# ISRAEL TELECOM SERVICES

## Why Israel is different

**The two new mobile operators launched what we believe are unsustainable disruptive pricing business models in attempt to grab market share. While there is a risk that the price collapse and profitability fall we have seen over the past six quarters might continue, we believe this is not likely. We downgrade HOT to UW from EW, upgrade Cellcom to EW, and reiterate our OW on Partner and Bezeq.**

**Unlimited is not the way to go:** We argue that HOT Mobile and Golan Telecom miscalculated in launching unlimited plans below the ILS 100 (€20) price level. 1) They underestimated the reaction by PTNR, CEL and BEZQ to respond quickly and drastically; 2) offering unlimited voice and SMS, they boxed themselves in as low cost/high usage providers and forfeited potential future price hikes; 3) their data packages are 3x-1.5x larger than competitors and are included in the monthly €20 price.

**Why Israel is different:** We examine disruptive pricing plans across Europe and show that though successful in the EU, the models differ from Israel for a few reasons: 1) New Mobile Network Operators lowered prices for unlimited plans by c. 55%, but the price gap with the incumbents is still narrow; 2) The MNOs launched services with minimal network coverage and use national roaming agreements to supplement coverage; 3) HOT's cash flow from fixed line can not fund the mobile network build out and Golan has no fixed line infrastructure at all. We believe that for these reasons the new MNOs will struggle to gain market share and generate FCF to finance new wireless networks.

**Bitstream access creates opportunity for some and challenges for others:** We downgrade HOT to UW, which based on our analysis is facing serious challenges heading into 2013. As we detail in the note below, HOT can currently manage its mobile business plans as the fixed line provides FCF to fund investment. Once the wholesale market is opened we expect the market dynamics to change (see our Bezeq note; "*Time to look deeper at the opportunity*", dated August 6th), and that HOT's FCF from fixed line will fall. We upgrade CEL to EW as we see the wholesale market creating opportunities for it and PTNR as they enter the fixed line through "triple play" and begin to market IPTV. Though BEZQ will face some of the same challenges as HOT, the opening of the market will unlock large efficiency opportunities for BEZQ.

**Valuations not challenging:** Trading in line with European peers at 4.7x EV/EBITDA vs. 4.8x in Europe we believe that BEZQ and PTNR offer good opportunities for investors. In Israel equity allocation, we continue to prefer the Energy E&P and Technology industries that have greater growth and upside potential relative to Telecom and Banks that are still reeling from regulation and disruptive competition.



PLEASE SEE ANALYST(S) CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 38.

INDUSTRY UPDATE

Israel Telecom Services
NEGATIVE
Unchanged

For a full list of our ratings, price target and earnings changes in this report, please see table on page 2.

Israel Telecom Services

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## Summary of our Ratings, Price Targets and Earnings Changes in this Report (all changes are shown in bold)

| Company | Rating | | Price | Price Target | | | EPS FY1 (E) | | | EPS FY2 (E) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Old | New | 19-Sep-12 | Old | New | %Chg | Old | New | %Chg | Old | New | %Chg |
| **Israel Telecom Services** | Neg | Neg | | | | | | | | | | |
| Bezeq (BEZQ IT / BEZQ.TA) | OW | OW | 4.75 | 5.50 | 5.50 | - | 0.65 | 0.65 | - | 0.60 | 0.60 | - |
| Cellcom Israel Ltd. (CEL IT / CEL.TA) | UW | **EW** | 31.75 | 24.00 | **34.00** | 42 | 5.68 | **5.57** | -2 | 4.96 | **5.11** | 3 |
| Hot Telecommunication System (HOT IT / HOT.TA) | EW | **UW** | 35.87 | 39.00 | **35.00** | -10 | 3.29 | **0.95** | -71 | 3.88 | **0.92** | -76 |
| Partner Communications Co. (PTNR IT / PTNR.TA) | OW | OW | 19.45 | 22.00 | 22.00 | - | 2.75 | **3.18** | 16 | 2.49 | **3.22** | 29 |

Source: Barclays Research. Share prices and target prices are shown in the primary listing currency and EPS estimates are shown in the reporting currency.
FY1(E): Current fiscal year estimates by Barclays Research. FY2(E): Next fiscal year estimates by Barclays Research.
Stock Rating: OW: Overweight; EW: Equal Weight; UW: Underweight; RS: Rating Suspended
Industry View: Pos: Positive; Neu: Neutral; Neg: Negative

## Valuation Methodology and Risks

### Israel Telecom Services

#### Cellcom Israel Ltd. (CEL IT / CEL.TA)

**Valuation Methodology:** Our price target is derived from the average of our DCF model which assumes a 10.5% WACC and 0% terminal growth rate, and our sum of the parts model that attributes ILS 6,784mn to the Mobile segment and ILS 1,667mn to the Fixed line segment.

**Risks which May Impede the Achievement of the Barclays Research Price Target:** Some of the risks facing Cellcom are: pricing pressure, new MVNOs, significant changes to the regulatory regime and the fact that Cellcom's potential merger with an ISP company may cost more than initially expected may present downside risk to our estimates.

#### Hot Telecommunication System (HOT IT / HOT.TA)

**Valuation Methodology:** We value HOT using a DCF model. Our assumptions include a WACC of 9.0% and terminal growth rate of 1%. The net present value of the cash flows equals ILS 5,692m, from which we subtract ILS 2,882m in net debt and add back ILS 121m in deffered tax benefits to arrive at and equity valuation of ILS 2,931m. With 76m share outstanding, the implied PT is ILS 39.

**Risks which May Impede the Achievement of the Barclays Research Price Target:** HOT's shareholder structure and changes in the regulatory enviornment may prevent HOT from acheiving our forecasted EPS estimates.

#### Partner Communications Co. (PTNR IT / PTNR.TA)

**Valuation Methodology:** Our price target is derived from the average of our DCF model which assumes a 10.5% WACC and 0% terminal growth rate. Our derived entreprise value is ILS 7,904m, to which we add ILS 477m of financial assets and substract ILS4,927 of financial liabilities. That gives us an EV of ILS 3,454m or ILS 22 per share.

**Risks which May Impede the Achievement of the Barclays Research Price Target:** Regulatory approval for stated acquisition is not received; and product launches do not gain market share and have to be rolled back.

Source: Barclays Research.

# Valuation sheet

**Figure 1: European Telecoms – Valuation sheet**

| Company | Ticker | CCY | Rating | Closing Price | Price Target | Market Cap | PE | | EV/EBITDA | | EV/OpFCF | | Dividend Yield | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | 18/09/12 | | EURbn | 2012E | 2013E | 2012E | 2013E | 2012E | 2013E | 2012E | 2013E |
| Belgacom | BCOM | EUR | UW | 23.47 | 23.0 | 7.4 | 10.8x | 11.5x | 5.3x | 5.3x | 9.6x | 9.5x | 9.3% | 8.5% |
| BT Group | BT.L | GBP | OW | 2.27 | 2.60 | 22.0 | 8.9x | 8.7x | 4.8x | 4.8x | 8.3x | 8.3x | 4.2% | 4.8% |
| Deutsche Telekom | DTEGn | EUR | OW | 9.65 | 11.00 | 42.1 | 15.6x | 15.5x | 4.6x | 4.7x | 8.7x | 9.3x | 7.3% | 7.3% |
| Elisa | ELI1V | EUR | UW | 16.59 | 16.00 | 2.6 | 12.1x | 11.6x | 6.7x | 6.5x | 10.6x | 9.8x | 8.8% | 8.6% |
| France Telecom | FTE.PA | EUR | UW | 10.02 | 10.00 | 26.6 | 7.9x | 8.6x | 4.2x | 4.3x | 7.3x | 7.7x | 12.0% | 10.0% |
| KPN | KPN.AS | EUR | OW | 6.49 | 10.00 | 9.3 | 8.7x | 8.4x | 4.3x | 4.2x | 9.0x | 7.1x | 5.4% | 5.4% |
| OTE | OTE.rAT | EUR | EW | 3.36 | 3.34 | 1.6 | 3.1x | 5.1x | 3.2x | 3.3x | 4.7x | 5.4x | - | - |
| Portugal Telecom | PTC.LS | EUR | EW | 3.96 | 4.40 | 3.5 | 11.3x | 10.3x | 4.7x | 4.8x | 10.3x | 10.7x | 8.2% | 8.2% |
| Swisscom | SCMN.VX | CHF | OW | 379.80 | 425.00 | 16.3 | 11.1x | 10.5x | 6.6x | 6.6x | 13.1x | 12.7x | 5.8% | 6.1% |
| TDC | TDC.CO | DKK | UW | 41.00 | 48.00 | 4.5 | 10.1x | 10.9x | 5.3x | 5.3x | 7.0x | 7.9x | 11.2% | 11.2% |
| Telecom Italia (blend) | TIT-Blend | EUR | - | 0.77 | - | 14.9 | 6.0x | 5.8x | 4.2x | 4.3x | 7.8x | 7.4x | 5.7% | 5.6% |
| Telecom Italia (ordinary) | TIT-MIL | EUR | OW | 0.80 | 1.10 | - | 6.3x | 6.1x | 4.3x | 4.4x | 8.0x | 7.5x | 5.4% | 5.4% |
| Telecom Italia (saver) | TITR-MIL | EUR | OW | 0.68 | 0.95 | - | 5.4x | 5.2x | 4.1x | 4.2x | 7.6x | 7.2x | 7.9% | 7.9% |
| Telefonica | TEF.MC | EUR | UW | 11.38 | 8.50 | 51.3 | 11.5x | 9.8x | 4.9x | 4.9x | 9.2x | 9.0x | - | 6.6% |
| Telekom Austria | TELA.VI | EUR | EW | 6.30 | 7.70 | 2.8 | 13.8x | 11.8x | 4.9x | 4.9x | 9.9x | 13.4x | 6.0% | 7.4% |
| Telenor | TEL.OL | NOK | OW | 109.80 | 130.00 | 23.6 | 13.0x | 10.2x | 6.7x | 6.1x | 10.3x | 8.8x | 5.4% | 6.9% |
| TeliaSonera | TLSN.ST | SEK | EW | 48.90 | 46.00 | 25.0 | 11.4x | 10.9x | 6.3x | 6.1x | 10.4x | 9.8x | 6.5% | 7.2% |
| **ISRAEL TELECOMS** | | | | | | | | | | | | | | |
| Bezeq | BEZQ | ILS | OW | 4.70 | 5.5 | 2.1 | 7.3 | 7.9 | 5.1 | 5.5 | 7.3 | 7.8 | 21.8% | 20.5% |
| Cellcom | CEL | ILS | EW | 30.90 | 34.0 | 0.5 | 5.5 | 6.0 | 4.4 | 4.5 | 6.3 | 7.0 | 7.9% | 8.3% |
| Hot | HOT | ILS | UW | 34.66 | 35.0 | 0.4 | 36.4 | 37.7 | 3.9 | 4.0 | 16.3 | 15.3 | 0.0% | 0.0% |
| Partner | PTNR | ILS | OW | 18.37 | 22.0 | 0.5 | 5.8 | 5.7 | 4.5 | 4.4 | 6.1 | 5.8 | 9.6% | 8.8% |
| Israeli Median | | | | | | | 13.8 | 14.3 | 4.5 | 4.6 | 9.0 | 9.0 | 9.8% | 9.4% |
| EU Incumbent Median | | | | | | | 11.0 | 10.1 | 4.8 | 4.8 | 9.0 | 8.6 | 7.3% | 7.3% |
| EU Altnet/Other Median | | | | | | | 13.8 | 12.2 | 5.7 | 5.2 | 10.6 | 9.5 | 5.5% | 6.3% |

Source: Company reports, Barclays Research

## Unlimited is not the way to go

We argue that in launching unlimited plans below ILS 100 (€20), HOT Mobile and Golan Telecom made some miscalculations and underestimations that may create barriers to the long term success of the operations. These underestimations may also make the build of the required new network more costly to finance.

### *1) Underestimated the incumbent reaction*

In May, HOT Mobile and Golan Telecom launched no-contract unlimited plans for ILS 89 (€20) and ILS 99 (€18) respectively. The plans include unlimited voice, SMS, and data (with data speed reduced after reaching 3GB).

Although pricing in the industry has been in a downward spiral for over 15 months, the unlimited plans of BEZQ PTNR and CEL were still 2.7x more expensive at the time of the new launch in May.

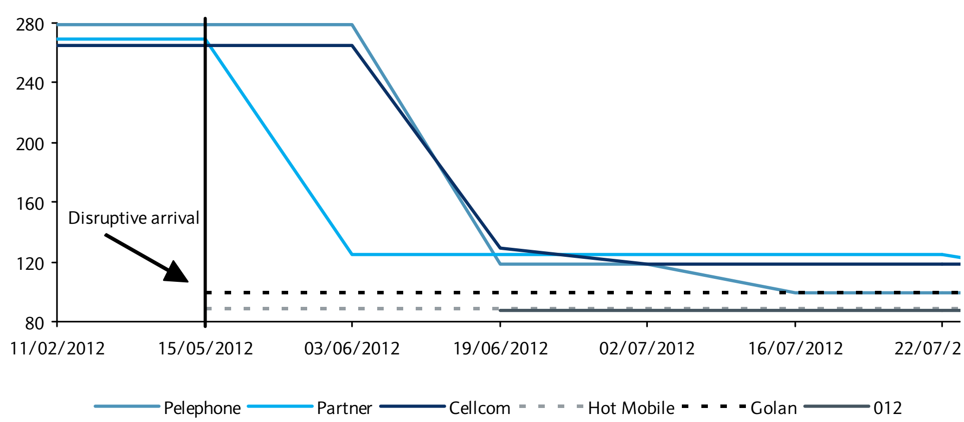
The first incumbent to react was PTNR: it took about 3 weeks before PTNR decreased its unlimited plan from ILS 269 to ILS 125 and to announce the launch of a sub-brand 012 Mobile with unlimited plans for ILS 88.

Bezeq also decreased its Pelephone plans from ILS 279 to ILS 119; with rebates to ILS 99 during the first year.

Cellcom launched a family plan costing about ILS 119 per family member.

The incumbents' response was quick: by matching the offers of the disruptive pricers, they slowed subscriber losses and reduced the value proposition introduced by the two new operators.

**Figure 2: Israel Mobile: Price evolution of unlimited mobile plans (ILS/month)**




Source: Company data, Barclays Research

### *2) Underestimated unlimited voice usage patterns*

HOT Mobile and Golan entered the market with disruptive pricing that was based on maintaining slight losses while winning market share and building out a new network. Two things stand in the way of that happening: 1) each currently uses wholesale agreements for the vast majority of network traffic as they build out a network 2) unlimited plans generate close to two times the amount of traffic that limited or "pay as you go" plans do.

In previous research reports we have argued that unlimited plans are only profitable if customers use less than 600 minutes, 600 SMS and 300 MB of data (see our report). By offering unlimited voice and SMS, MNOs boxed themselves in as low-cost high usage providers and have forfeited the potential for future price hikes.

**Figure 3: Israel unlimited plans**

| | Bezeq | Partner | Cellcom | Hot Mobile | Golan | 012 |
|---|---|---|---|---|---|---|
| **Price (ILS)** | **99** | **109** | **119** | **89** | **99** | **88** |
| Voice | UL | UL | UL | UL | UL | UL |
| SMS | UL | UL | UL | UL | UL | UL |
| Data | 1GB | 500MB | 1GB | 3GB* | 3GB* | 500MB |
| Additional services | | | | | UL Calls to 31 countries | |

*Based on fair usage
Source: Company data, Barclays Research

### Roaming on competitor networks isn't cheap

In the two figures below we break down the mobile termination rates (MTRs) which are the basis of the MNO wholesale cost model. We argue that the mobile termination rates are too high to allow the MNOs to generate a sustainable profit.

**Figure 4: Israel Mobile Termination Rates**

| Service | Cost (ILS) |
|---|---|
| Price for initiating a call (MTR -50%) | 0.035 |
| Price for call completion (MTR) | 0.070 |
| Price per MB of data (MTR -25%) | 0.053 |
| Price per SMS (SMS MTR) | 0.02 |

Source: Barclays Research

**Figure 5: MNO cost model**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Voice usage (mn) | 100 | 200 | 300 | 400 | 500 | 600 | 700 | 800 | 900 | 1000 |
| SMS usage (units) | 50 | 100 | 150 | 200 | 250 | 300 | 350 | 400 | 450 | 500 |
| Data usage (MB) | 100 | 200 | 300 | 400 | 500 | 600 | 700 | 800 | 900 | 1000 |
| **Cost to MNO (ILS)** | **13** | **27** | **40** | **53** | **66** | **80** | **93** | **106** | **119** | **133** |

Source: Barclays Research

### *3) Underestimated data usage*

The disruptive operators offer unlimited data in their €20 based on a fair usage; i.e. 3GB of usage then surf speed is decreased. This is 3-6x over the incumbents' offers of 500MB (PTNR, 012), and 1GB (BEZQ, CEL); who also charge for "overuse".

We estimate the data roaming cost for the MNOs to be ILS 0.053 per MB or ILS 53 per GB (see figure 3 below). This means that customers using between 1GB and 2GB imply a net loss for the MNOs even before they start using voice and SMS.

**Figure 6: Data Roaming MNO cost**

| Usage | 100 MB | 200 MB | 300 MB | 1GB | 2GB | 3GB |
|---|---|---|---|---|---|---|
| Cost (ILS) | 5.3 | 10.5 | 26.3 | 52.5 | 105 | 157.5 |

Source: Barclays Research

## And they still need to build out a network

HOT and Golan launched services with minimal 3G UMTS/HSPA mobile network infrastructure; this leads to a higher operating costs and lower free cash flow generation. Moreover, the lack of free cash flow means that the borrowing costs needed to build a new network may come at a high price. Presuming that the new network will cost in the range of $350m - $700m these concerns are significant.

**Building a network is very expensive**

HOT Mobile and Golan Telecom, are both in the process of rolling out nationwide 3G 2.1 GHz networks over 2x10MHz spectrum. The most recent roll out of a similar UMTS/HSPA+ network was by Pelephone over the course of 2008-2011. We estimate that the cost to Pelephone was c. EUR 100m.

Ahead of the roll out Pelephone already had a CDMA network running on 850MHz band over 2x10MHz spectrum and a tower infrastructure that included 1500 towers. This made the upgrade to UMTS relatively inexpensive as it needed to add only 600 new towers. The rest of the cost was in carriers and not the more costly cell splitting. The new MNOs are likely to be facing similar investments over the next five years (according to the license agreement with the government).

HOT and Golan acquired their mobile licenses through a tender. HOT was awarded the first license for ILS 705m (EUR 140m) and Golan the second license for ILS 360m (EUR 72m). According to the tender's terms if the new MNOs achieve a 7% market share within 5 years the tender and licence fees will be reimbursed.

We take a shot at estimating how much HOT and Golan will spend on building their wireless networks (see appendix for detailed calculations). When building a mobile network, much of the cost in greenfield operation is in the tower construction which we estimate is c.€100k per radio site. Once the sites are built, operators can add additional frequencies and carriers, often requiring additional backhaul/power.

We estimate that Golan will need approximately 2,000 radio sites to cover the country, implying an expense of c. €210m (c. ILS 1bn). To this we need to add the cost of acquiring extra spectrum as they grow.

HOT's situation is slightly different since it can use the MIRS (acquired in July 2011) network with its 600 radio sites as a starting point. We estimate that HOT will need to spend c. €162m (c. ILS 810m) to build approximately 1,500 additional radio sites.

Our calculations are based on what Bezeq spent on network development/upgrade over the past few years as well as on the proprietary research of our colleagues, found in the appendix.

## Reiterating out Negative sector view

Our Negative industry rating is based on continuing competitive pressure in the mobile sector and imminent new competition in fixed line. The changes and the intense competition lead to our modelling for net income to fall over 5% in 2013.

We prefer the Technology and Energy industries to Telecoms. In technology we see growth opportunities across the hardware, semis and chip companies as the need to deal with big data grows. The energy sector will begin producing positive cash flows in 2013 once the local natural gas resources begin commercial production.

## Why Israel is different

We examine similar cases of disruptive pricing plans across Europe. In particular, the markets where “disrupters”/”challengers” like Iliad and 3 Europe have an impact. We conclude that the business models implemented there do not copy to Israel despite the success in Israel. We also note that France proves a better comparison than the others for two reasons. 1) Israeli and French new network operators all launched in 2012 and are all building greenfield 3G networks. 2) The new mobile businesses of Iliad and HOT are in addition to existing fixed line networks whose FCF is used as a counter balance to the initial investment phase of the mobile network.

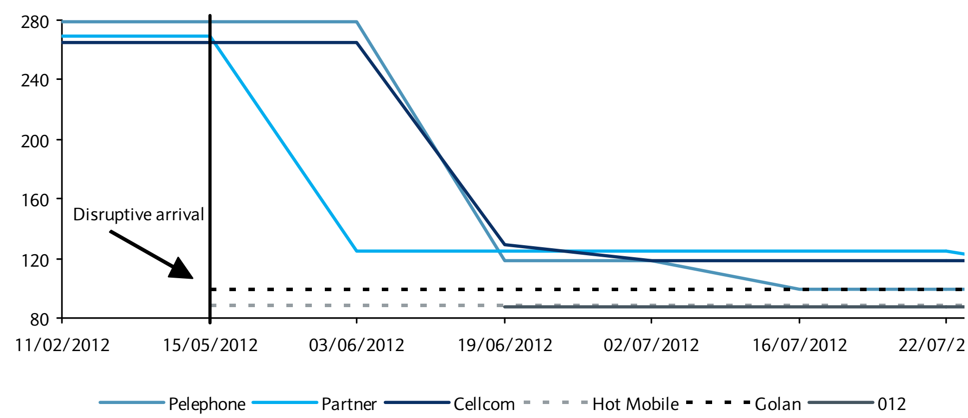
### *1) Narrow price gap*

In Israel

Although the new MNO’s arrivals brought prices down c. 55% for unlimited plans (see fig. 1), the price gap with the incumbents is not significant enough to make the new MNOs truly attractive. The ILS 89 and ILS 99 for unlimited plans at HOT and Golan compare with ILS 99 at Bezeq, ILS 109 at Partner and ILS 119 at Cellcom. Customers might be discouraged to switch operators for such a small difference.

It is important to note that the new operators are essentially sim-only operators and offer handsets from third party equipment retailers. The handsets are not subsidized and the ability to subsidize lies with the retailers and not with HOT and Golan.

**Figure 7: Israel Mobile: Price evolution of unlimited mobile plans (ILS/month)**




Source: Company data, Barclays

In France

This compares with the launch by Iliad of unlimited mobile plans on the French market. Although French incumbents (FT, SFR, Bouygues Telecom) have lowered the prices of their unlimited mobile plans by c.35% since Iliad’s arrival, those are still c. 2-2.5x more expensive than Iliad’s prices. The Incumbents have however launched sub-brands (Sosh, Red and B&You) that are priced very closely to Iliad’s prices.

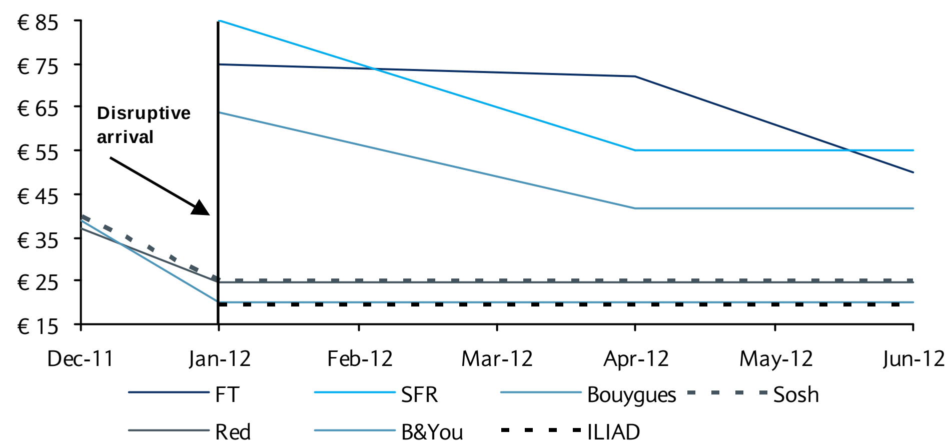
In Austria

Austria has experienced a similar development where aggressive pricing by Orange and Austria 3 Network has resulted in rapid pricing declines and brand segmentation. The situation is now similar to France where "no-frills" brands are now priced similarly to aggressive players and premium brands are still at a significant premium. For the incumbent operators this has resulted in years of service revenue declines as offers such as 1000Mins, 1000SMS and 1GB of data have been prolific and caused cannibalization of their premium brands.

In UK, Italy, Denmark, and Sweden

Pricing in all of these countries has eroded with 3 Europe leading the charge. Where it differs from Israel is that the "challenger" 3 has aggressively subsidised handsets and committed capital in an effort to win market share, while in Israel the "challengers" are sim only, and the "incumbents" have stopped all subsidies. See ("European Telcos: 3 Europe (not covered) - Continuing to commit capital")

**Figure 8: French Mobile: Price evolution of unlimited mobile plans (€/month)**




Source: Barclays Research

*2) No network infrastructure*

In Israel

HOT and Golan had a requirement to roll out 10% of network coverage prior to launching service. With minimal coverage and relatively only a small market share (c. 100k clients for Golan and c. 350k for HOT) the amount of calls generated on competing networks and completing on competing networks is high. This raises the costs for the new operators and minimizes the profit.

In France

Iliad already had 27% network coverage prior to launching commercial mobile services. This was a requirement by the French regulator when Iliad acquired the 3G license for EUR242.7m.

In UK, Italy, Denmark, Austria and Sweden

The networks in these countries are all fully built out 3G UMTS/HSPA networks. This creates more efficiencies in the business model and allows for further price erosion.

### *3) Mobile termination rates impact income as well as costs*

In Israel

Israel has symmetric Mobile Termination Rates (MTRs), in other words, all operators pay the same amount for calls completed on competing networks (see fig. 4). This places HOT and Golan at a disadvantage to peers. The disadvantage is based on the fact that HOT and Golan have relatively few customers and so pay out a larger amount of MTRs for calls completed on competing networks than they receive for calls completed on their own network.

In France

This compares with the asymmetric MTR rates granted to Iliad to allow the company to compete in the first few years while increasing market share.

**Figure 9: French MTRs**

| MTRs ( c€/min) | 1 July to 31 December 2011 | 1 January to 30 June 2012 | 1 July to 31 December 2012 | 1 January to 31 December 2013 |
|---|---|---|---|---|
| French Incumbents | 2.0 | 1.5 | 1.0 | 0.8 |
| Iliad | N/A | 2.4 | 1.6 | 1.1 |

Source: Arcep, Barclays Research

In UK, Italy, Denmark, Austria and Sweden

These examples all began with asymmetric MTRs but have slowly made there way to symmetry.

### *4) No cushion from fixed line infrastructure.*

In Israel

Based on the reasons above, we believe the Israeli MNOs will struggle to gain significant market share and generate enough FCF to finance their wireless networks.

This is particularly true for Golan Telecom, which is a pure mobile play and therefore doesn't have any other income source. As a private company though, the depth of the balance sheet and the ultimate ability to sustain losses is an unknown entity.

HOT is different from Golan since it has a fixed line business that provides FCF to fund investment. Nevertheless, we believe that once the wholesale market is opened that market dynamics will change (see our Bezeq note; "*Time to look deeper at the opportunity*", dated August 6th) and that HOT's FCF from fixed line will fall.

In France

This compares with Iliad's strong position in the French wireline market, with over 20% market share over several years prior to launching its mobile offering.

In UK, Italy, Denmark, Austria and Sweden

The 3 Group is mobile only and so like Golan requires a well capitalized balance sheet to fund investment in the mobile business

## Opening the fixed line market to wholesale creates opportunity for some and challenges for others

Bezeq remains our top pick for the sector and we continue to prefer PTNR to CEL in the mobile sector. We upgrade CEL to EW from UW and downgrade HOT to UW from EW believing that CEL will out perform HOT over the next 12 months.

### Bezeq still the top pick

Bezeq is the strongest and best managed and has significant cost savings opportunities from regulatory relaxation over the next 12-18 months. We reiterate our OW rating on Bezeq.

Bezeq's dividend yield of 21% in 2013e is made up of the regular dividend of ILS 0.60 and capital reduction paid out in cash of ILS 0.97. While the yield does stand out we point out that it is not coming at the expense of investing in Bezeq's future. Bezeq invested in a new UMTS network, new fibre network and will be investing additional infrastructure to shorten the "last mile" over the next few years.

The cost savings opportunities are tied closely to the regulatory decision to open the fixed line to wholesale/bitstream access. On the one hand, Bezeq will sign agreements with Partner, Cellcom and any other potential third party fixed line operator to allow them to offer television, broadband and telephony services over fibre. On the other hand, the regulator said that it will remove the current corporate structural separation at Bezeq "within" nine months from when a bitstream access agreement is signed. We already model ILS 200m in savings during 2014 vs. 2013 but believe that in a best case scenario the savings could be 3x that.

### We downgrade HOT to UW from EW

We believe HOT's investment in its mobile business plus the expected pricing pressure on FCF from the fixed plans will prove challenging in 2013. We therefore downgrade HOT to UW from EW and lower our PT to ILS 35.

HOT's two main challenges are connected. The first challenge is to increase mobile market share in a highly competitive market while building out and upgrading the network to 3G. The second challenge is related to the fixed line which is going to be opened to operators through whole sale agreements.

For specifics on the mobile challenges we refer you to pages 1-8 of this research note where we lay out what is going on in the Israeli market and why we believe it is different than other European markets.

Fixed line markets in Israel are about to undergo some significant changes. The first is the regulatory requirement to open fixed line infrastructure to new competition. This means that Bezeq and HOT will need to come to agreements with Cellcom, Partner and any other third party service provider on a price for wholesale/bitstream access. We believe that Bezeq will win more wholesale market share than will HOT and that HOT's 2013 FCF generation from the fixed line will suffer. It will decline for three reasons: 1) as more service providers enter the triple play market (TV, broadband and telephony) the prices will fall. For the past five years HOT has been the only operator in Israel allowed to offer a subsidized triple play, and that will end in 2013. 2) Revenues from wholesale will mitigate some of the lower revenues from subscribers but it is our view that HOT's share of the whole sale market will not be significant.

See our note: "*Time to look deeper at the opportunity*", dated August 6th for full implications of regulatory updates.

### *Cool's tender offer not HOT enough*

On 26 August, Cool Holdings submitted a tender for the remaining 30.75% of HOT's outstanding shares at a price of ILS 37. According to the letter by Cool Holdings, the offer implies a valuation of ILS 2,700m and a 12.5% premium over the average share price during the month of July. Cool set no time frame set for completing the tender other than to say that it hoped to do so within 30 days.

We believe that the first tender offer attempt to take HOT private at a 12.5% premium (as close of 23 August) will not be enough to entice investors to give up their shares. Although in our view the price is fair. On the other hand, we do not believe that HOT's owners "Cool Holdings" will improve the offer and so we believe that the tender offer may not be successful. In our view, HOT is facing a challenging next 12 months as all of its markets are faced with high levels of competition and approaching changes in regulation and we see the ILS 37 offer as appropriate and in-line with our price target of ILS 35.

### *Changes to our model*

We leave our revenues forecast practically unchanged at ILS 4,180m and ILS 4,479m for 2012 and 2013 versus ILS 4,171m and ILS 4,493m previously forecasted.

On the cost side, we have increased our depreciation and amortisation expenses from ILS 943m to ILS 1,039 in 2012 and from ILS 983m to ILS 1,074m in 2013.

We have also increased our share based compensation expense forecast to ILS 41m up from our ILS 7m in 2012 and to ILS 40m in 2013 up from no compensation expense.

Our operating profit drops to ILS 439m in 2012 (15.0% operating margin) from ILS 625m and to ILS 403m (15.4% operating margin) in 2013E down from ILS 690m.

Our new net income forecast is now ILS 74m and ILS 71m in 2012 and 2013 respectively, down from ILS 255m and ILS 301m.

**EPS for 2012 and 2013 are now ILS 0.95 and ILS 0.92 versus our previous ILS 3.29 and ILS 3.88.**

Figure 10: HOT Changes to the model

| P&L (ILSm) | | | |
|---|---|---|---|
| **New** | **2011** | **2012** | **2013** |
| Revenues | 3374.0 | 4180.2 | 4478.6 |
| Operating Costs | 1996.0 | 2661.1 | 2961.5 |
| EBITDA | 1378.0 | 1519.1 | 1517.1 |
| Depreciation and Amortization | 841.0 | 1039.3 | 1073.7 |
| Operating Profit | 640.0 | 438.9 | 403.5 |
| Net Income (Reported) | 328.0 | 73.7 | 71.5 |
| Net Income Excl one-offs | 341.0 | 73.7 | 71.5 |
| Basic EPS (ILS) | 4.4 | 0.95 | 0.92 |
| Capex | 539.0 | 1158.0 | 1119.7 |
| OpFCF | 839.0 | 361.2 | 397.5 |
| **Old** | | | |
| Revenues | 3374.0 | 4171 | 4493 |
| Operating Costs | 1996.0 | 2596 | 2819 |
| EBITDA | 1378.0 | 1575 | 1673 |
| Depreciation and Amortization | 841.0 | 943 | 983 |
| Operating Profit | 640.0 | 625 | 690 |
| Net Income (Reported) | 328.0 | 255 | 301 |
| Net Income Excl one-offs | 341.0 | 255 | 301 |
| Basic EPS (ILS) | 4.4 | 3.29 | 3.88 |
| Capex | 539.0 | 1,276 | 1,348 |
| OpFCF | 839.0 | 886.4 | 835.3 |
| **Change (%)** | | | |
| Revenues | | 0.2 | -0.3 |
| Operating Costs | | 2.5 | 5.1 |
| EBITDA | | -3.5 | -9.3 |
| Depreciation and Amortization | | 10.2 | 9.2 |
| Operating Profit | | -29.8 | -41.5 |
| Net Income (Reported) | | -71.1 | -76.3 |
| Net Income Excl one-offs | | -71.1 | -76.3 |
| Basic EPS (ILS) | | -71.2 | -76.3 |
| Capex | | -9.2 | 16.9 |
| OpFCF | | -59.3 | -52.4 |

Source: Company reports, Barclays

## We upgrade CEL to EW from UW

We see the wholesale market creating opportunities for CEL and PTNR as they enter the fixed line through "triple play" and begin to market IPTV. Though BEZQ will face some of the same challenges as HOT the opening of the market will unlock large efficiency opportunities for BEZQ. Cellcom's skipping of the 2Q 12 dividend was, in our view, a prudent step towards strengthening the balance sheet and putting the company on a track to de-lever. We increase our 2013 EPS estimates for CEL to ILS 5.11 from ILS 4.96, upgrade the stock to EW from UW and raise our price target to ILS 34 from ILS 24.

### *Changes to our model*

We have increased mobile churn from 26% to 30.6% in 2012 and 32.4% in 2013.

We further decrease mobile net subscriber losses from -49k to -56k, reducing total subscribers from 3,398 to 3,293 in 2012; for 2013 we lower net subscriber losses to -40k from 58k, reducing our total subscriber base to 3,253 from. 3,446.

We maintain mobile ARPU unchanged at ILS 88 in 2012 and ILS 79 in 2013.

We decrease equipment sales down to ILS 1,177m from ILS 1,565m in 2012 to ILS 1,026m from ILS 1,593m in 2013.

We maintain mobile operating margins at 19%.

Mobile revenues decrease to ILS 4,755m from ILS 5,155m in 2012 and to ILS 4,151m from ILS 4,832m in 2013. The decrease is mainly driven by lower handset sales. The first half of 2012 has seen a change in the market as Cellcom and its peers have moved away from handset subsidies. In the long run, this will prove to be positive for margins.

We maintain our fixed line business forecast unchanged.

We reduce CEL dividends payout ratio down from 75% to 50% in 2012 and 2013.

Our EPS forecast decrease to ILS 5.57 down from ILS 5.68 in 2012 and up to ILS 5.11 from ILS 4.96 in 2013.

Figure 11: CEL Changes to the model

| New (ILSm) | 2011 | 2012E | 2013E |
|---|---|---|---|
| Net Sales | 6,506 | 5,849 | 5,283 |
| Gross Profit | 3,098 | 2,508 | 2,264 |
| Depreciation, amortization and impairment losses | - 738 | - 735 | - 728 |
| Sales and marketing | 990 | 818 | 779 |
| Gen and admin | 685 | 609 | 578 |
| Total Opex | 1,675 | 1,426 | 1,357 |
| Operating Income | 1,422 | 1,087 | 995 |
| Income after financial items | 1,129 | 751 | 678 |
| Net income | 825 | 554 | 508 |
| Reported diluted EPS | ILS 8.29 | ILS 5.57 | ILS 5.11 |
| Operating free cash flow | 999 | 945 | 813 |
| **Old** | **2011** | **2012E** | **2013E** |
| Net Sales | 6,506 | 5,868 | 5,462 |
| Gross Profit | 3,098 | 2,486 | 2,311 |
| Depreciation, amortization and impairment losses | - 738 | - 680 | - 680 |
| Sales and marketing | 990 | 821 | 808 |
| Gen and admin | 685 | 609 | 599 |
| Total Opex | 1,675 | 1,429 | 1,408 |
| Operating Income | 1,422 | 1,065 | 976 |
| Income after financial items | 1,129 | 754 | 658 |
| Net income | 825 | 565 | 493 |
| Reported diluted EPS | ILS 8.29 | ILS 5.68 | ILS 4.96 |
| Operating free cash flow | 999 | 625 | 1,075 |
| **Change (%)** | **2011** | **2012E** | **2013E** |
| Net Sales | | -0.3 | -3.3 |
| Gross Profit | | 0.9 | -2.0 |
| Depreciation, amortization and impairment losses | | 8.1 | 7.1 |
| Sales and marketing | | -0.4 | -3.6 |
| Gen and admin | | 0.0 | -3.6 |
| Total Opex | | -0.2 | -3.6 |
| Operating Income | | 2.1 | 2.0 |
| Income after financial items | | -0.4 | 3.0 |
| Net income | | -2.0 | 3.0 |
| Reported diluted EPS | | -2.0 | 3.0 |
| Operating free cash flow | | 51.1 | -24.4 |

Source: Company reports, Barclays

## We reiterate our OW rating on PTNR

PTNR will be a beneficiary of a new wholesale market that is likely to begin operating in early 2013. The wholesale market will allow PTNR to launch IPTV services and compete with Bezeq and HOT and offer a triple play (TV, broadband and telephony) to its customers without having to carry the heavy load of capex development. Beyond the opportunities on the top line PTNR has plenty of opportunities on the cost side. Its merger with 012 Smile has not yet been fully implemented leaving room for cost savings in 2013. We reiterate our OW rating on PTNR.

*Changes to our model*

We slightly decrease 2012 total sales to ILS 5,838m from ILS 6,011m, and 2013 to ILS m from ILS 5,251m.

In the mobile segment, we leave ARPU unchanged at ILS 98 in 2012 and 89 in 2013. We lower our equipment sales forecast to ILS 929m from ILS 1,131 in 2012 and to ILS 827m from ILS 1,128m in 2013. As a result, mobile revenues decrease to ILS 4,613m from ILS 4,837m in 2012 and to ILS 4,059m from ILS 4,495m in 2013.

We leave EBITDA relatively unchanged at ILS1,665m in 2012 compared to our previous ILS1,699m and at ILS 1,591m in 2013 compared to our previous ILS 1,637m.

We increase our net income forecast to ILS 493m and ILS 502m in 2012 and 2013, compared to our previous ILS 428m and ILS 389m respectively.

Our EPS for 2012 is now ILS 3.18 up from our previous ILS2.75; and ILS 3.22 in 2013 compared to our previous ILS 2.49.

### Figure 12: PTNR Changes to the model

| New | 2011 | 2012E | 2013E |
|---|---|---|---|
| Net Sales | 6998 | 5838 | 5251 |
| Gross Profit | 2020 | 1782 | 1536 |
| Depreciation, amortisation and impairment losses | -782 | -686 | -626 |
| Sales and marketing | 711 | 656 | 461 |
| Gen and admin | 291 | 288 | 203 |
| Total Opex | 1107 | 815 | 571 |
| Operating Income | 1036 | 967 | 965 |
| Income after financial items | 742 | 690 | 670 |
| Net income | 443 | 493 | 502 |
| Diluted EPS | ILS 2.82 | ILS 3.18 | ILS 3.22 |
| Operating free cash flow | 1221 | 550 | 703 |
| **Old** | **2011** | **2012E** | **2013E** |
| Net Sales | 6998 | 6011 | 5698 |
| Gross Profit | 2020 | 1698 | 1623 |
| Depreciation, amortisation and impairment losses | -782 | -698 | -667 |
| Sales and marketing | 711 | 597 | 553 |
| Gen and admin | 291 | 264 | 244 |
| Total Opex | 1107 | 756 | 700 |
| Operating Income | 1036 | 942 | 923 |
| Income after financial items | 742 | 569 | 519 |
| Net income | 443 | 428 | 389 |
| Diluted EPS | ILS 2.82 | ILS 2.75 | ILS 2.49 |
| Operating free cash flow | 1221 | 446 | 580 |
| **Change (%)** | **2011** | **2012E** | **2013E** |
| Net Sales | 0.0 | -2.9 | -7.8 |
| Gross Profit | 0.0 | 5.0 | -5.4 |
| Depreciation, amortisation and impairment losses | 0.0 | -1.8 | -6.2 |
| Sales and marketing | 0.0 | 9.8 | -16.5 |
| Gen and admin | 0.0 | 9.3 | -17.0 |
| Total Opex | 0.0 | 7.8 | -18.5 |
| Operating Income | 0.0 | 2.6 | 4.6 |
| Income after financial items | 0.0 | 21.2 | 29.1 |
| Net income | 0.0 | 15.0 | 29.1 |
| Diluted EPS | 0.0 | 15.4 | 29.1 |
| Operating free cash flow | 0.0 | 23.4 | 21.2 |

Source: Company reports, Barclays

# COMPANY SNAPHOTS

## COMPANY SNAPSHOT

Bezeq — Israel Telecom Services

| Income statement (ILSmn) | 2011A | 2012E | 2013E | 2014E | CAGR |
|---|---|---|---|---|---|
| Revenue | 11,373 | 10,464 | 10,088 | 9,880 | -4.6% |
| EBITDA | 4,637 | 4,480 | 4,253 | 4,259 | -2.8% |
| EBIT | 3,242 | 3,052 | 2,894 | 2,992 | -2.6% |
| Finance costs - net | -210 | -198 | -286 | -314 | N/A |
| Pre-tax income | 2,816 | 2,517 | 2,438 | 2,312 | -6.4% |
| Tax rate (%) | 26.8 | 28.5 | 32.3 | 32.0 | 6.1% |
| Net income | 2,061 | 1,801 | 1,650 | 1,571 | -8.6% |
| EPS (reported) (ILS) | 0.76 | 0.65 | 0.60 | 0.57 | -9.4% |
| Diluted shares (mn) | 2,825.0 | 2,825.0 | 2,825.0 | 2,825.0 | 0.0% |
| DPS (ILS) | 1.13 | 1.02 | 0.96 | 0.57 | -20.5% |

| Margin and return data | | | | | Average |
|---|---|---|---|---|---|
| EBITDA margin (%) | 40.8 | 42.8 | 42.2 | 43.1 | 42.2 |
| EBIT margin (%) | 28.5 | 29.6 | 28.9 | 28.6 | 28.9 |
| Pre-tax margin (%) | 24.8 | 24.1 | 24.2 | 23.4 | 24.1 |
| Net margin (%) | 18.1 | 17.2 | 16.4 | 15.9 | 16.9 |
| Operating CF margin (%) | 28.0 | 33.7 | 31.9 | 30.8 | 31.1 |
| ROIC (%) | 22.3 | 16.9 | 14.6 | 17.1 | 17.8 |
| RONTA (%) | N/A | N/A | N/A | N/A | N/A |
| ROA (%) | 15.0 | 12.7 | 11.6 | 12.9 | 13.1 |
| ROE (%) | 51.2 | 78.9 | 78.5 | 89.5 | 74.5 |

| Balance sheet and cash flow (ILSmn) | | | | | CAGR |
|---|---|---|---|---|---|
| Tangible fixed assets | 6,022 | 6,089 | 5,996 | 5,959 | -0.3% |
| Intangible fixed assets | 2,369 | 2,203 | 2,203 | 2,203 | -2.4% |
| Cash and equivalents | 1,352 | 1,716 | 567 | 310 | -38.8% |
| Total assets | 17,331 | 17,162 | 15,805 | 15,397 | -3.9% |
| Short and long-term debt | 9,578 | 11,025 | 10,825 | 10,625 | 3.5% |
| Other long-term liabilities | 1,246 | 774 | 774 | 774 | -14.7% |
| Total liabilities | 14,643 | 15,284 | 14,889 | 14,460 | -0.4% |
| Net debt/(funds) | 7,280 | 8,691 | 9,660 | 9,736 | 10.2% |
| Shareholders' equity | 2,688 | 1,878 | 915 | 936 | -29.6% |
| Cash flow from operations | 3,186 | 3,530 | 3,216 | 3,038 | -1.6% |
| Capex and acquisitions | -4,772 | -1,848 | -1,266 | -1,230 | N/A |
| Free cash flow | 1,638 | 2,163 | 1,950 | 1,808 | 3.3% |
| NOPAT | 2,373 | 2,183 | 1,959 | 2,034 | -5.0% |

| Valuation and leverage metrics | | | | | Average |
|---|---|---|---|---|---|
| P/E (reported) (x) | 6.2 | 7.3 | 8.0 | 8.4 | 7.5 |
| EV/EBITDA (x) | 4.5 | 4.8 | 5.3 | 5.5 | 5.0 |
| Equity FCF yield (%) | 12.2 | 16.1 | 14.5 | 13.5 | 14.1 |
| EV/sales (x) | 1.8 | 2.1 | 2.2 | 2.4 | 2.1 |
| P/BV (x) | 5.0 | 7.1 | 14.7 | 14.3 | 10.3 |
| Dividend yield (%) | 23.8 | 21.6 | 20.3 | 12.0 | 19.4 |
| Total debt/capital (%) | 78.1 | 85.4 | 92.2 | 91.9 | 86.9 |
| Net debt/EBITDA (x) | 1.6 | 1.9 | 2.3 | 2.3 | 2.0 |

**Selected operating metrics**

| | |
|---|---|
| Stock Rating | OVERWEIGHT |
| Industry View | NEGATIVE |
| Price (19-Sep-2012) | ILS 4.75 |
| Price Target | ILS 5.50 |
| Ticker | BEZQ.TA |

**Investment case**

**Why Overweight?** Bezeq is Israel's largest telecom operator. Despite the challenges that the industry faces, we view Bezeq as the most likely to outperform. Its advantages stem from the fact that it owns infrastructure in all four of its operating businesses.

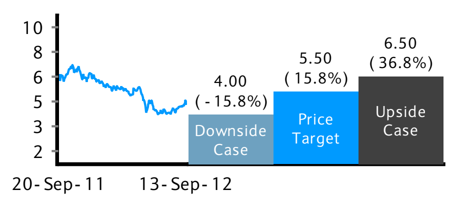
**Upside case** — **ILS 6.50**

The main catalyst in our upside case is the potential synergies that would be brought about by a removal of structural separation. We do not give this a very high probability although it is currently being discussed by the government sponsored Hayek Committee.

**Downside case** — **ILS 4.00**

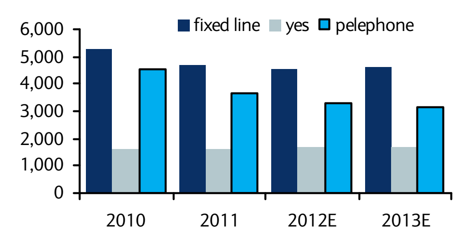
The downside case scenario sees the mobile business enter into significant pricing wars with its competitors that may drag on results and require the company to find a new strategy.

**Upside/Downside scenarios**




Source: Barclays Research

**Service Revenues (ILSm)**




Source: Company Data, Barclays Research

Source: Company data, Barclays Research
Note: FY End Dec

## COMPANY SNAPSHOT

Cellcom Israel Ltd. | Israel Telecom Services

| Income statement (ILSmn) | 2011A | 2012E | 2013E | 2014E | CAGR |
|---|---|---|---|---|---|
| Revenue | 6,506 | 5,849 | 5,283 | 5,201 | -7.2% |
| EBITDA | 2,163 | 1,822 | 1,724 | 1,737 | -7.1% |
| EBIT | 1,425 | 1,087 | 995 | 980 | -11.7% |
| Finance costs - net | -293 | -337 | -318 | -318 | N/A |
| Pre-tax income | 1,129 | 751 | 678 | 662 | -16.3% |
| Tax rate (%) | 26.9 | 26.2 | 25.0 | 25.0 | -2.4% |
| Net income | 825 | 554 | 508 | 497 | -15.6% |
| EPS (reported) (ILS) | 8.29 | 5.57 | 5.11 | 4.99 | -15.6% |
| Diluted shares (mn) | 99.5 | 99.5 | 99.5 | 99.5 | 0.0% |
| DPS (ILS) | 7.90 | 2.44 | 2.55 | 2.50 | -31.9% |
| **Margin and return data** | | | | | **Average** |
| EBITDA margin (%) | 33.2 | 31.2 | 32.6 | 33.4 | 32.6 |
| EBIT margin (%) | 21.9 | 18.6 | 18.8 | 18.8 | 19.5 |
| Pre-tax margin (%) | 17.4 | 12.8 | 12.8 | 12.7 | 13.9 |
| Net margin (%) | 12.7 | 9.5 | 9.6 | 9.5 | 10.3 |
| Operating CF margin (%) | 20.5 | 25.7 | 26.7 | 30.7 | 25.9 |
| ROIC (%) | 19.0 | 9.4 | 7.9 | 7.7 | 11.0 |
| RONTA (%) | N/A | N/A | N/A | N/A | N/A |
| ROA (%) | 11.3 | 6.2 | 5.5 | 5.1 | 7.0 |
| ROE (%) | 312.5 | 116.9 | 99.6 | 86.2 | 153.8 |
| **Balance sheet and cash flow (ILSmn)** | | | | | **CAGR** |
| Tangible fixed assets | 2,168 | 2,116 | 2,133 | 1,952 | -3.4% |
| Intangible fixed assets | 1,680 | 1,632 | 1,686 | 1,735 | 1.1% |
| Cash and equivalents | 920 | 1,053 | 1,231 | 1,950 | 28.5% |
| Total assets | 8,557 | 9,340 | 9,735 | 10,334 | 6.5% |
| Short and long-term debt | 6,276 | 6,702 | 6,702 | 6,702 | 2.2% |
| Other long-term liabilities | 246 | 251 | 268 | 284 | 4.9% |
| Total liabilities | 8,370 | 8,865 | 9,188 | 9,544 | 4.5% |
| Net debt/(funds) | -5,356 | -4,675 | -4,497 | -3,778 | N/A |
| Shareholders' equity | 187 | 474 | 547 | 789 | 61.6% |
| Cash flow from operations | 1,332 | 1,502 | 1,413 | 1,598 | 6.3% |
| Capex and acquisitions | -333 | -557 | -600 | -424 | N/A |
| Free cash flow | 999 | 945 | 813 | 1,174 | 5.5% |
| NOPAT | 825 | 554 | 508 | 497 | -15.6% |
| **Valuation and leverage metrics** | | | | | **Average** |
| P/E (reported) (x) | 3.8 | 5.7 | 6.2 | 6.4 | 5.5 |
| EV/EBITDA (x) | 4.0 | 4.4 | 4.6 | 4.2 | 4.3 |
| Equity FCF yield (%) | 31.6 | 29.9 | 25.7 | 37.2 | 31.1 |
| EV/sales (x) | 1.3 | 1.4 | 1.5 | 1.4 | 1.4 |
| P/BV (x) | 16.9 | 6.7 | 5.8 | 4.0 | 8.3 |
| Dividend yield (%) | 24.9 | 7.7 | 8.0 | 7.9 | 12.1 |
| Total debt/capital (%) | 97.1 | 93.4 | 92.5 | 89.5 | 93.1 |
| Net debt/EBITDA (x) | 2.5 | 2.6 | 2.6 | 2.2 | 2.5 |

**Selected operating metrics**

Source: Company data, Barclays Research
Note: FY End Dec

| | |
|---|---|
| Stock Rating | **EQUAL WEIGHT** |
| Industry View | **NEGATIVE** |
| Price (19-Sep-2012) | **ILS 31.75** |
| Price Target | **ILS 34.00** |
| Ticker | **CEL.TA** |

### Investment case

**Why Equal Weight?** The mobile sector seems to be stabilizing after facing severe pressure from pricing competition that was brought on even prior to disruptive MVNOs launching service.

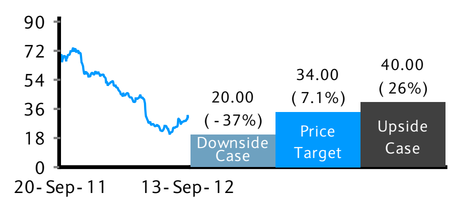
### Upside case — ILS 40.00

In the upside case we see value rising to ILS 40 assuming that it excution well on its entrance into the fixed line market that we expect will begin in 2013.

### Downside case — ILS 20.00

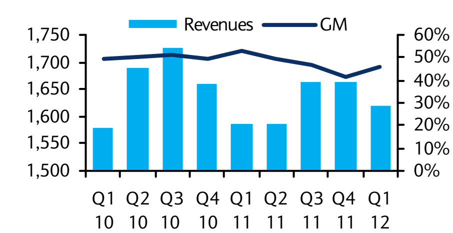
In our downside case, the potential increased competitive climate from MVNOs and MNOs may drive subscriber acquisition costs higher and revenue per minute lower, impacting Cellcom's profitability.

### Upside/Downside scenarios




Source: Barclays Research

### Revenues and GM (%)




Source: Company data, Barclays Research

## COMPANY SNAPSHOT

Hot Telecommunication System — Israel Telecom Services

| Income statement (ILSmn) | 2011A | 2012E | 2013E | 2014E | CAGR |
|---|---|---|---|---|---|
| Revenue | 3,374 | 4,180 | 4,479 | 4,695 | 11.6% |
| EBITDA | 1,378 | 1,519 | 1,517 | 1,528 | 3.5% |
| EBIT | 2,219 | 2,558 | 2,591 | 2,604 | 5.5% |
| Finance costs - net | 199 | 288 | 308 | 308 | 15.7% |
| Pre-tax income | 441 | 151 | 95 | 104 | -38.2% |
| Tax rate (%) | 22.7 | 51.1 | 25.0 | 25.0 | 3.3% |
| Net income | 328 | 74 | 71 | 78 | -38.0% |
| EPS (reported) (ILS) | 4.41 | 0.95 | 0.92 | 1.01 | -38.9% |
| Diluted shares (mn) | 77.7 | 77.7 | 77.7 | 77.7 | 0.0% |
| DPS (ILS) | 0.00 | 0.00 | 0.00 | 0.00 | N/A |

| Margin and return data | | | | | Average |
|---|---|---|---|---|---|
| EBITDA margin (%) | 40.8 | 36.3 | 33.9 | 32.5 | 35.9 |
| EBIT margin (%) | 65.8 | 61.2 | 57.8 | 55.5 | 60.1 |
| Pre-tax margin (%) | 13.1 | 3.6 | 2.1 | 2.2 | 5.3 |
| Net margin (%) | 9.7 | 1.8 | 1.6 | 1.7 | 3.7 |
| Operating CF margin (%) | 36.8 | 24.4 | 20.6 | 30.5 | 28.1 |
| ROIC (%) | 42.1 | 25.4 | 38.9 | 39.3 | 36.4 |
| RONTA (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| ROA (%) | 28.5 | 17.9 | 27.7 | 27.2 | 25.3 |
| ROE (%) | 19.0 | 4.3 | 4.5 | 5.0 | 8.2 |

| Balance sheet and cash flow (ILSmn) | | | | | CAGR |
|---|---|---|---|---|---|
| Tangible fixed assets | 3,763 | 4,171 | 4,217 | 4,314 | 4.7% |
| Intangible fixed assets | 2,101 | 2,082 | 2,082 | 2,082 | -0.3% |
| Cash and equivalents | 16 | 146 | -150 | 9 | -18.2% |
| Total assets | 6,663 | 7,286 | 7,233 | 7,260 | 2.9% |
| Short and long-term debt | 2,500 | 3,334 | 3,234 | 3,134 | 7.8% |
| Other long-term liabilities | 922 | 952 | 952 | 952 | 1.1% |
| Total liabilities | 4,732 | 5,815 | 5,651 | 5,560 | 5.5% |
| Net debt/(funds) | -2,484 | -3,188 | -3,384 | -3,125 | N/A |
| Shareholders' equity | 1,931 | 1,471 | 1,582 | 1,700 | -4.2% |
| Cash flow from operations | 1,240 | 1,021 | 923 | 1,433 | 4.9% |
| Capex and acquisitions | -539 | -1,158 | -1,120 | -1,174 | N/A |
| Free cash flow | 701 | -137 | -197 | 259 | -28.2% |
| NOPAT | 1,716 | 1,250 | 1,943 | 1,953 | 4.4% |

| Valuation and leverage metrics | | | | | Average |
|---|---|---|---|---|---|
| P/E (reported) (x) | 8.1 | 37.7 | 39.0 | 35.7 | 30.1 |
| EV/EBITDA (x) | 3.8 | 3.9 | 4.1 | 3.9 | 3.9 |
| Equity FCF yield (%) | 25.2 | -4.9 | -7.1 | 9.3 | 5.6 |
| EV/sales (x) | 1.6 | 1.4 | 1.4 | 1.3 | 1.4 |
| P/BV (x) | 1.4 | 1.9 | 1.8 | 1.6 | 1.7 |
| Dividend yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total debt/capital (%) | 56.4 | 69.4 | 67.1 | 64.8 | 64.4 |
| Net debt/EBITDA (x) | 1.8 | 2.1 | 2.2 | 2.0 | 2.0 |

**Selected operating metrics**

Source: Company data, Barclays Research
Note: FY End Dec

| | |
|---|---|
| Stock Rating | UNDERWEIGHT |
| Industry View | NEGATIVE |
| Price (19-Sep-2012) | ILS 35.87 |
| Price Target | ILS 35.00 |
| Ticker | HOT.TA |

**Investment case**

**Why Underweight?** HOT is positioned to compete with Bezeq across all infrastructures; however we believe that 1) increased competition on the fixed line side and 2) liquidity concerns and low trading volumes are weighing on the stock.

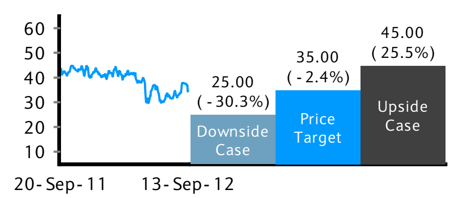
**Upside case** — **ILS 45.00**

The advantages of a quad play would be unmatched in the market and allow HOT significant competitive advantages over its peers. IF HOT were to be able to secure long term cheap financing we belive the stock could outperform.

**Downside case** — **ILS 25.00**

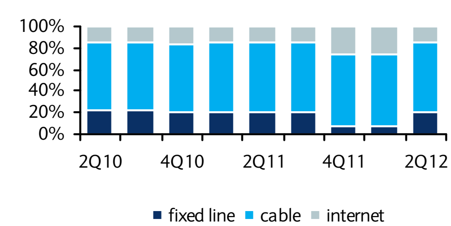
HOT's main risks lie in the financing requirements and capex needed to establish itself as a credible player in mobile while maintaining its positive momentum in fixed line.

**Upside/Downside scenarios**




Source: Barclays Research

**ARPU by segment (% of total)**




Source: Company data, Barclays Research

## COMPANY SNAPSHOT

Partner Communications Co. | Israel Telecom Services

| Income statement (ILSmn) | 2011A | 2012E | 2013E | 2014E | CAGR |
|---|---|---|---|---|---|
| Revenue | 6,998 | 5,838 | 5,251 | 5,215 | -9.3% |
| EBITDA | 2,178 | 1,665 | 1,591 | 1,578 | -10.2% |
| EBIT | 1,396 | 979 | 245 | 243 | -44.2% |
| Finance costs - net | -294 | -277 | -296 | -268 | N/A |
| Pre-tax income | 742 | 690 | 670 | 707 | -1.6% |
| Tax rate (%) | 40.3 | 28.6 | 25.0 | 25.0 | -14.7% |
| Net income | 443 | 493 | 502 | 530 | 6.2% |
| EPS (reported) (ILS) | 2.82 | 3.18 | 3.22 | 3.43 | 6.7% |
| Diluted shares (mn) | 155.6 | 155.1 | 156.1 | 154.6 | -0.2% |
| DPS (ILS) | 2.25 | 1.76 | 1.61 | 1.71 | -8.7% |
| **Margin and return data** | | | | | **Average** |
| EBITDA margin (%) | 31.1 | 28.5 | 30.3 | 30.3 | 30.0 |
| EBIT margin (%) | 19.9 | 16.8 | 4.7 | 4.7 | 11.5 |
| Pre-tax margin (%) | 10.6 | 11.8 | 12.8 | 13.6 | 12.2 |
| Net margin (%) | 6.3 | 8.4 | 9.6 | 10.2 | 8.6 |
| Operating CF margin (%) | 22.4 | 17.1 | 20.3 | 24.8 | 21.2 |
| ROIC (%) | 70.8 | 115.9 | 87.4 | 78.0 | 88.0 |
| RONTA (%) | N/A | N/A | N/A | N/A | N/A |
| ROA (%) | 7.0 | 7.1 | 7.1 | 7.4 | 7.1 |
| ROE (%) | 84.3 | 88.0 | 65.8 | 55.3 | 73.4 |
| **Balance sheet and cash flow (ILSmn)** | | | | | **CAGR** |
| Tangible fixed assets | 2,051 | 2,049 | 2,209 | 2,369 | 4.9% |
| Intangible fixed assets | 1,290 | 1,171 | 910 | 666 | -19.8% |
| Cash and equivalents | 532 | 203 | 561 | 1,086 | 26.8% |
| Total assets | 7,087 | 6,847 | 7,175 | 7,614 | 2.4% |
| Short and long-term debt | 5,171 | 4,735 | 4,735 | 4,735 | -2.9% |
| Other long-term liabilities | 10 | 9 | 9 | 9 | -3.5% |
| Total liabilities | 6,662 | 6,159 | 6,169 | 6,329 | -1.7% |
| Net debt/(funds) | -4,639 | -4,532 | -4,093 | -3,649 | N/A |
| Shareholders' equity | 425 | 695 | 952 | 1,231 | 42.6% |
| Cash flow from operations | 1,570 | 998 | 1,068 | 1,294 | -6.2% |
| Capex and acquisitions | -349 | -449 | -365 | -359 | N/A |
| Free cash flow | 1,221 | 550 | 703 | 936 | -8.5% |
| NOPAT | 443 | 493 | 502 | 530 | 6.2% |
| **Valuation and leverage metrics** | | | | | **Average** |
| P/E (reported) (x) | 6.9 | 6.1 | 6.0 | 5.7 | 6.2 |
| EV/EBITDA (x) | 3.5 | 4.5 | 4.5 | 4.2 | 4.2 |
| Equity FCF yield (%) | 40.3 | 18.2 | 23.2 | 31.1 | 28.2 |
| EV/sales (x) | 1.1 | 1.3 | 1.4 | 1.3 | 1.3 |
| P/BV (x) | 7.1 | 4.3 | 3.2 | 2.4 | 4.3 |
| Dividend yield (%) | 11.6 | 9.1 | 8.3 | 8.8 | 9.4 |
| Total debt/capital (%) | 92.4 | 87.2 | 83.3 | 79.4 | 85.6 |
| Net debt/EBITDA (x) | 2.1 | 2.7 | 2.6 | 2.3 | 2.4 |

**Selected operating metrics**

| | |
|---|---|
| Stock Rating | OVERWEIGHT |
| Industry View | NEGATIVE |
| Price (19-Sep-2012) | ILS 19.45 |
| Price Target | ILS 22.00 |
| Ticker | PTNR.TA |

**Investment case**

**Why Overweight?** The mobile sector is under severe pressure from pricing competition that was brought on even prior to disruptive MVNOs launching service. However, we believe that PTNR's underperformance relative to CEL is unjustified.

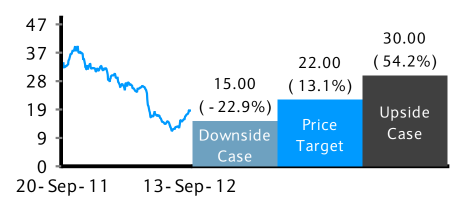
**Upside case** **ILS 30.00**

Our upside case takes into account margin recovery in the mobile business presuming that one of the new network operators fails. We also beloive that successful launch and executinon of its fixed line business would lead to further outperformance.

**Downside case** **ILS 15.00**

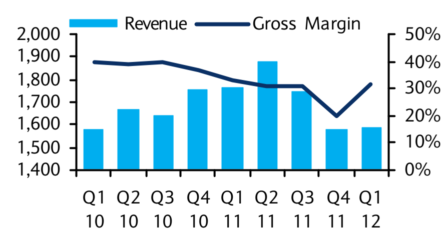
If we were to remove 012 from our valuation we would arrive at an ILS 31 valuation. We believe that investors are not yet ready to give PTNR credit for this acquistion and often view PTNR's volumes as making it untradeable.

**Upside/Downside scenarios**




Source: Barclays Research

**Revenue & Gross Margin (ILSm)**




Source: Company data, Barclays Research

Source: Company data, Barclays Research
Note: FY End Dec

## Appendix 1 - Economics of Mobile Data

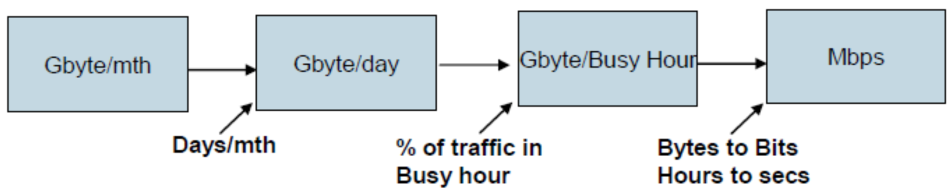
(This article was first published in *Watch out for Mobile Data MVNOs!* (20 September 2010). To view analysts' certifications and important disclosures, please refer to the report or click on the hyperlink above).

### *Costs*

Assessing the 'cost per Gbyte per month' is more complicated. First, the cost of a network varies with peak capacity (in Mbps), not the average over a period. Second, the cost of adding capacity varies with the amount of spectrum, the network architecture, and technology itself.

1) **Peak capacity and average per month**. To translate 1Gbyte into a peak throughput, assumptions need to be made as to: 1) amount of traffic in the busy hour; and 2) number of days per month, adjusting bits to bytes and hours to seconds. Assuming 12% of traffic in the busy hour, with 30 days per month, we calculate 1Gbyte/mth equates to 9.7kbps on average.

**Figure 10: Converting Gbytes/mth in Mbps**

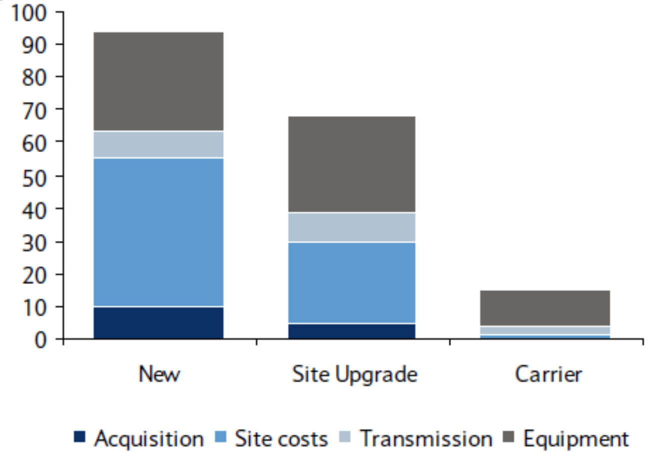



Source: Barclays Research

2) **Varying cost of capacity**. The cost of adding capacity depends on a number of factors, which is covered in detail in Appendix 1. The key building blocks are initially the cost of the radio base station + civil works along with supporting backhaul and core infrastructure which offers a base capacity. More carriers are then added with more spectrum which add capacity at relatively lower incremental cost, although backhaul/power upgrades scale also. Technology migration to HSPA+ and LTE should drive higher efficiency and therefore lower cost per bit.

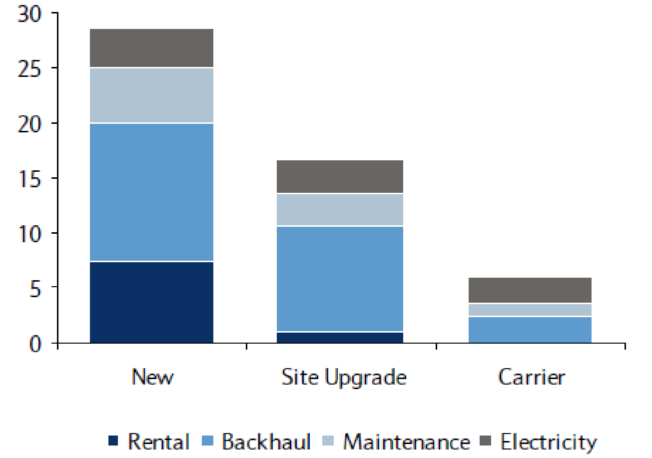
We break down the cost into a new site build (Greenfield site), an upgrade to an existing site (such as W-CDMA to HSPA), and adding new carriers (on an existing HSPA-enabled site). Our analysis of the base configuration cost of a radio site indicates that the majority of capex per site cost is civil-related, whereas much of the opex is rental and backhaul.

**Figure 11: Cost per site - split of capex (€k)**




Source: Barclays Research, Neu Mobile

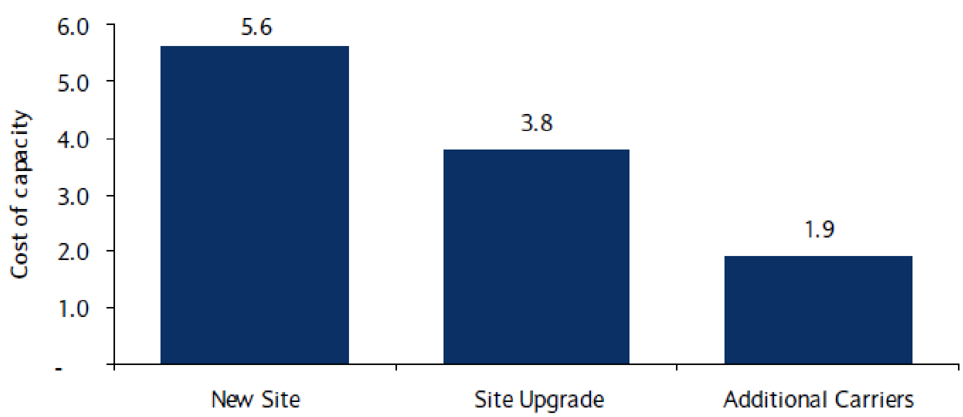
**Figure 12: Cost per site - split of opex (€k)**




Source: Barclays Research, Neu Mobile

We estimate it costs an operator between €2 and €5 to provide 1 Gbyte/mth of capacity. This compares to a current yield of c.€3-20/Gbyte/mth. In Appendix 1 we provide a detailed calculation of how we derive this.

**Figure 13: Cost of capacity with network topology (€/Gbyte/month)**




Source: Barclays Research, Neu Mobile

Based on a yield of €10 per Gbyte (€5/Gbyte with 50% bundle utilisation), assuming SAC/overhead of €2/month/sub, usage of 1Gbyte/sub/month, network cost of €3.8/Gbyte/month, and spectrum cost of €0.08Gbyte/sub/month (see later section), this would give an EBIT of €4.1/Gbyte – or a 41% margin. This compares favourably with current network EBIT margins.

**Figure 14: Implied EBIT margins of mobile data**

| | Amount | |
|---|---|---|
| Traffic per data subscriber | 1.0 | Gbyte/sub |
| Revenue per Gbyte | 10.0 | €/Gbyte |
| Overhead cost – per sub | 2.0 | €/sub |
| Overhead cost – per Gbyte | 2.0 | €/Gbyte |
| Gross Profit | 8.0 | €/Gbyte |
| **Gross Margin** | **80.0** | **%** |
| Network Cost | 3.8 | €/Gbyte |
| Spectrum Cost | 0.1 | €/Gbyte |
| EBIT | 4.1 | €/Gbyte |
| **EBIT margin** | **41.2** | **%** |

Source: Barclays Research

The table below flexes revenue per Gbyte with cost per Gbyte, with the output being the incremental EBIT margin. As can be seen in the table, as long as revenue/Gbyte remains above €6, and cost/Gbyte below €3, then returns will be above the cost of capital, but the model is clearly sensitive to changes in parameters.

**Figure 15: Incremental EBIT margin - Flexing Revenue/Gbyte and Network Cost/Gbyte**

| | | Revenue/Gbyte | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 41.2 | 2 | 4 | 6 | 8 | 10 | 12 | 14 | 16 | 18 | 20 |
| Network Cost/Gbyte | 1 | -54 | 23 | 48.7 | 61.5 | 69.2 | 74.3 | 78 | 80.8 | 82.9 | 84.6 |
| | 2 | -104 | -2 | 32 | 49 | 59.2 | 66 | 70.9 | 74.5 | 77.3 | 79.6 |
| | 3 | -154 | -27 | 15.3 | 36.5 | 49.2 | 57.7 | 63.7 | 68.3 | 71.8 | 74.6 |
| | 4 | -204 | -52 | -1.3 | 24 | 39.2 | 49.3 | 56.6 | 62 | 66.2 | 69.6 |
| | 5 | -254.0 | -77 | -18 | 11.5 | 29.2 | 41 | 49.4 | 55.8 | 60.7 | 64.6 |
| | 6 | -304.0 | -102 | -34.7 | -1 | 19.2 | 32.7 | 42.3 | 49.5 | 55.1 | 59.6 |
| | 7 | -354.0 | -127 | -51.3 | -13.5 | 9.2 | 24.3 | 35.1 | 43.3 | 49.6 | 54.6 |
| | 8 | -404.0 | -152 | -68 | -26 | -0.8 | 16 | 28 | 37 | 44 | 49.6 |

Source: Barclays Research

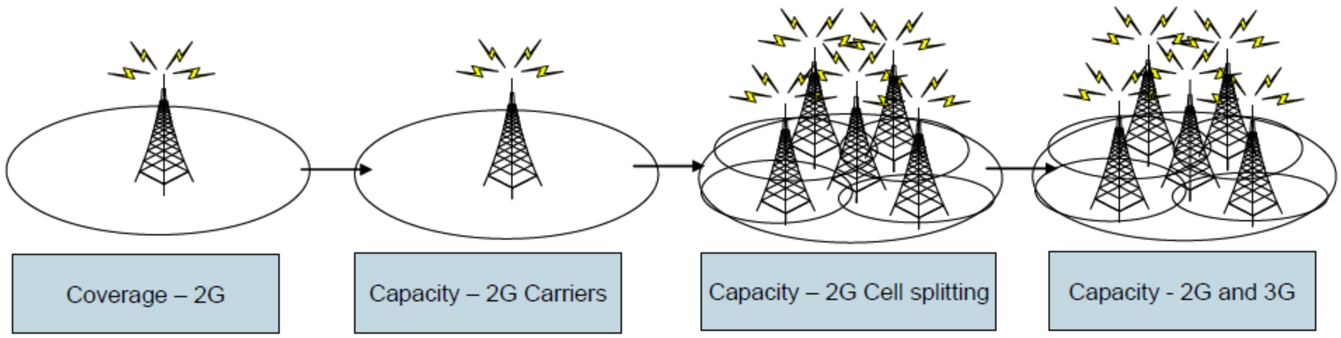
## Importance of spectrum

*Much of the cost of radio networks is the initial install (c.€100k - finding/building the site, installing power/backhaul, rental). However, once a mobile operator has built a radio site for coverage, additional frequencies (carriers) can be added at relatively low incremental cost (although this does often require additional backhaul/power). We estimate an extra 2x5MHz of spectrum can reduce the incremental cost per Gbyte/month by up to 50%. Significantly, spectrum allocations across Europe are about to double with the auctioning of 2.6GHz and 800MHz auctions.*

Operators want lower frequencies, because they transmit farther, hence the historical preference for 900MHz over the 1800MHz and 2100MHz bands. This is because signals at higher frequencies decrease faster than at lower frequencies, and so operators using 1800MHz (rather than 900MHz) requires more cell sites per square km for coverage. Using Okumura-Hata, the radius is 40% smaller for 1800MHz operators, requiring 3.5x as many sites for coverage. *This was a problem for GSM late entrants, where the original analogue operators got the lower frequencies. A new radio base station costs c.€100k to build* *(including civil engineering), whereas the equipment element is c.€20k and additional units of capacity cost c.€1k each.*

Once all the frequencies have been used up on the base stations, operators have to do cell splitting, which involves building new base stations, on which carriers (capacity) is added. In many urban locations it is now hard to find new sites, and so smaller microcells are required, which can be even less economic.

**Figure 16: Adding coverage – then capacity**

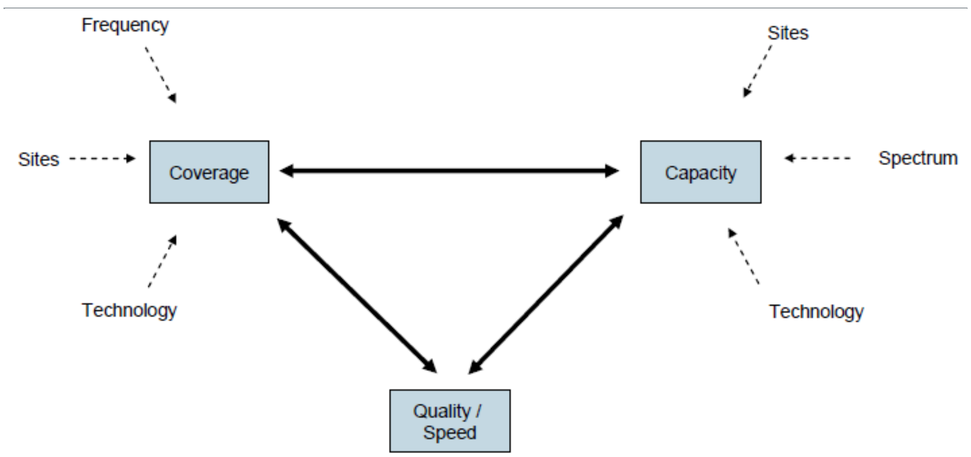



Source: Barclays Research

Because the main element of the cost of a base station is coverage related, and incremental capacity costs are relatively inexpensive, having more spectrum allows the €100k upfront cost to be spread over a greater number of calls/users/Mbytes. In addition, most urban networks are not coverage-constrained (capacity is the major issue), due to extensive cell splitting over the past eight years.

In-building coverage is becoming increasingly important for mobile data. The superior propagation characteristics of lower frequencies mean that 800/900MHz gives much better in-building coverage than the 1.8/2.1/2.6GHz ranges, as the higher frequencies degrade quicker. As most data usage in in-building, operators want to ensure high levels of coverage.

**Figure 17: Network drivers – coverage, capacity, quality, speed**




Source: Barclays Research

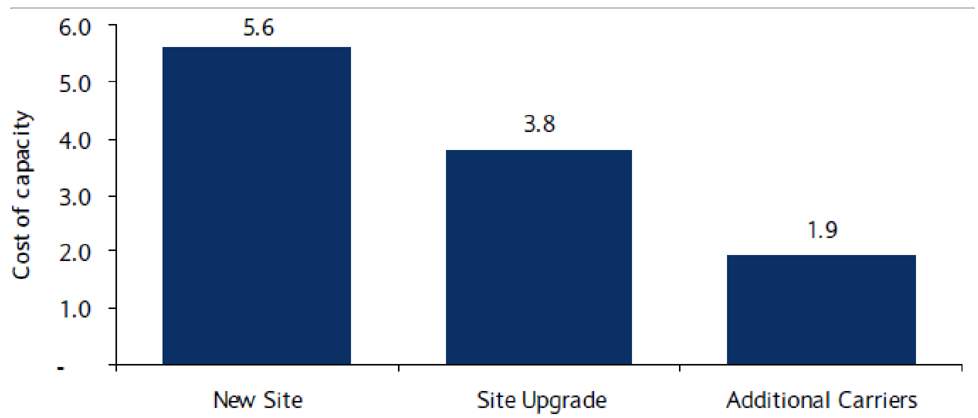
3G/4G capacity degrades as the signal weakens. Unlike GSM networks, 3G and 4G mix the original signal with a code, and sends over all frequencies, and all base stations use the same frequency band. This is not the same as GSM networks. As a result, other signals are seen as noise, and this is what limits the capacity. As more users are added, each additional user creates more traffic, which contributes to the overall noise level. At some point the mobile and radio site will be unable to distinguish the original signal due to the noise level. The cell size is thus limited by noise. By transmitting in buildings, the noise level rises quicker, and the capacity of the site decreases.

**Quality versus quantity.** As a result of the propagation characteristics of wireless spectrum, operators should want lower frequencies to ensure good quality of coverage, but also lots of it. The problem (and trade-off) is that most of the new spectrum is at the higher frequency ranges. So the problem is to quantify the relative value of 5MHz of 800MHz spectrum against 5MHz of 2.6GHz spectrum.

- **Value of 800/900MHz = 2x1800MHz**. We estimate that 900MHz spectrum is twice as valuable as 1800Mhz spectrum. Although 3.5x as many radio sites are required for coverage for 1800MHz vs 900MHz, this has become less of an issue for larger operators, as the networks have become denser (via cell splitting) due to higher traffic levels, and so the coverage 'advantage' from 900MHz has lessened.
- **Value of 800/900MHz = 4x2.6GHz**. As mobile data will be the principal user of additional incremental spectrum, indoor penetration (we estimate 95% of mobile data is indoor) will become increasingly important. The weaker propagation characteristics of 2.6GHz will likely reduce the cell capacity compared to 800MHz. We therefore estimate a further 2x value delta versus 1800MHz.

We estimate the cost per Gbyte falls by 50% for an additional 2x5MHz of spectrum if an operator can add additional carriers to an existing site rather than site upgrades or a new site.

**Figure 18: Cost of capacity with network topology**




Source: Barclays Research

It is worth putting this in some context – if the cost per Gbyte/month/sub can be reduced by 50%, then this can be compared with the total spectrum acquired.

- **Cost of acquiring spectrum**. Assuming a cost of €0.2/MHz/pop, along with assumed market share, data penetration and licence length, we can derive a monthly cost per data sub. For example, 2x5MHz of spectrum, at €0.20/MHz/pop, 30% market share, 35% average data penetration, with a 20-year licence results in a monthly cost of €0.08/data sub/mth per block of 2x5MHz. If 4 blocks of 2x5MHz are required, this increases to €0.32/data sub/mth.

- **Cost saving from more spectrum**. Based on a cost of capacity of €3.8/Gbyte/mth, along with assumed data usage per subscriber, and cost saving from more spectrum (more carriers vs additional sites), we can derive a monthly cost saving per data sub. For example, 2x5MHz of spectrum, for 1Gbye/sub/mth, and a 50% saving on €3.8/Gbyte/mth gives a total saving of €1.82/data sub/mth.

**Figure 19: Comparing network cost and spectrum cost**

| | Amount | |
|---|---|---|
| Cost of spectrum | 0.2 | €/MHz/pop |
| Pops | 50 | m |
| Cost of 2x5MHz | 100 | €m |
| Data penetration of pop | 35 | % |
| Market share | 30 | % |
| Data users | 5.25 | m |
| Data usage | 1 | Gbyte/data sub/mth |
| Network cost/sGbyte/mth | 3.8 | €/Gbyte/mth |
| Network cost/sub/mth | 3.8 | €/data sub/mth |
| Saving from extra capacity | 50 | % |
| Saving/sub/mth | 1.9 | €/data sub/mth |
| Cost/mth/sub per 2x5MHz | 0.08 | €/data sub/mth |
| Saving per sub | 1.82 | €/data sub/mth |

Source: Barclays Research

Clearly larger operators can spread the cost of the spectrum over a larger subscriber base. In Figure 20 we calculate the cost of the spectrum per data sub per month for four blocks of 2x5MHz spectrum for different market shares.

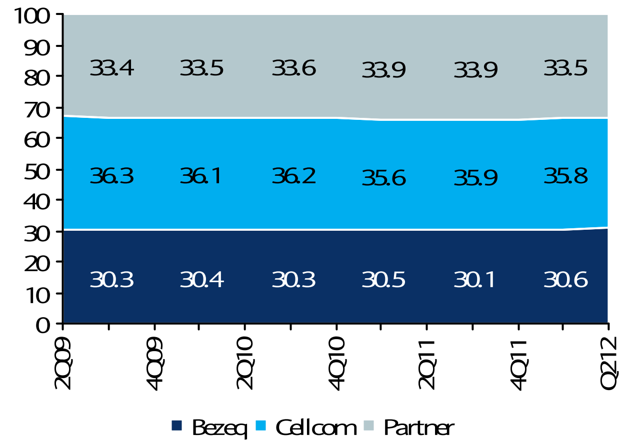
**Figure 20: Flexing spectrum cost and market share**

| | | Cost of spectrum - €/MHz/pop | | | |
|---|---|---|---|---|---|
| | | 0.2 | 0.4 | 0.6 | 0.8 |
| Market share (%) | 5 | 1.9 | 3.81 | 5.71 | 7.62 |
| | 10 | 0.95 | 1.9 | 2.86 | 3.81 |
| | 15 | 0.63 | 1.27 | 1.9 | 2.54 |
| | 20 | 0.48 | 0.95 | 1.43 | 1.9 |
| | 25 | 0.38 | 0.76 | 1.14 | 1.52 |
| | 30 | 0.32 | 0.63 | 0.95 | 1.27 |
| | 35 | 0.27 | 0.54 | 0.82 | 1.09 |
| | 40 | 0.24 | 0.48 | 0.71 | 0.95 |

Source: Barclays Research

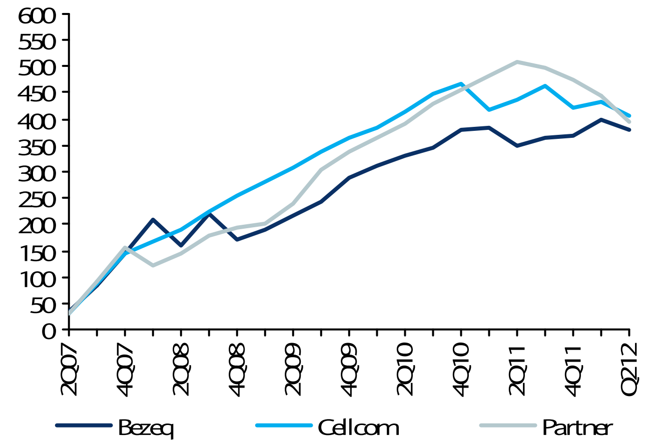
# Appendix 2 – Company charts

**Figure 21: Israel mobile Subscriber share %**



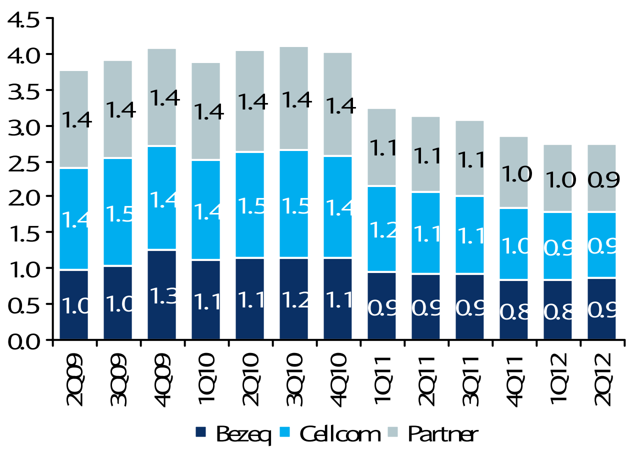

Source: Company data, Barclays Research

**Figure 22: Israel mobile Cumulative net adds, m**



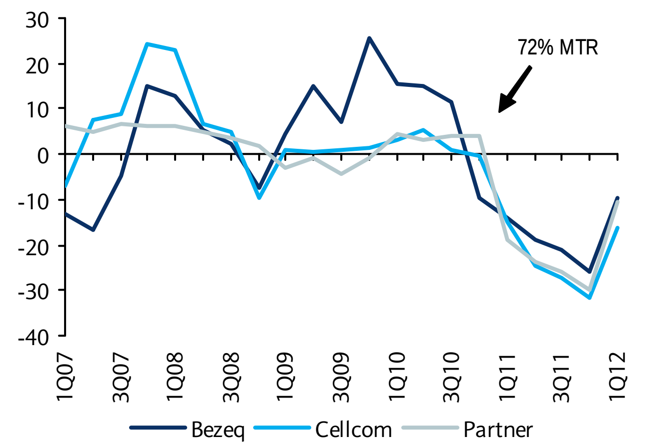

Source Company data, Barclays Research

**Figure 23: Israel – Service Revenue market share, ILS bn**




Source: Company data, Barclays Research

**Figure 24: Israel-Service Revenue growth, %**




Source: Company data, Barclays Research

Figure 24: CEL P&L

| ILSm | 2011 | Q1 12 | Q2 12 | Q3 12E | Q4 12E | 2012E | 2013E |
|---|---|---|---|---|---|---|---|
| **Net Sales** | **6,506** | **1,585** | **1,498** | **1,398** | **1,369** | **5,849** | **5,283** |
| Costs of sales | 3,408 | 899 | 838 | 808 | 797 | 3,342 | 3,019 |
| **Gross Profit** | 3,098 | 686 | 660 | 590 | 572 | 2,508 | 2,264 |
| Sales and marketing | 990 | 236 | 220 | 184 | 177 | 818 | 779 |
| Gen and admin | 685 | 175 | 164 | 138 | 132 | 609 | 578 |
| Total Opex | 1,675 | 411 | 384 | 322 | 309 | 1,426 | 1,357 |
| **EBITDA** | **2,163** | **475** | **474** | **441** | **432** | **1,822** | **1,724** |
| Depreciation, amortization and impairment losses | -738 | -200 | -192 | -173 | -170 | -735 | -728 |
| Write downs / exceptional | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Operating Income** | **1,422** | **275** | **282** | **268** | **262** | **1,087** | **995** |
| Finance costs, and other financial items, net | -293 | -36 | -117 | -92 | -92 | -337 | -318 |
| **Income after financial items** | **1,129** | **239** | **165** | **176** | **170** | **751** | **678** |
| Income taxes | -304 | -66 | -44 | -44 | -43 | -197 | -169 |
| Effective tax rate | 27% | 28% | 27% | 25% | 25% | 26% | 25% |
| **Net income** | **825** | **173** | **121** | **132** | **128** | **554** | **508** |
| Weighted average basic and diluted shares | 99.46 | 99.46 | 99.46 | 99.46 | 99.46 | 99.46 | 99.46 |
| Reported diluted EPS | 8.29 | 1.74 | 1.22 | 1.33 | 1.29 | 5.57 | 5.11 |
| Adjusted EPS | 8.85 | 1.74 | 1.13 | 1.19 | 1.15 | 5.30 | 5.11 |
| Total DPS | 7.90 | 1.30 | 0.00 | 0.66 | 0.64 | 2.44 | 2.55 |
| Total dividends paid | 786 | 130 | 0 | 66 | 64 | 242 | 254 |

Source: Company data, Barclays Research

**Figure 25: CEL Balance sheet**

| ILSm | 2011E | 2012E | 2013E |
|---|---|---|---|
| Intangible fixed Assets | 1680 | 1632 | 1686 |
| Tangible fixed Assets | 2,168 | 2,116 | 2,133 |
| Trade and other receivables | 1,377 | 1,411 | 1,411 |
| **Fixed Assets** | **5,225** | **5,159** | **5,231** |
| Inventories etc. | 170 | 118 | 153 |
| Receivables | 1,859 | 1,943 | 2,054 |
| Interest bearing receivables | 93 | 93 | 93 |
| Cash and equivalents | 920 | 1,053 | 1,231 |
| Other | 290 | 974 | 974 |
| **Current Assets** | **3,332** | **4,181** | **4,505** |
| **TOTAL ASSETS** | **8,557** | **9,340** | **9,735** |
| Debentures | 5,452 | 5,929 | 5,929 |
| Long Term Loans | 19 | 15 | 15 |
| Deferred tax and Other provisions | 184 | 192 | 209 |
| Other long-term liabilities | 62 | 59 | 59 |
| **Long-term liabilities** | **5,717** | **6,195** | **6,212** |
| Other short term liabilities | 822 | 1,107 | 1,425 |
| Short Term Loans | 805 | 758 | 758 |
| Trade payables and other current liabilities | 1,026 | 806 | 794 |
| **Short-term liabilities** | **2,653** | **2,671** | **2,976** |
| Cash flow hedge and minorities | 7 | 8 | 8 |
| Retained earnings | 179 | 465 | 538 |
| **Shareholders Equity** | **187** | **474** | **547** |
| **EQUITY AND LIABILITIES** | **8,557** | **9,339** | **9,735** |

Source: Company data, Barclays Research

**Figure 26: HOT P&L**

| ILS | 2011 | 1Q12 | 2Q12 | 3Q12E | 4Q12E | 2012E | 2013E |
|---|---|---|---|---|---|---|---|
| Revenues | 3,374 | 1,027 | 1,032 | 1,060 | 1,061 | 4,180 | 4,479 |
| Operating Costs | 1,996 | 632 | 664 | 675 | 691 | 2,661 | 2,962 |
| EBITDA | 1,378 | 395 | 368 | 386 | 371 | 1,519 | 1,517 |
| EBITDA margin (%) | 41 | 38 | 36 | 36 | 35 | 36 | 34 |
| Depreciation and Amortization | 841 | 242 | 265 | 266 | 267 | 1,039 | 1,074 |
| Share based compensation | -103 | 7 | 14 | 10 | 10 | 41 | 40 |
| Operating Profit | 640 | 146 | 89 | 110 | 94 | 439 | 403 |
| Net finance costs | 199 | 65 | 70 | 76 | 77 | 288 | 308 |
| Profit before tax | 441 | 81 | 19 | 33 | 17 | 151 | 95 |
| Net Income (Reported) | 328 | 59 | 4 | 7 | 4 | 74 | 71 |
| Net Income Excl one-offs | 341 | 59 | 4 | 7 | 4 | 74 | 71 |
| Weighted average number of shares | 7,767 | 7,684 | 7,767 | 7,767 | 7,767 | 7,767 | 7,767 |
| Diluted weighted average number of shares | 7,725 | 7,684 | 7,767 | 7,767 | 7,767 | 7,746 | 7,767 |
| Basic EPS (ILS) | 4.39 | 0.77 | 0.05 | 0.09 | 0.05 | 0.95 | 0.92 |
| Diluted EPS (ILS) | 4.41 | 0.77 | 0.05 | 0.09 | 0.05 | 0.95 | 0.92 |
| DPS | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

Source: Company data, Barclays Research

**Figure 26: HOT Balance sheet**

| ILSm | 2011 | 2012E | 2013E |
|---|---|---|---|
| Property Plant and Equipment, net | 3763 | 4170 | 4216 |
| Goodwill | 1264 | 1264 | 1264 |
| Other intangible assets, net | 837 | 818 | 818 |
| Other assets | 301 | 288 | 288 |
| Total non-current assets | 6165 | 6540 | 6586 |
| Inventories | 24 | 35 | 35 |
| Trade receivables, net | 379 | 481 | 679 |
| Other current assets | 79 | 82 | 82 |
| Cash designated for projects | 0 | 0 | 0 |
| Cash and cash equivalents | 16 | 146 | -150 |
| Total current assets | 498 | 745 | 646 |
| Total assets | 6663 | 7285 | 7233 |
| Contributed Capital | 1750 | 1567 | 1567 |
| Other reserves | 31 | 42 | 42 |
| Hedging reserves | 21 | 4 | 4 |
| Retained loss | 129 | -142 | -30 |
| Total equity | 1931 | 1470 | 1582 |
| Long term debt, less current portion | 2064 | 2732 | 2632 |
| Other liabilities | 922 | 952 | 952 |
| Total non-current liabilities | 2986 | 3684 | 3584 |
| Short-term borrowings | 436 | 602 | 602 |
| Accounts payable | 341 | 302 | 289 |
| Accrued expenses and other current liabilities | 801 | 1060 | 1009 |
| Unearned revenue | 168 | 166 | 166 |
| Total current liabilities | 1746 | 2131 | 2067 |
| Total liabilities | 4732 | 5815 | 5651 |
| Total equity and liabilities | 6663 | 7285 | 7233 |

Source: Company data, Barclays Research

**Figure 27: PTNR P&L**

| ILSm | 2011 | Q1 12 | Q2 12 | Q3 12E | Q4 12E | 2012E | 2013E |
|---|---|---|---|---|---|---|---|
| **Net Sales** | **6,998** | **1,571** | **1,428** | **1,431** | **1,408** | **5,838** | **5,251** |
| Costs of sales | 4,978 | 1,128 | 1,000 | 971 | 956 | 4,055 | 3,716 |
| **Gross Profit** | 2,020 | 443 | 428 | 459 | 452 | 1,782 | 1,536 |
| Sales and marketing | 711 154 | 148 | 178 | 176 | | 656 | 461 |
| Gen and admin | 291 68 | 65 | 78 | 77 | | 288 | 203 |
| Other income (IFRS) | 105 27 | 30 | 36 | 36 | | 129 | 94 |
| Total Opex | 1,107 | 195 | 183 | 220 | 217 | 815 | 571 |
| **EBITDA** | **2,178** | **438** | **423** | **406** | **398** | **1,665** | **1,591** |
| Depreciation, amortisation and impairment losses | -782 | -180 | -176 | -166 | -164 | -686 | -626 |
| Capitalization of handsets | -97 | -45 | -45 | -45 | -45 | -180 | -180 |
| **Operating Income** | **1,036** | **248** | **245** | **239** | **234** | **967** | **965** |
| Finance costs, and other financial items, net | -294 | -55 | -73 | -74 | -75 | -277 | -296 |
| **Income after financial items** | **742** | **193** | **172** | **166** | **159** | **690** | **670** |
| Income taxes | -299 | -47 | -52 | -50 | -48 | -197 | -167 |
| Effective tax rate | 40% | 24% | 30% | 30% | 30% | 29% | 25% |
| **Net income** | **443** | **146** | **120** | **116** | **111** | **493** | **502** |
| **EPS diluted** | **2.82** | **0.94** | **0.77** | **0.75** | **0.72** | **3.18** | **3.22** |
| Weighted average basic and diluted | 155.65 | 155.65 | 155.65 | 154.64 | 154.64 | 155.14 | 156.06 |
| Total DPS | 2.25 | 0.00 | 1.03 | 0.37 | 0.36 | 1.76 | 1.61 |
| Total dividends paid | 350 | 0 | 160 | 58 | 56 | 274 | 251 |

Source: Company data, Barclays Research

Figure 28: PTNR Balance sheet

| ILSm | 2011E | 2012E | 2013E |
|---|---|---|---|
| Intangible fixed Assets | 1,290 | 1,171 | 910 |
| Tangible fixed Assets | 2,051 | 2,049 | 2,209 |
| Financial Assets | 582 | 437 | 437 |
| **Fixed Assets** | **3,923** | **3,657** | **3,556** |
| Inventories etc. | 162 | 140 | 114 |
| Receivables | 1,518 | 1,863 | 1,958 |
| Interest bearing receivables | 41 | 54 | 54 |
| Cash and equivalents | 532 | 203 | 561 |
| Deferred Income Tax | 55 | 55 | 55 |
| **Current Assets** | **2,308** | **2,314** | **2,742** |
| LT receivables | 856 | 729 | 729 |
| Other assets | 1 | 148 | 148 |
| **TOTAL ASSETS** | **7,087** | **6,847** | **7,175** |
| Debentures | 2,605 | 2,623 | 2,623 |
| Long Term Loans | 2,068 | 2,031 | 2,031 |
| Deferred tax and Other provisions | 90 | 85 | 85 |
| Other long-term liabilities | 10 | 9 | 9 |
| **Long-term liabilities** | **4,773** | **4,748** | **4,748** |
| Short Term Loans | 498 | 81 | 81 |
| Trade payables | 913 | 784 | 747 |
| Other current liabilities | 478 | 546 | 593 |
| **Short-term liabilities** | **1,889** | **1,411** | **1,421** |
| Share Capital | 2 | 2 | 2 |
| Capital Surplus | 1,100 | 1,100 | 1,100 |
| Accumulated Deficit (earnings) | -326 | -56 | 201 |
| Treasury shares at cost | -351 | -351 | -351 |
| **Total Equity** | **425** | **695** | **952** |
| **EQUITY AND LIABILITIES** | **7,087** | **6,853** | **7,121** |

Source: Company data, Barclays Research

**Figure 29: BEZQ P&L**

| ILSm | 2011 | Q1 12 | Q2 12 | Q3 12E | Q4 12E | 2012E | 2013E |
|---|---|---|---|---|---|---|---|
| Net Sales | 11,373 | 2,740 | 2,595 | 2,567 | 2,563 | 10,464 | 10,088 |
| % Change | -5.1% | -5.9% | -10.3% | -12.0% | -3.3% | -8.0% | -3.6% |
| EBITDA | 4,637 | 1,208 | 1,104 | 1,085 | 1,083 | 4,480 | 4,253 |
| Margin | 40.8% | 44.1% | 42.6% | 42.3% | 42.3% | 42.8% | 42.2% |
| % Change | -10.0% | 20.8% | -13.9% | -16.6% | 2.8% | -3.4% | -5.1% |
| Underlying EBITDA | 4,802 | 1,181 | 1,114 | 1,055 | 1,053 | 4,403 | 4,133 |
| Margin | 42.2% | 43.1% | 42.9% | 41.1% | 41.1% | 42.1% | 41.0% |
| % Change | -3.5% | -7.8% | -8.0% | -11.7% | -5.6% | -8.3% | -6.1% |
| Clean EBITDA | 4,802 | 1,181 | 1,114 | 1,055 | 1,053 | 4,403 | 4,133 |
| Depreciation, amortization and impairment losses | -1,395 | -358 | -358 | -356 | -356 | -1,429 | -1,359 |
| Wages | -2,103 | -511 | -505 | -513 | -519 | -2,048 | -2,060 |
| G&A | -4,494 | -1,044 | -969 | -969 | -969 | -3,951 | -3,876 |
| Other Operating Expenses | 139 | -23 | 17 | -30 | -30 | -66 | -120 |
| Operating Income | 3,242 | 850 | 746 | 758 | 748 | 3,102 | 2,912 |
| Operating Margin % | 29% | 31% | 29% | 30% | 29% | 30% | 29% |
| Finance income (expenses), net | -210 | 44 | -77 | -81 | -84 | -198 | -286 |
| Income after financial items | 3,032 | 894 | 669 | 676 | 664 | 2,905 | 2,626 |
| Equity in Profits (losses) | -216 | -58 | -83 | -122 | -123 | -387 | -188 |
| Income Before Taxes | 2,816 | 836 | 586 | 554 | 541 | 2,517 | 2,438 |
| Income taxes | -755 | -245 | -174 | -151 | -146 | -716 | -787 |
| Effective tax rate | 27% | 29% | 30% | 27% | 27% | 28% | 32% |
| Net income | 2,061 | 591 | 412 | 403 | 395 | 1,801 | 1,650 |
| Diluted Shares | 2,825 | 2,825 | 2,825 | 2,825 | 2,825 | 2,825 | 2,825 |
| Reported EPS | 0.76 | 0.21 | 0.15 | 0.15 | 0.14 | 0.65 | 0.60 |
| Diluted EPS | 0.74 | 0.21 | 0.15 | 0.15 | 0.14 | 0.65 | 0.60 |

Source: Company data, Barclays Research

**Figure 30: BEZQ Balance Sheet**

| ILSm | 2011 | 2012E | 2013E |
|---|---|---|---|
| Intangible fixed Assets | 2,369 | 2,203 | 2,203 |
| Tangible fixed Assets | 6,022 | 6,089 | 5,996 |
| Financial Assets | 3,070 | 2,886 | 2,886 |
| **Fixed Assets** | **11,461** | **11,179** | **11,085** |
| Assets for Sale | 23 | 28 | 28 |
| Inventories etc. | 204 | 203 | 197 |
| Receivables | 3,059 | 3,077 | 2,980 |
| Interest bearing receivables | 286 | 341 | 350 |
| Investments and loans | 946 | 618 | 599 |
| Cash and equivalents | 1,352 | 1,716 | 567 |
| **Current Assets** | **5,870** | **5,984** | **4,719** |
| TOTAL ASSETS | 17,331 | 17,162 | 15,805 |
| Long Term Loans | 8,813 | 10,290 | 10,090 |
| Deferred tax and Other provisions | 138 | -40 | -327 |
| Other long-term liabilities | 1,246 | 774 | 774 |
| **Long-term liabilities** | **10,197** | **11,024** | **10,537** |
| Short Term Loans | 765 | 735 | 735 |
| Trade payables | 890 | 889 | 861 |
| Other current liabilities | 2,791 | 2,636 | 2,756 |
| **Short-term liabilities** | **4,446** | **4,260** | **4,352** |
| Share premium | 68 | 82 | 82 |
| Reserves | 608 | 593 | 593 |
| Deficit (profit) | -1,852 | -2,628 | -3,591 |
| Minority Interests | 38 | 0 | 0 |
| **Shareholders Equity** | **2,688** | **1,878** | **915** |
| EQUITY AND LIABILITIES | 17,331 | 17,162 | 15,805 |

Source: Company data, Barclays Research

## ANALYST(S) CERTIFICATION(S)

I, David Kaplan, hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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**Primary Stocks (Ticker, Date, Price)**

Bezeq (BEZQ.TA, 19-Sep-2012, ILS 4.75), Overweight/Negative

Cellcom Israel Ltd. (CEL.TA, 19-Sep-2012, ILS 31.75), Equal Weight/Negative

Hot Telecommunication System (HOT.TA, 19-Sep-2012, ILS 35.87), Underweight/Negative

Partner Communications Co. (PTNR.TA, 19-Sep-2012, ILS 19.45), Overweight/Negative

**Materially Mentioned Stocks (Ticker, Date, Price)**

Belgacom (BCOM.BR, 18-Sep-2012, EUR 23.47), Underweight/Positive

BT Group PLC (BT.L, 18-Sep-2012, GBp 227.0), Overweight/Positive

Deutsche Telekom AG (DTEGn.DE, 18-Sep-2012, EUR 9.63), Overweight/Positive

Elisa Oyj (ELI1V.HE, 18-Sep-2012, EUR 16.59), Underweight/Positive

France Telecom SA (FTE.PA, 18-Sep-2012, EUR 10.02), Underweight/Positive

KPN (KPN.AS, 18-Sep-2012, EUR 6.49), Overweight/Positive

OTE (OTEr.AT, 18-Sep-2012, EUR 3.36), Equal Weight/Positive

Portugal Telecom SGPS SA (PTC.LS, 18-Sep-2012, EUR 3.97), Equal Weight/Positive

Swisscom (SCMN.VX, 18-Sep-2012, CHF 379.80), Overweight/Positive

TDC (TDC.CO, 18-Sep-2012, DKK 41.00), Underweight/Positive

Telecom Italia SpA (TLIT.MI, 18-Sep-2012, EUR 0.80), Overweight/Positive

Telecom Italia-RSP (TLITn.MI, 18-Sep-2012, EUR 0.68), Overweight/Positive

Telefónica SA (TEF.MC, 18-Sep-2012, EUR 11.38), Underweight/Positive

Telekom Austria (TELA.VI, 18-Sep-2012, EUR 6.30), Equal Weight/Positive

Telenor ASA (TEL.OL, 18-Sep-2012, NOK 109.80), Overweight/Positive

TeliaSonera AB (TLSN.ST, 18-Sep-2012, SEK 48.90), Equal Weight/Positive

**Other Material Conflicts**

BT.L: A non-executive director of Barclays Bank PLC is a chairman of BT Group PLC.

**Guide to the Barclays Fundamental Equity Research Rating System:**

Our coverage analysts use a relative rating system in which they rate stocks as Overweight, Equal Weight or Underweight (see definitions below) relative to other companies covered by the analyst or a team of analysts that are deemed to be in the same industry (the "industry coverage

## IMPORTANT DISCLOSURES CONTINUED

universe").

In addition to the stock rating, we provide industry views which rate the outlook for the industry coverage universe as Positive, Neutral or Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

**Stock Rating**

**Overweight** - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

**Equal Weight** - The stock is expected to perform in line with the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

**Underweight** - The stock is expected to underperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

**Rating Suspended** - The rating and target price have been suspended temporarily due to market events that made coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Corporate and Investment Banking Division of Barclays is acting in an advisory capacity in a merger or strategic transaction involving the company.

**Industry View**

**Positive** - industry coverage universe fundamentals/valuations are improving.

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

**Negative** - industry coverage universe fundamentals/valuations are deteriorating.

Below is the list of companies that constitute the "industry coverage universe":

| | | |
|---|---|---|
| **European Telecom Services** | | |
| Belgacom (BCOM.BR) | Bouygues SA (BOUY.PA) | BT Group PLC (BT.L) |
| Cable & Wireless Communications PLC (CWC.L) | Cable & Wireless Worldwide PLC (CWW.L) | Colt (COLT.L) |
| Daisy (DAY.L) | Deutsche Telekom AG (DTEGn.DE) | Elisa Oyj (ELI1V.HE) |
| France Telecom SA (FTE.PA) | Iliad SA (ILD.PA) | Inmarsat plc (ISA.L) |
| Jazztel Plc (JAZ.MC) | Kabel Deutschland (KD8Gn.DE) | KCOM (KCOM.L) |
| KPN (KPN.AS) | Mobistar (MSTAR.BR) | OTE (OTEr.AT) |
| Portugal Telecom SGPS SA (PTC.LS) | Sonaecom SGPS SA (SNC.LS) | Swisscom (SCMN.VX) |
| TalkTalk Telecom Group (TALK.L) | TDC (TDC.CO) | Tele2 AB (TEL2b.ST) |
| TeleCity Group Plc (TCY.L) | Telecom Italia SpA (TLIT.MI) | Telecom Italia-RSP (TLITn.MI) |
| Telefónica SA (TEF.MC) | Telekom Austria (TELA.VI) | Telenet Group Holding NV (TNET.BR) |
| Telenor ASA (TEL.OL) | TeliaSonera AB (TLSN.ST) | Virgin Media Inc. (VMED.L) |
| Vodafone Group Plc (VOD.L) | Ziggo (ZIGGO.AS) | Zon Multimedia (ZON.LS) |
| **Israel Telecom Services** | | |
| Bezeq (BEZQ.TA) | Cellcom Israel Ltd. (CEL.TA) | Hot Telecommunication System (HOT.TA) |
| Partner Communications Co. (PTNR.TA) | | |

**Distribution of Ratings:**

Barclays Equity Research has 2464 companies under coverage.

42% have been assigned an Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 54% of companies with this rating are investment banking clients of the Firm.

42% have been assigned an Equal Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 48% of companies with this rating are investment banking clients of the Firm.

13% have been assigned an Underweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Sell rating; 41% of companies with this rating are investment banking clients of the Firm.

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Each analyst has a single price target on the stocks that they cover. The price target represents that analyst's expectation of where the stock will trade in the next 12 months. Upside/downside scenarios, where provided, represent potential upside/potential downside to each analyst's price target over the same 12-month period.

**Barclays offices involved in the production of equity research:**

## IMPORTANT DISCLOSURES CONTINUED

London

Barclays Bank PLC (Barclays, London)

New York

Barclays Capital Inc. (BCI, New York)

Tokyo

Barclays Securities Japan Limited (BSJL, Tokyo)

São Paulo

Banco Barclays S.A. (BBSA, São Paulo)

Hong Kong

Barclays Bank PLC, Hong Kong branch (Barclays Bank, Hong Kong)

Toronto

Barclays Capital Canada Inc. (BCCI, Toronto)

Johannesburg

Absa Capital, a division of Absa Bank Limited (Absa Capital, Johannesburg)

Mexico City

Barclays Bank Mexico, S.A. (BBMX, Mexico City)

Taiwan

Barclays Capital Securities Taiwan Limited (BCSTW, Taiwan)

Seoul

Barclays Capital Securities Limited (BCSL, Seoul)

Mumbai

Barclays Securities (India) Private Limited (BSIPL, Mumbai)

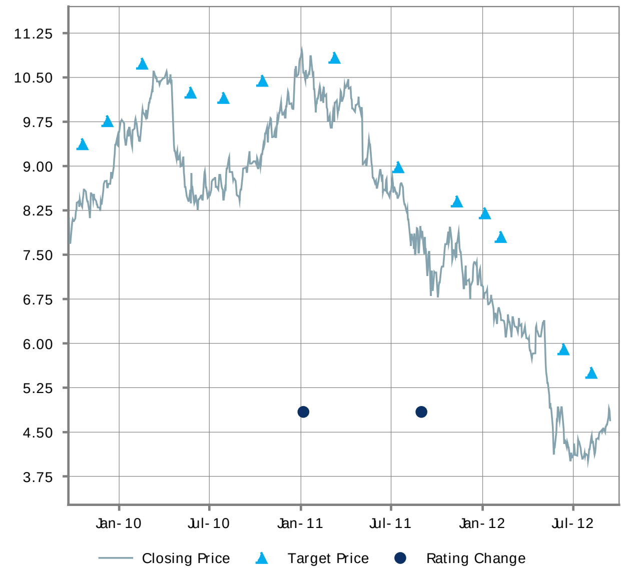
Singapore

Barclays Bank PLC, Singapore branch (Barclays Bank, Singapore)

## IMPORTANT DISCLOSURES CONTINUED

| Bezeq (BEZQ IT / BEZQ.TA) | Stock Rating | Industry View |
|---|---|---|
| ILS 4.75 (19-Sep-2012) | OVERWEIGHT | NEGATIVE |

**Rating and Price Target Chart - ILS (as of 19-Sep-2012)**




Link to Barclays Live for interactive charting

**Currency=ILS**

| Date | Closing Price | Rating | Price Target |
|---|---|---|---|
| 06-Aug-2012 | 4.40 | | 5.50 |
| 11-Jun-2012 | 4.61 | | 5.90 |
| 06-Feb-2012 | 6.48 | | 7.80 |
| 05-Jan-2012 | 6.85 | | 8.20 |
| 10-Nov-2011 | 7.70 | | 8.40 |
| 31-Aug-2011 | 7.84 | Overweight | |
| 15-Jul-2011 | N/A | | 8.98 |
| 09-Mar-2011 | 9.52 | | 10.83 |
| 06-Jan-2011 | 10.58 | Equal Weight | |
| 15-Oct-2010 | N/A | | 10.44 |
| 29-Jul-2010 | 8.22 | | 10.15 |
| 24-May-2010 | 8.39 | | 10.24 |
| 16-Feb-2010 | 9.64 | | 10.73 |
| 08-Dec-2009 | 8.43 | | 9.76 |
| 19-Oct-2009 | 8.11 | | 9.37 |

**D:** Barclays Bank PLC and/or an affiliate has received compensation for investment banking services from Bezeq in the past 12 months.

**J:** Barclays Bank PLC and/or an affiliate trades regularly in the securities of Bezeq.

**L:** Bezeq is, or during the past 12 months has been, an investment banking client of Barclays Bank PLC and/or an affiliate.

**Valuation Methodology:** Our price target is derived from a sum-of-the-parts, DCF-based valuation. Our assumptions include a 10.5% WACC and terminal growth rates of 0% for the fixed, mobile and ISP businesses. We apply a 1% terminal growth rate for the multi-channel television business, of which Bezeq owns 49.8%. After subtracting net debt, we arrive at a value of ILS per share 5.50.

**Risks which May Impede the Achievement of the Barclays Research Price Target:** A severe economic slowdown impacting usage behavior of mobile and fixed line telephones may cause the company results to differ from our expectations.

## IMPORTANT DISCLOSURES CONTINUED

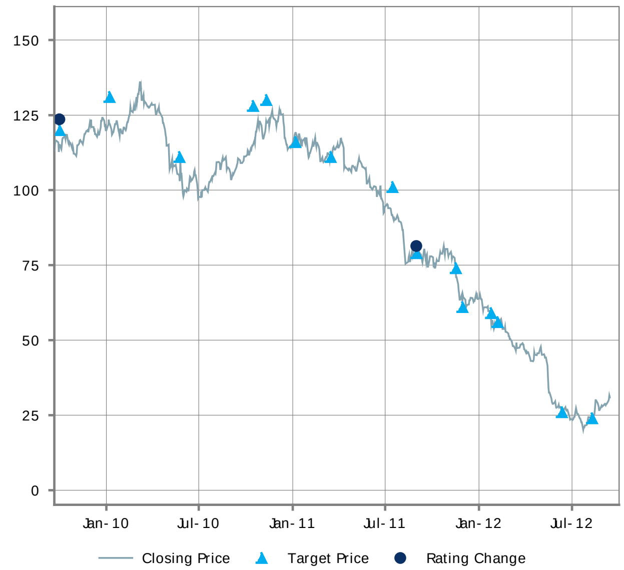
## Cellcom Israel Ltd. (CEL IT / CEL.TA)

**ILS 31.75 (19-Sep-2012)**

Stock Rating: **EQUAL WEIGHT**

Industry View: **NEGATIVE**

**Rating and Price Target Chart - ILS (as of 19-Sep-2012)**




Link to Barclays Live for interactive charting

**Currency=ILS**

| Date | Closing Price | Rating | Price Target |
|---|---|---|---|
| 09-Aug-2012 | 24.92 | | 24.00 |
| 11-Jun-2012 | 26.59 | | 26.00 |
| 06-Feb-2012 | 55.80 | | 56.00 |
| 24-Jan-2012 | 58.26 | | 59.00 |
| 29-Nov-2011 | 63.04 | | 61.00 |
| 16-Nov-2011 | 73.31 | | 74.00 |
| 31-Aug-2011 | 80.10 | Underweight | 79.00 |
| 15-Jul-2011 | N/A | | 101.00 |
| 16-Mar-2011 | 111.50 | | 111.00 |
| 06-Jan-2011 | 119.10 | | 116.00 |
| 10-Nov-2010 | 123.00 | | 130.00 |
| 15-Oct-2010 | N/A | | 128.00 |
| 24-May-2010 | 105.00 | | 111.00 |
| 07-Jan-2010 | 122.00 | | 131.00 |
| 01-Oct-2009 | 115.10 | Equal Weight | 120.00 |

**J**: Barclays Bank PLC and/or an affiliate trades regularly in the securities of Cellcom Israel Ltd..

**K**: Barclays Bank PLC and/or an affiliate has received non-investment banking related compensation from Cellcom Israel Ltd. within the past 12 months.

**M**: Cellcom Israel Ltd. is, or during the past 12 months has been, a non-investment banking client (securities related services) of Barclays Bank PLC and/or an affiliate.

**Valuation Methodology:** Our price target is derived from the average of our DCF model which assumes a 10.5% WACC and 0% terminal growth rate, and our sum of the parts model that attributes ILS 6,784mn to the Mobile segment and ILS 1,667mn to the Fixed line segment.

**Risks which May Impede the Achievement of the Barclays Research Price Target:** Some of the risks facing Cellcom are: pricing pressure, new MVNOs, significant changes to the regulatory regime and the fact that Cellcom's potential merger with an ISP company may cost more than initially expected may present downside risk to our estimates.

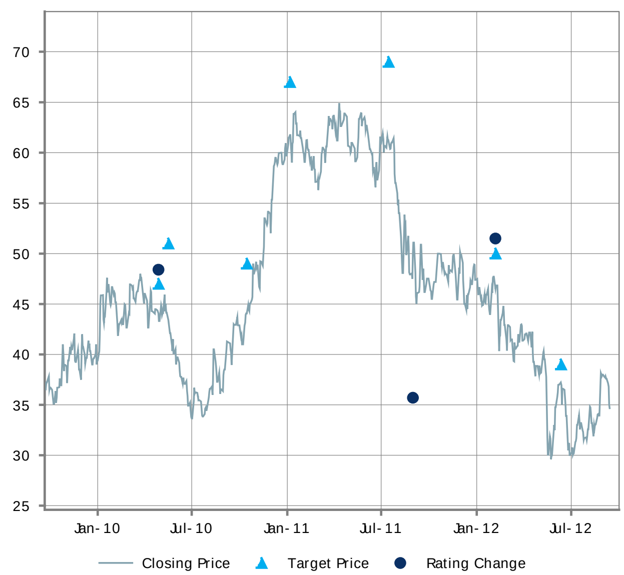
IMPORTANT DISCLOSURES CONTINUED

## Hot Telecommunication System (HOT IT / HOT.TA)

**ILS 35.87 (19-Sep-2012)**

| Stock Rating | Industry View |
|---|---|
| **UNDERWEIGHT** | **NEGATIVE** |

**Rating and Price Target Chart - ILS (as of 19-Sep-2012)**




Link to Barclays Live for interactive charting

**Currency=ILS**

| Date | Closing Price | Rating | Price Target |
|---|---|---|---|
| 11-Jun-2012 | 37.23 | | 39.00 |
| 06-Feb-2012 | 46.50 | Equal Weight | 50.00 |
| 31-Aug-2011 | 49.93 | Overweight | |
| 15-Jul-2011 | N/A | | 69.00 |
| 06-Jan-2011 | 61.75 | | 67.00 |
| 15-Oct-2010 | N/A | | 49.00 |
| 17-May-2010 | 43.42 | | 51.00 |
| 28-Apr-2010 | 44.09 | Equal Weight | 47.00 |

J: Barclays Bank PLC and/or an affiliate trades regularly in the securities of Hot Telecommunication System.

**Valuation Methodology:** We value HOT using a DCF model. Our assumptions include a WACC of 9.0% and terminal growth rate of 1%. The net present value of the cash flows equals ILS 5,692m, from which we subtract ILS 2,882m in net debt and add back ILS 121m in deffered tax benefits to arrive at and equity valuation of ILS 2,931m. With 76m share outstanding, the implied PT is ILS 39.

**Risks which May Impede the Achievement of the Barclays Research Price Target:** HOT's shareholder structure and changes in the regulatory enviornment may prevent HOT from acheiving our forecasted EPS estimates.

## IMPORTANT DISCLOSURES CONTINUED

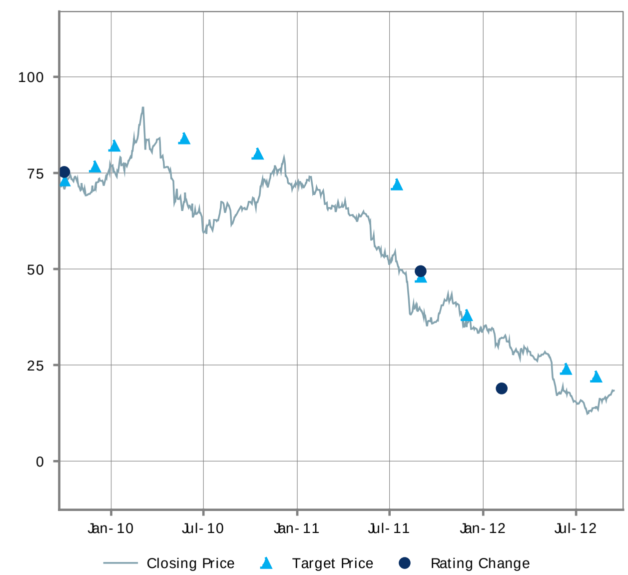
### Partner Communications Co. (PTNR IT / PTNR.TA)

**ILS 19.45 (19-Sep-2012)**

Stock Rating: **OVERWEIGHT**

Industry View: **NEGATIVE**

**Rating and Price Target Chart - ILS (as of 19-Sep-2012)**




Link to Barclays Live for interactive charting

**Currency=ILS**

| Date | Closing Price | Rating | Price Target |
|---|---|---|---|
| 09-Aug-2012 | 14.10 | | 22.00 |
| 11-Jun-2012 | 17.80 | | 24.00 |
| 06-Feb-2012 | 32.14 | Overweight | |
| 29-Nov-2011 | 34.90 | | 38.00 |
| 31-Aug-2011 | 39.40 | Underweight | 48.00 |
| 15-Jul-2011 | N/A | | 72.00 |
| 15-Oct-2010 | N/A | | 80.00 |
| 24-May-2010 | 67.50 | | 84.00 |
| 07-Jan-2010 | 67.82 | | 82.06 |
| 30-Nov-2009 | 63.63 | | 76.65 |
| 01-Oct-2009 | 63.93 | Overweight | 73.04 |

**J:** Barclays Bank PLC and/or an affiliate trades regularly in the securities of Partner Communications Co..

**Valuation Methodology:** Our price target is derived from the average of our DCF model which assumes a 10.5% WACC and 0% terminal growth rate. Our derived entreprise value is ILS 7,904m, to which we add ILS 477m of financial assets and substract ILS4,927 of financial liabilities. That gives us an EV of ILS 3,454m or ILS 22 per share.

**Risks which May Impede the Achievement of the Barclays Research Price Target:** Regulatory approval for stated acquisition is not received; and product launches do not gain market share and have to be rolled back.

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