,135	10,519	10,512	10,512
Enterprise value (ILSm)	13,389	12,163	13,868	14,165	13,993	13,850
Valuation Metrics						
P/E (DB) (x)	10.3	9.2	9.0	9.5	9.0	8.3
P/E (Reported) (x)	10.3	9.2	9.0	9.5	9.0	8.3
P/BV (x)	5.56	6.04	17.93	16.79	16.79	16.79
FCF Yield (%)	11.2	9.7	13.2	nm	12.5	13.4
Dividend Yield (%)	7.9	23.4	10.6	10.5	11.1	12.1
EV/Sales (x)	2.1	2.0	2.1	2.0	1.9	1.8
EV/EBITDA (x)	6.0	5.3	5.4	6.0	5.5	5.2
EV/EBIT (x)	7.6	7.2	7.5	8.8	7.8	7.2
Income Statement (ILSm)						
Sales revenue	**6,302**	**6,079**	**6,674**	**7,117**	**7,428**	**7,599**
Gross profit	**2,434**	**2,309**	**2,581**	**2,456**	**2,586**	**2,649**
EBITDA	**2,227**	**2,278**	**2,545**	**2,378**	**2,565**	**2,676**
Depreciation	465	577	685	760	760	760
Amortisation	0	0	0	0	0	0
EBIT	**1,762**	**1,701**	**1,860**	**1,618**	**1,805**	**1,916**
Net interest income(expense)	-184	-176	-181	-184	-292	-284
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	**1,578**	**1,525**	**1,679**	**1,434**	**1,513**	**1,632**
Income tax expense	444	384	436	330	348	359
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**1,134**	**1,141**	**1,243**	**1,104**	**1,165**	**1,273**
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	**1,134**	**1,141**	**1,243**	**1,104**	**1,165**	**1,273**
Cash Flow (ILSm)						
Cash flow from operations	**1,839**	**1,753**	**1,958**	**2,002**	**2,062**	**2,168**
Net Capex	-521	-732	-486	-2,070	-743	-760
Free cash flow	**1,318**	**1,021**	**1,472**	**-68**	**1,319**	**1,408**
Equity raised/(bought back)	-351	0	0	0	0	0
Dividends paid	-930	-2,467	-1,183	-1,104	-1,165	-1,273
Net inc/(dec) in borrowings	0	-557	-599	0	0	0
Other investing/financing cash flows	-1	667	328	1,095	-105	-105
Net cash flow	**35**	**-1,336**	**18**	**-76**	**49**	**30**
Change in working capital	*0*	*0*	*0*	*0*	*0*	*0*
Balance Sheet (ILSm)						
Cash and other liquid assets	184	329	321	245	293	323
Tangible fixed assets	1,935	2,064	2,058	2,081	2,104	2,127
Goodwill/intangible assets	1,261	1,260	1,077	2,566	2,541	2,515
Associates/investments	418	492	662	629	597	568
Other assets	1,368	1,478	1,509	1,576	1,519	1,465
Total assets	**5,165**	**5,623**	**5,627**	**7,097**	**7,054**	**6,998**
Interest bearing debt	2,267	2,431	3,716	4,520	4,371	4,228
Other liabilities	1,166	1,230	1,285	1,950	2,057	2,144
Total liabilities	**3,433**	**3,661**	**5,001**	**6,471**	**6,428**	**6,372**
Shareholders' equity	1,731	1,962	626	626	626	626
Minorities	0	0	0	0	0	0
Total shareholders' equity	**1,731**	**1,962**	**626**	**626**	**626**	**626**
Net debt	*2,083*	*2,102*	*3,395*	*4,276*	*4,078*	*3,905*
Key Company Metrics						
Sales growth (%)	3.1	-3.5	9.8	6.6	4.4	2.3
DB EPS growth (%)	19.9	1.8	9.1	-11.6	5.6	9.2
EBITDA Margin (%)	35.3	37.5	38.1	33.4	34.5	35.2
EBIT Margin (%)	28.0	28.0	27.9	22.7	24.3	25.2
Payout ratio (%)	82.0	216.1	95.2	100.0	100.0	100.0
ROE (%)	66.9	61.8	96.1	176.3	186.1	203.3
Capex/sales (%)	8.3	12.0	7.3	29.1	10.0	10.0
Capex/depreciation (x)	1.1	1.3	0.7	2.7	1.0	1.0
Net debt/equity (%)	120.3	107.1	542.3	683.0	651.5	623.8
Net interest cover (x)	9.6	9.7	10.3	8.8	6.2	6.7

Source: Company data, Deutsche Bank estimates

Model updated:27 March 2011

Running the numbers

Emerging Europe

Israel

Telecoms

Cellcom

Reuters: CEL.TA Bloomberg: CEL IT

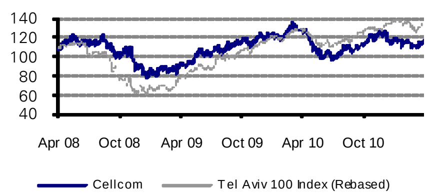
Hold

Price (3 Apr 11)	ILS 116.30
Target price	ILS 120.00
52-week Range	ILS 97.00 - 128.50
Market Cap (m)	ILSm 11,543 USDm 3,322

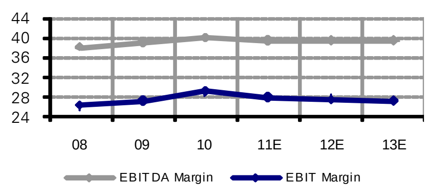
Company Profile

Cellcom is Israel's largest wireless operator in Israel by number of subscribers, with over 3m subs and a 34% market share. The other key operators are Partner and Pelephone with 32% and 29% shares respectively. Cellcom was acquired from founding shareholders Bell South and the Safra family by IDB subsidiary DIC in September 2005. IDB replaced new management and turned around the company's fortunes before floating the company on the NYSE in an IPO in February 2007, followed by a dual listing on the TASE. DIC remains the largest shareholder with a 46.9% stake.

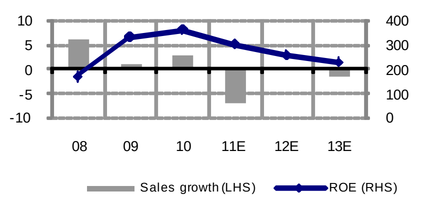
Price Performance



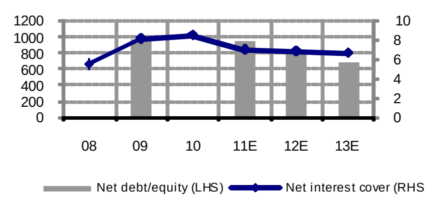
Margin Trends



Growth & Profitability



Solvency



Richard Gussow

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Fiscal year end 31-Dec	2008	2009	2010	2011E	2012E	2013E
Financial Summary						
DB EPS (ILS)	10.01	12.03	13.12	11.35	11.17	10.88
Reported EPS (ILS)	10.01	12.03	13.12	11.35	11.17	10.88
DPS (ILS)	9.51	11.43	12.47	10.78	10.61	10.33
BVPS (ILS)	3.4	3.8	3.4	4.0	4.7	4.8
Weighted average shares (m)	99	99	99	99	99	99
Average market cap (ILSm)	10,823	10,177	11,422	11,543	11,543	11,543
Enterprise value (ILSm)	14,278	13,809	15,150	15,316	15,206	14,858
Valuation Metrics						
P/E (DB) (x)	10.9	8.5	8.8	10.2	10.4	10.7
P/E (Reported) (x)	10.9	8.5	8.8	10.2	10.4	10.7
P/BV (x)	24.31	31.85	33.53	29.09	24.77	24.07
FCF Yield (%)	10.9	14.9	15.4	11.1	11.0	10.9
Dividend Yield (%)	8.7	11.2	10.8	9.3	9.1	8.9
EV/Sales (x)	2.2	2.1	2.3	2.5	2.5	2.4
EV/EBITDA (x)	5.9	5.5	5.7	6.3	6.2	6.2
EV/EBIT (x)	8.5	7.8	7.8	8.9	9.0	9.0
Income Statement (ILSm)						
Sales revenue	**6,417**	**6,483**	**6,662**	**6,193**	**6,196**	**6,106**
Gross profit	**3,015**	**3,150**	**3,340**	**2,989**	**2,978**	**2,922**
EBITDA	**2,435**	**2,529**	**2,662**	**2,440**	**2,436**	**2,398**
Depreciation	751	761	724	720	740	740
Amortisation	0	0	0	0	0	0
EBIT	**1,684**	**1,768**	**1,938**	**1,720**	**1,696**	**1,658**
Net interest income(expense)	-310	-219	-230	-250	-250	-250
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	**1,374**	**1,549**	**1,708**	**1,470**	**1,446**	**1,408**
Income tax expense	389	365	417	353	347	338
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**985**	**1,184**	**1,291**	**1,117**	**1,099**	**1,070**
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	**985**	**1,184**	**1,291**	**1,117**	**1,099**	**1,070**
Cash Flow (ILSm)						
Cash flow from operations	**1,763**	**2,090**	**2,380**	**1,903**	**1,852**	**1,842**
Net Capex	-579	-573	-619	-617	-588	-580
Free cash flow	**1,184**	**1,517**	**1,761**	**1,286**	**1,264**	**1,262**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-936	-1,125	-1,227	-1,061	-1,044	-1,016
Net inc/(dec) in borrowings	-328	509	-542	-27	-22	-25
Other investing/financing cash flows	39	-212	-270	-270	-100	-100
Net cash flow	**-41**	**689**	**-277**	**-72**	**98**	**120**
Change in working capital	*346*	*145*	*40*	*1*	*13*	*-329*
Balance Sheet (ILSm)						
Cash and other liquid assets	275	903	533	461	683	897
Tangible fixed assets	2,159	2,096	2,063	1,962	1,897	1,883
Goodwill/intangible assets	675	711	753	969	1,022	999
Associates/investments	0	0	0	0	0	0
Other assets	2,311	2,669	2,647	2,635	2,612	2,606
Total assets	**5,420**	**6,379**	**5,996**	**6,026**	**6,213**	**6,385**
Interest bearing debt	3,730	4,535	4,261	4,233	4,346	4,212
Other liabilities	1,348	1,470	1,394	1,396	1,401	1,694
Total liabilities	**5,078**	**6,005**	**5,655**	**5,629**	**5,747**	**5,905**
Shareholders' equity	342	374	341	397	466	479
Minorities	0	0	0	0	0	0
Total shareholders' equity	**342**	**374**	**341**	**397**	**466**	**479**
Net debt	*3,455*	*3,632*	*3,728*	*3,773*	*3,663*	*3,314*
Key Company Metrics						
Sales growth (%)	6.1	1.0	2.8	-7.0	0.0	-1.5
DB EPS growth (%)	22.7	20.2	9.1	-13.5	-1.6	-2.6
EBITDA Margin (%)	37.9	39.0	40.0	39.4	39.3	39.3
EBIT Margin (%)	26.2	27.3	29.1	27.8	27.4	27.2
Payout ratio (%)	95.8	95.8	95.8	95.8	95.8	95.8
ROE (%)	168.1	330.7	361.2	302.7	254.7	226.3
Capex/sales (%)	9.4	8.9	9.3	10.0	9.5	9.5
Capex/depreciation (x)	0.8	0.8	0.9	0.9	0.8	0.8
Net debt/equity (%)	nm	971.1	nm	950.7	786.1	691.2
Net interest cover (x)	5.4	8.1	8.4	6.9	6.8	6.6

Source: Company data, Deutsche Bank estimates

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist			
Company	**Ticker**	**Recent price***	**Disclosure**
Bezeq	BEZQ.TA	1044.00 (ILa) 3 Apr 11	NA
Partner Communications	PTNR.TA	6750.00 (ILa) 3 Apr 11	2,8
Cellcom	CEL.TA	116.30 (ILS) 3 Apr 11	NA

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

Important Disclosures Required by U.S. Regulators

Disclosures marked with an asterisk may also be required by at least one jurisdiction in addition to the United States. See "Important Disclosures Required by Non-US Regulators" and Explanatory Notes.

2. Deutsche Bank and/or its affiliate(s) makes a market in securities issued by this company.

8. Deutsche Bank and/or its affiliate(s) expects to receive, or intends to seek, compensation for investment banking services from this company in the next three months.

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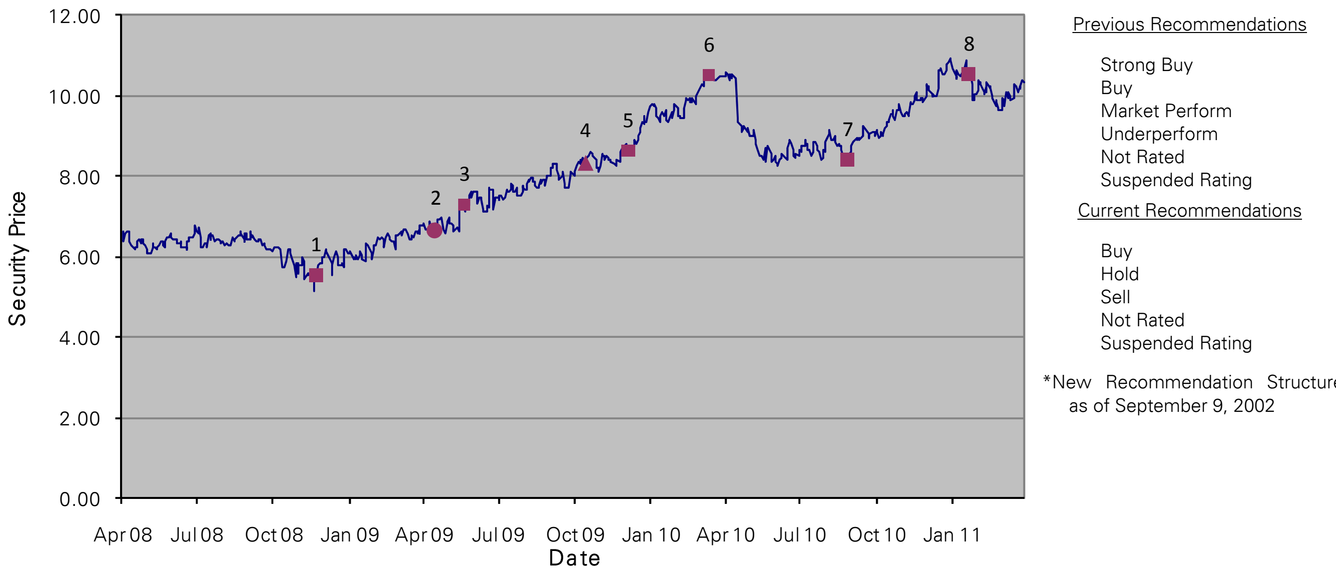
Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst about the subject issuers and the securities of those issuers. In addition, the undersigned lead analyst has not and will not receive any compensation for providing a specific recommendation or view in this report. Richard Gussow

Historical recommendations and target price: Bezeq (BEZQ.TA)

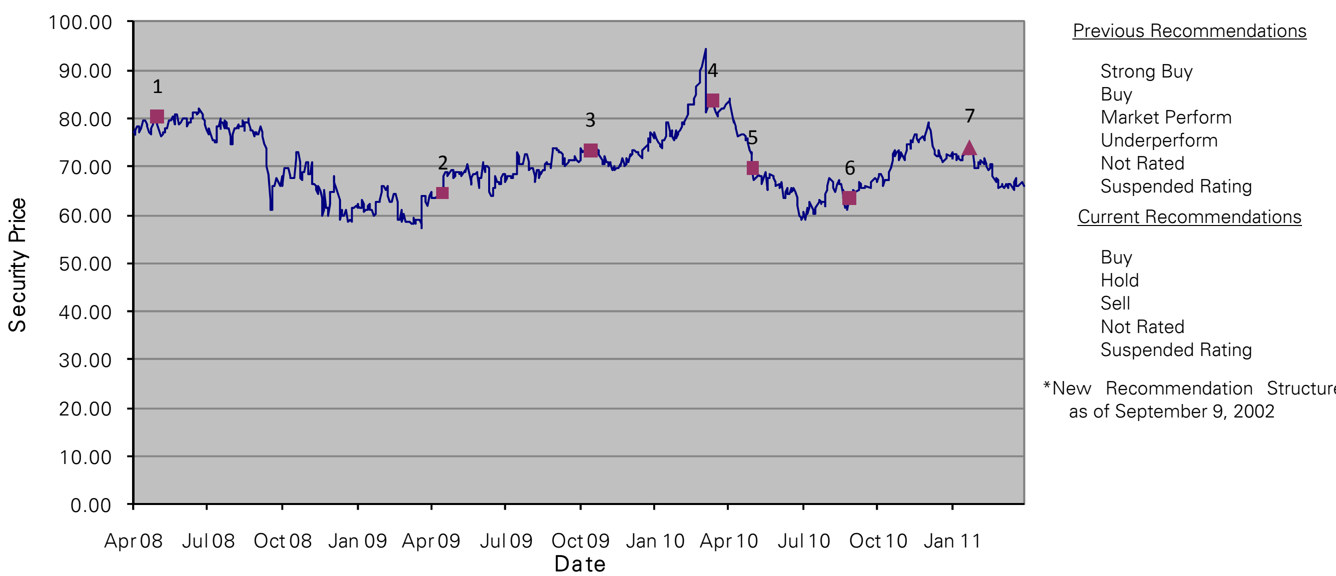
(as of 4/3/2011)



1.	26/11/2008:	Buy, Target Price Change ILS6.50	5.	9/12/2009:	Buy, Target Price Change ILS9.50
2.	20/4/2009:	Downgrade to Hold, ILS6.50	6.	17/3/2010:	Buy, Target Price Change ILS11.00
3.	25/5/2009:	Hold, Target Price Change ILS7.00	7.	1/9/2010:	Buy, Target Price Change ILS10.00
4.	18/10/2009:	Upgrade to Buy, Target Price Change ILS9.00	8.	26/1/2011:	Buy, Target Price Change ILS11.40

Historical recommendations and target price: Partner Communications (PTNR.TA)

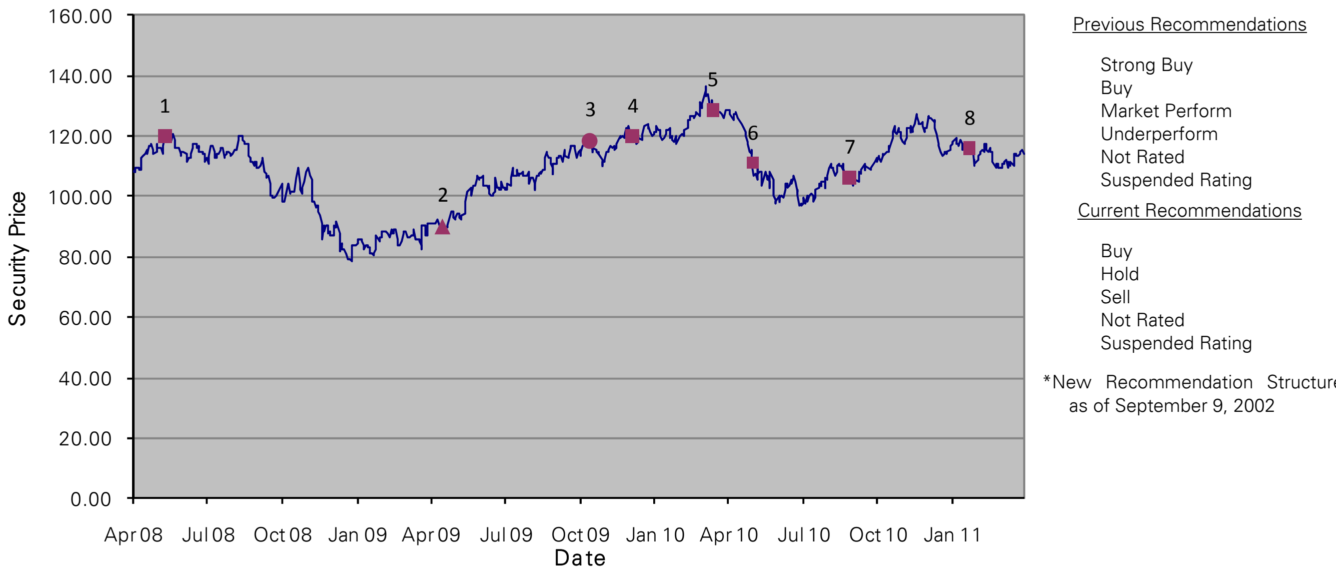
(as of 4/3/2011)



1.	5/5/2008:	Hold, Target Price Change ILS78.00	5.	5/5/2010:	Hold, Target Price Change ILS70.00
2.	20/4/2009:	Hold, Target Price Change ILS70.00	6.	1/9/2010:	Hold, Target Price Change ILS67.00
3.	18/10/2009:	Hold, Target Price Change ILS72.00	7.	26/1/2011:	Upgrade to Buy, Target Price Change ILS80.00
4.	17/3/2010:	Hold, Target Price Change ILS77.00			

Historical recommendations and target price: Cellcom (CEL.TA)

(as of 4/3/2011)

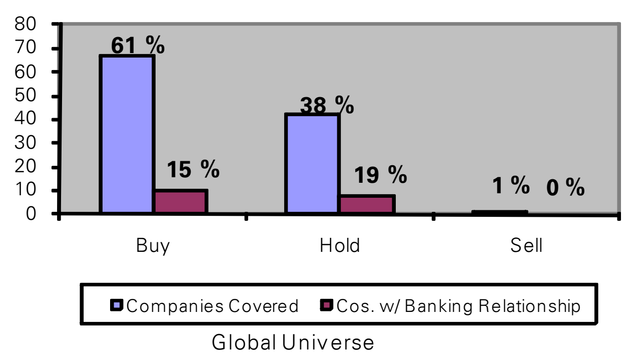


1.	14/5/2008:	Hold, Target Price Change ILS118.00	5.	17/3/2010:	Hold, Target Price Change ILS125.00
2.	20/4/2009:	Upgrade to Buy, Target Price Change ILS112.00	6.	5/5/2010:	Hold, Target Price Change ILS111.00
3.	18/10/2009:	Downgrade to Hold, Target Price Change ILS115.00	7.	1/9/2010:	Hold, Target Price Change ILS108.00
4.	9/12/2009:	Hold, Target Price Change ILS117.00	8.	26/1/2011:	Hold, Target Price Change ILS120.00

Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.
Notes:
1. Newly issued research recommendations and target prices always supersede previously published research.
2. Ratings definitions prior to 27 January, 2007 were:
   Buy: Expected total return (including dividends) of 10% or more over a 12-month period
   Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period
   Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



Regulatory Disclosures

1. Important Additional Conflict Disclosures

Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

2. Short-Term Trade Ideas

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