

**Partner Communications**  
 (Bloomberg Ticker :PTNR IT)

**Ahead of Large One –Time Dividend  
 Dividend Yield is hiding an Expensive company**

Partner published a brand valuation which attempts to convince an Israeli court of the logic behind the planned distribution of a NIS 1.4 b. dividend through a reduction of capital. Neutralizing the positive effect of a large dividend, Partner is facing competition that threatens its market share and profitability, and is thus richly priced. In the short term: the negative trend still dominates and we expect to see a decline in main parameters in the fourth quarter. **We are lowering downgrading Partner to UnderPerform with a price target of NIS 75.**

**Cash Flow** – Overall, we expect a free cash flow of a billion NIS for Partner in 2009, when broken down to EV that is at NIS 14.2 b. (a value of 12.2 + debt of NIS 2 b.), generates free cash flow of only 7.1%. Therefore, the company's leverage is so important to Partner, which is interested in having a larger debt in order to generate a more leveraged return to shareholders. This concept is favorable because of the low cost of raising debt but it is not enough to make it an attractive share.

**The Fourth Quarter** – The previous quarter showed a dramatic decline of more than 9% in ARPU vs. the same quarter last year. We believe that we will see slight improvement in rate of deterioration but the direction is still negative with a continued 5% decline in ARPU rate from NIS 158 to NIS 150 in the current quarter, in spite of the effects of seasonality which will positively affect the quarter. This reduction is directly related to the erosion of profitability resulting from the declining trend in the price per minute due to a competitive business market and to the reduced revenue from roaming fees, which seems to be unable to recover. The number of subscribers is still a positive angle as Partner is expected to sign up 22 thousand new subscribers, but the overall trend is negative and we expect a 2.2% decrease in service revenue, 0.8% decline in EBITDA, and 9.3% decline in net profit vs. the same period last year (which was also affected by the global slowdown).

A new regulation to come: interconnectivity fees - the NERA consulting firm is expected to recommend a reduction of interconnectivity fees, to the Communication Ministry, which may take effect mid-year, after hearing the appeals of the cellular companies. We estimate that we will see a further decline to a level of NIS 0.16-0.13/minute (maybe even lower) to encourage the entry of virtual operators. Due to the uncertainty we are not pricing the effect of this change. In the past, cellular companies were able to successfully deal with such declines, but it is doubtful that history will fully repeat itself, and in any case, it will be felt in the short term.

**Virtual Operator** – Yesterday, the Communications Ministry signed the regulations that allow the licensing of virtual cellular operators. The road to the service being offered is still a long way away, but the commitment of the Minister of Communications to this move and the interest of a long list of potential players in entering this field will create pressure on the profitability of the private sector and on the results of 2011, which may largely be lower than those in the current model.

**ISP and Telephony.** We believe that Partner has so far signed up only 50 thousand subscribers despite the massive advertising campaign for this business, which was at the expense of the cellular business. Currently, Partner is far from reaching critical mass in this area, although its net expense will decline in 2010 and 2011.

**Updates**

- Rating**
- Price Target**
- Forecast**

**Key figures**

Rating	Underperform
<b>Price target (NIS)</b>	<b>75.00</b>
<b>Current price (NIS)</b>	<b>79.00</b>
Market Cap (Bil ILS)	12.2
12-mo. high (NIS)	79.0
12-mo. low (NIS)	53.5
52-weeks. Change	29%
52-weeks. Change TA25	69%
P/E 2009E	11.0
P/E 2010E	11.1
EV/EBITDA 2009E	6.4
EV/EBITDA 20010E	6.5
<b>Previous rating</b>	Market Perform
<b>Previous price target (ILS)</b>	72.00



**The distribution of the one-time dividend is positive** - we estimate that eventually the dividend distribution will be approved. We are not experts in Law but it's hard to believe that the court will think that the leverage, created by dividend distribution, would be a real concern to Partner's repayment ability. The expected leverage is acceptable and even financially recommended to a communications company such as Partner with a monthly cash flow spread over 3 million customers.

### **The Fourth quarter and beyond**

- **Roaming** - Roaming revenues continue to fall and are expected to negatively affect the results of the largest cellular companies (though the fourth quarter is significantly less at this point). Damage to revenue comes both through a decrease in volume of tourism to Israel, though moderate compared to the past, but still exists, and the roaming agreements that are influenced by the European regulations on local companies, which ultimately leads to a sharp decline in revenue from incoming tourism. The last effect indicates that even if we see a full recovery in tourism the decline in revenues from Roaming charges is permanent.
- **Seasonal** - The fourth quarter of 2009 has a technical advantage compared to the corresponding quarter of 2008 due to the spread of holiday days over the quarter. There is an additional 1%-1.5% added to services revenues in the coming quarter.
- **MOU** - The continuing price decline for a minute's conversation is not reflected by a parallel rise in the number of minutes as we have seen in the past. Partly for technical reasons (minute plan deals), that were given in the past, but it may also suggest that we came to an equilibrium in terms of the number of average minutes/subscriber.
- **iPhone** - In light of the agreement with Apple in 2010 adversely affected by the subsidies totaling tens of millions. At present, we do not see price discounts or sharp changes in policy by any of the cellular companies where the all-inclusive packages produce the cellular companies' profits. However, it is hard to believe that the companies will succeed in selling the quantities to which they are committed since no one is rushing to purchase the I-Phone from any of the cellular companies.
- **The Big Threat** from iPhone on the cellular companies is hidden and is not summed up by the tough conditions these companies signed with Apple, but also includes the core of the companies – the brand. Partner invested a lot in strengthening its brand, which is normally ranked by consumers at the top, but the combined publicity that Apple forced on the companies, and the removal of the logos from the equipment may mark the beginning of a trend of transferring the power from the operators to the new manufacturers (Apple and Google), that are expected to capture the market, and that maintain more attractive global super brands.
- **The new owner, Ilan Ben Dov**, is trying to learn the details of the business in order to find a way to further increase profitability. In our opinion, his opportunity on the revenue side is very low since Partner is in a saturated business with strong competitors and it appears that even maintaining the status quo, as it is, is a challenge. In light of this, the key challenge is on the expense side, and the company's ability to cut current expenses or its CapEx, which is already a well managed business, resulting in it being a difficult challenge.
- **Pelephone** – Continues its strategic goal to aim at the business market. Its presence with the new network is felt and creates very strong competition in the business market, and even if Pelephone's market share is not going to sharply change, the companies in this sector are already feeling the decline in prices.

## Partner Communications Revenues Model

Partner	2007	2008	1Q09	2Q09	3Q09	4Q09E	2009E	2010E	2011E	2012E	2013E
<b>Revenues</b>	<b>6,113.6</b>	<b>6,329.5</b>	<b>1,412.4</b>	<b>1,514.0</b>	<b>1,575.0</b>	<b>1,529.3</b>	<b>6,028.6</b>	<b>5,995.3</b>	<b>6,054.6</b>	<b>6,081.0</b>	<b>6,107.9</b>
YoY	9.0%	3.5%	-10.7%	-1.6%	-3.3%	-1.5%	-4.8%	-0.6%	1.0%	0.4%	0.4%
Services	5,328.7	5,573.2	1,298	1,360.0	1,389.0	1,358.3	5,405.1	5,366.9	5,424.4	5,433.0	5,441.6
YoY	6.0%	4.6%	-2.9%	-0.7%	-4.3%	-2.2%	-3.0%	-0.7%	1.1%	0.2%	0.2%
Equipment	784.9	756.3	114.6	154.0	186.0	171.0	623.5	628.4	630.3	648.0	666.3
YoY	35.5%	-3.6%	-53.3%	-8.9%	4.5%	4.3%	-17.6%	0.8%	0.3%	2.8%	2.8%
<b>Cost revenues</b>	<b>4,103.1</b>	<b>4,079.1</b>	<b>846.1</b>	<b>924.0</b>	<b>1,003.0</b>	<b>986.7</b>	<b>3,759.8</b>	<b>3,770.3</b>	<b>3,780.3</b>	<b>3,808.7</b>	<b>3,838.4</b>
Services	3,101.6	3235.8	749.5	777.0	846.0	832.9	3205.4	3217.9	3220.0	3216.3	3212.8
% from Services	58.2%	58.1%	57.8%	57.1%	60.9%	61.3%	59.3%	60.0%	59.4%	59.2%	59.0%
YoY	0.5%	4.3%	#DIV/0!	3.1%			-0.9%	0.4%	0.1%	-0.1%	-0.1%
Equipment	1,001.5	843.3	96.6	147.0	157.0	153.8	554.4	552.4	560.3	592.3	625.7
% from Equipment	127.6%	111.5%	84.3%	95.5%	84.4%	89.9%	88.9%	87.9%	88.9%	91.4%	93.9%
YoY	23.4%	-15.8%	#DIV/0!	-23.8%			-34.3%	-0.3%	1.4%	5.7%	5.6%
<b>Gross Profit</b>	<b>2,010.5</b>	<b>2,250.4</b>	<b>566.3</b>	<b>590.0</b>	<b>572.0</b>	<b>542.6</b>	<b>2,268.9</b>	<b>2,225.0</b>	<b>2,274.3</b>	<b>2,272.4</b>	<b>2,269.4</b>
<b>Gross margin</b>	<b>32.9%</b>	<b>35.6%</b>	<b>40.1%</b>	<b>39.0%</b>	<b>36.3%</b>	<b>35.5%</b>	<b>37.6%</b>	<b>37.1%</b>	<b>37.6%</b>	<b>37.4%</b>	<b>37.2%</b>
<b>Service - GM</b>	<b>41.8%</b>	<b>41.9%</b>	<b>42.2%</b>	<b>42.9%</b>	<b>39.1%</b>	<b>38.7%</b>	<b>40.7%</b>	<b>40.0%</b>	<b>40.6%</b>	<b>40.8%</b>	<b>41.0%</b>
<b>Equipment- GM</b>	<b>-27.6%</b>	<b>-11.5%</b>	<b>15.7%</b>	<b>4.5%</b>	<b>15.6%</b>	<b>10.1%</b>	<b>11.1%</b>	<b>12.1%</b>	<b>11.1%</b>	<b>8.6%</b>	<b>6.1%</b>
YoY	17.6%	11.9%	-2.1%	-0.3%	-14.8%	-8.5%	0.8%	-1.9%	2.2%	-0.1%	-0.1%
S&M	370.2	389.3	83.4	102.0	107.0	96.3	388.7	386.5	384.3	386.0	387.7
% from revenues	6.1%	6.2%	5.9%	6.7%	6.8%	6.3%	6.4%	6.4%	6.3%	6.3%	6.3%
G&A	235.9	255.9	72.9	69.0	80.0	79.5	301.5	293.8	290.7	285.8	287.1
% from revenues	3.9%	4.0%	5.2%	4.6%	5.1%	5.2%	5.0%	4.9%	4.8%	4.7%	4.7%
Other exp (Income)	-	-	(24.0)	(15.0)	(16.0)	(16.0)	(70.9)	(64.0)	(64.0)	(64.0)	(64.0)
% from revenues	0.0%	0.0%	-1.7%	-1.0%	-1.0%	-1.0%	-1.2%	-1.1%	-1.1%	-1.1%	-1.0%
OPEX	606.1	645.2	132.3	156.0	171.0	159.9	619.2	616.4	611.0	607.8	610.8
% from revenues	9.9%	10.2%	9.4%	10.3%	10.9%	10.5%	10.3%	10.3%	10.1%	10.0%	10.0%
<b>Operating Income</b>	<b>1404.5</b>	<b>1605.2</b>	<b>433.9</b>	<b>434.0</b>	<b>401.0</b>	<b>382.8</b>	<b>1649.6</b>	<b>1608.6</b>	<b>1663.3</b>	<b>1664.5</b>	<b>1658.6</b>
<b>Operating margin</b>	<b>23.0%</b>	<b>25.4%</b>	<b>30.7%</b>	<b>28.7%</b>	<b>25.5%</b>	<b>25.0%</b>	<b>27.4%</b>	<b>26.8%</b>	<b>27.5%</b>	<b>27.4%</b>	<b>27.2%</b>
YoY	15.3%	14.3%	2.4%	-2.9%	-23.2%	-11.6%	2.8%	-2.5%	3.4%	0.1%	-0.4%
Financial expenses	(126.3)	(157.9)	(25.9)	(48.0)	(61.0)	(27.3)	(162.3)	(127.9)	(127.9)	(127.9)	(127.9)
Income before tax	<b>1,278.2</b>	<b>1,447.2</b>	<b>408.0</b>	<b>386.0</b>	<b>340.0</b>	<b>355.4</b>	<b>1,487.3</b>	<b>1,480.7</b>	<b>1,535.4</b>	<b>1,536.6</b>	<b>1,530.7</b>
Taxes	(338.4)	(395.8)	(111.5)	(98.0)	(77.0)	(92.4)	(378.9)	(370.2)	(383.8)	(384.2)	(382.7)
Taxes %	26.5%	27.3%	27.3%	25.4%	22.6%	26.0%	25.5%	25.0%	25.0%	25.0%	25.0%
Accounting changes											
<b>Net Income</b>	<b>939.7</b>	<b>1,051.5</b>	<b>296.5</b>	<b>288.0</b>	<b>263.0</b>	<b>263.0</b>	<b>1,108.4</b>	<b>1,110.6</b>	<b>1,151.5</b>	<b>1,152.5</b>	<b>1,148.0</b>
<b>Net margin</b>	<b>15.4%</b>	<b>16.6%</b>	<b>21.0%</b>	<b>19.0%</b>	<b>16.7%</b>	<b>17.2%</b>	<b>18.4%</b>	<b>18.5%</b>	<b>19.0%</b>	<b>19.0%</b>	<b>18.8%</b>
YoY	37.7%	11.9%	0.0%	2.1%	-20.3%	-9.3%	5.4%	0.2%	3.7%	0.1%	-0.4%
<b>EBITDA</b>	<b>2,014.7</b>	<b>2,258.7</b>	<b>549.2</b>	<b>569.7</b>	<b>564.0</b>	<b>545.6</b>	<b>2,226.4</b>	<b>2,203.3</b>	<b>2,273.5</b>	<b>2,285.2</b>	<b>2,290.0</b>
<b>EBITDA margin</b>	<b>33.0%</b>	<b>35.7%</b>	<b>38.9%</b>	<b>37.6%</b>	<b>35.8%</b>	<b>35.7%</b>	<b>36.9%</b>	<b>36.8%</b>	<b>37.5%</b>	<b>37.6%</b>	<b>37.5%</b>
YoY	8.9%	12.1%	1.9%	0.9%	-11.7%	-0.8%	38.7%	-1.0%	3.2%	0.5%	0.2%
EPS (diluted)	5.96	6.73	1.92	1.86	1.70	1.69	7.16	7.14	7.37	7.34	7.27
shares -diluted (millions)	157.58	156.35	154.17	154.46	154.83	155.60	154.77	155.54	156.32	157.10	157.88
Payout Ratio			1.54	1.49	1.94	1.69	6.66				
			80%	80%	114%	100.0%					
Partner	2007	2008	1Q09	2Q09	3Q09	4Q09E	2009E	2010E	2011E	2012E	2013E
Cash Flow from Operations	1,456.3	1,839.1	426.2	434.8	464.0	441.0	1,766.0	1,835.1			
Working Capital	86.8	-	16.1	28.9	20.0	12.2	77.2	(1.9)	16.3	5.4	5.4
Depreciation	603.4	653.5	115.3	135.7	163.0	162.8	576.8	594.7	610.2	620.7	631.3
CAPEX	540.1	530.8	226.0	212.0	158.0	159.5	755.5	749.6	715.2	727.3	729.7
% from revenues	8.8%	8.4%	16.0%	14.0%	10.0%	10.4%	12.5%	12.5%	11.8%	12.0%	11.9%
<b>FCF</b>	<b>916.2</b>	<b>1,308.3</b>	<b>200.2</b>	<b>222.8</b>	<b>306.0</b>	<b>281.5</b>	<b>1,010.5</b>	<b>1,085.5</b>	<b>1,158.2</b>	<b>1,168.3</b>	<b>1,172.1</b>

The model was created before the reduction of capital which requires the Courts approval and without the impact of the entry of a virtual operator, where we still do not know its chances for success and the value of the weight imposed (if and when) on the cellular companies by the Communication Ministry.

**Sensitivity Analysis**

<b>g/wacc</b>	<b>0.5%</b>	<b>1.0%</b>	<b>1.5%</b>	<b>2.0%</b>	<b>2.5%</b>
<b>8.1%</b>	78.0	83.0	88.7	95.4	103.2
<b>8.6%</b>	72.2	76.4	81.3	86.9	93.5
<b>9.1%</b>	67.0	70.7	74.9	79.7	85.2
<b>9.6%</b>	62.4	65.6	69.3	73.4	78.1
<b>10.1%</b>	58.3	61.2	64.3	67.9	71.9

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**Warning notes and full disclosure concerning this analysis****a. Details on the author of the analysis**

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**b. Full disclosure by the author of this analysis**

As far as he is aware, the author of this analysis does not have any conflict of interest at the time of its publication.

**c. Notes on the analysis****1. Scale of recommendations**

- **Buy** – the stock is expected to out perform TA100 by 20% or more in 12 months.
- **Outperform** - the stock is expected to out perform TA100 by 10% to 20% in 12 months.
- **Marketperform** – the stock is expected to out perform/ under perform TA100 by 10 % in 12 months.
- **Underperform** – the stock is expected to under perform TA100 by 10% to 20% in 12 months.
- **Sell** – the stock is expected to under perform TA100 by 20% or more in 12 months.

2. The approach used in establishing \_\_\_\_\_ price target combined a discounted cash flow model with comparisons of market-to-book multiples and price-earnings ratios of other companies in the sector.

3. The key risks which have the power to impact the company's price target are as follows:

**d. Independent Judgment**

I, Tsahi Avraham, License Number 7553, declare that the opinions stated in this analysis faithfully represent my personal opinions about the shares reviewed and the corporation which issued these shares.

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e. **Full disclosure on behalf of Clal Finance Investments Management Ltd. (henceforth "The licensed Corporation")**. Hereafter is full disclosure on conflict of interest by the licensed Corporation, as far as known or that there is a risk for its existence at the time of the publication of this analysis:

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2. Date of publication. This research report was issued on January 21 2010.

**f. Comments and general warnings by Clal Finance Investments Management Ltd.**

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