# 012 Smile.Communications, Ltd. SMLC (NAS)

| Last Close | Industry | Sector |
|---|---|---|
| 15.67 USD | Diversified Communication Services | Telecommunications |

## Profile

Pricing data through 19 Nov 2009

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012 Smile.Communications Ltd. is a communications services provider in Israel and offers a range of broadband and traditional voice services.

The company offers broadband access at speeds of up to 6 Megabits per second. Its broadband services include broadband Internet access with a suite of value-added services, data services and server hosting, as well as new innovative services such as local telephony via voice over broadband, or VoB, and a WiFi network of hotspots across Israel.

Its traditional voice services include outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services. Its data services to bandwidth organizations and international carriers, allows them to transmit electronic data from point to point or from point to multi-points. Its IP-TRUNKING services provide interconnections between service providers using session initiation protocol, to business customers.

It currently operates a network of hotspots covering hotels, hospitals, other public areas and all commercial airports throughout Israel. 012 Smile provides global international telephony services through direct connections with over 100 carriers. Its outgoing international telephony services for its residential and business customers include direct international dialing services, international and domestic pre-paid and post-paid calling cards and call-back services. It provides hubbing-traffic routing between approximately 100 network operators. 012 Smile provides roaming and signaling services for cellular operators.

The company offers its services to residential and business customers, as well as to Israeli cellular operators and international communication services providers, or carriers through its integrated multipurpose network, which allow it to provide services to almost all homes and businesses in Israel. It provides these services through its integrated multipurpose network that is deployed through points of presence, throughout Israel and in England, Germany and the United States.

# 012 Smile.Communications, Ltd. SMLC

| Sales ILS Mil | Mkt Cap USD Mil | Industry | Sector |
|---|---|---|---|
| 278 | 397 | Diversified Communication Services | Telecommunications |

012 Smile.Communications provides communication services to Israel, offering voice over broadband (VoB) and traditional voice services, as well as broadband and WiFi internet services. The company serves residential and business customers in Israel, along with Israeli cellular operators and international communication services providers. The company changed its name from Smile.Communications to 012 Smile.Communications in 2007 following its acquisition of 012 Golden Lines.

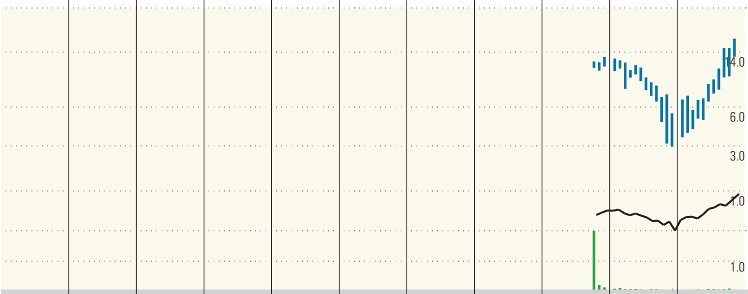
25 Hasavim St.
Petach-Tikva, IS 49170
Phone: 1 972722002111
Website: http://www.012.net

Employees: 1715

| Morningstar Rating | Last Price | Fair Value | Uncertainty | Economic Moat™ | Stewardship Grade |
|---|---|---|---|---|---|
| - | 15.67 | - | - | - | - |

per share prices in USD

| | 2007 | 2008 | YTD |
|---|---|---|---|
| Annual Price High | 13.47 | 13.17 | 17.47 |
| Low | 11.06 | 3.40 | 3.98 |
| Recent Splits | | | |



**Price Volatility**
Monthly High/Low
Rel Strength to S&P 500

52 week High/Low
17.47 - 3.40

10 Year High/Low
17.47 - 3.40

Bear-Market Rank
0 (10=worst)

Trading Volume Million

## Growth Rates Compound Annual

| | 1 Yr | 3 Yr | 5 Yr | 10 Yr |
|---|---|---|---|---|
| Revenue % | 0.3 | 65.3 | — | — |
| Operating Income % | 11.3 | 74.4 | — | — |
| Earnings/Share % | -6.8 | 43.9 | — | — |
| Dividends % | — | — | — | — |
| Book Value/Share % | 3.9 | 53.9 | — | — |
| Stock Total Return % | 213.4 | — | — | — |
| +/- Industry | 157.2 | — | — | — |
| +/- Market | 177.6 | — | — | — |

## Profitability Analysis

| | Current | 5 Yr Avg | Ind | Mkt |
|---|---|---|---|---|
| Return on Equity % | 13.0 | — | 6.5 | 15.1 |
| Return on Assets % | 5.7 | — | 2.1 | 5.9 |
| Fixed Asset Turns | 6.7 | — | 1.6 | 6.8 |
| Inventory Turns | — | — | 28.8 | 11.3 |
| Revenue/Employee ILS K | 162.0 | 125.7* | — | 871.2 |
| Gross Margin % | 31.7 | — | 53.2 | 40.7 |
| Operating Margin % | 12.2 | — | 12.9 | 14.4 |
| Net Margin % | 8.1 | 4.0 | 4.7 | 6.6 |
| Free Cash Flow/Rev % | — | — | 19.7 | 0.0 |
| R&D/Rev % | — | — | — | 11.0 |

## Financial Position

| | 12-08 ILS Mil | 03-09 ILS Mil |
|---|---|---|
| Cash | 16 | 2 |
| Inventories | — | — |
| Receivables | 54 | 48 |
| Current Assets | 101 | 81 |
| Fixed Assets | 45 | 40 |
| Intangibles | 155 | 136 |
| Total Assets | 424 | 378 |
| Payables | 50 | 34 |
| Short-Term Debt | 56 | 45 |
| Current Liabilities | 125 | 107 |
| Long-Term Debt | 102 | 77 |
| Total Liabilities | 242 | 200 |
| Total Equity | 182 | 179 |

## Stock Performance

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Return % | — | — | — | — | — | — | — | — | — | -69.3 | 293.7 |
| +/- Market | — | — | — | — | — | — | — | — | — | -30.8 | 272.5 |
| +/- Industry | — | — | — | — | — | — | — | — | — | -16.4 | 262.0 |
| Dividend Yield % | — | — | — | — | — | — | — | — | — | — | 0.0 |
| Market Cap USD Mil | — | — | — | — | — | — | — | — | 325 | 101 | 397 |

## Financials

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenue ILS Mil | — | — | — | — | — | 41 | 55 | 77 | 268 | 307 | 278 |
| Gross Margin % | — | — | — | — | — | — | 44.0 | 34.5 | 30.9 | 31.9 | 31.7 |
| Oper Income ILS Mil | — | — | — | — | — | — | 5 | 6 | 28 | 36 | 34 |
| Operating Margin % | — | — | — | — | — | — | 9.8 | 7.4 | 10.4 | 11.6 | 12.2 |
| Net Income ILS Mil | — | — | — | — | — | 3 | 3 | 0 | 10 | 13 | 23 |
| Earnings Per Share ILS | — | — | — | — | — | 0.17 | 0.14 | -0.02 | 0.50 | 0.53 | 0.89 |
| Dividends ILS | — | — | — | — | — | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Shares Mil | — | — | — | — | — | 18 | 18 | 18 | 19 | 25 | 25 |
| Book Value Per Share ILS | — | — | — | — | — | — | — | — | 6.78 | 7.19 | 8.50 |
| Oper Cash Flow ILS Mil | — | — | — | — | — | — | 4 | 9 | 54 | 58 | — |
| Cap Spending ILS Mil | — | — | — | — | — | — | -3 | -3 | -12 | -16 | — |
| Free Cash Flow ILS Mil | — | — | — | — | — | — | 1 | 6 | 42 | 42 | — |

## Profitability

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets % | — | — | — | — | — | — | 5.3 | -0.3 | 2.7 | 3.1 | 5.7 |
| Return on Equity % | — | — | — | — | — | — | 8.6 | -1.4 | 10.0 | 7.2 | 13.0 |
| Net Margin % | — | — | — | — | — | 7.9 | 4.8 | -0.6 | 3.6 | 4.4 | 8.1 |
| Asset Turnover | — | — | — | — | — | — | 1.09 | 0.43 | 0.75 | 0.70 | 0.70 |
| Financial Leverage | — | — | — | — | — | — | 1.6 | 9.5 | 2.4 | 2.3 | 2.1 |

## Financial Health

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 03-09 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Working Capital ILS Mil | — | — | — | — | — | — | — | -209 | 22 | -24 | -26 |
| Long-Term Debt ILS Mil | — | — | — | — | — | — | 2 | 1 | 120 | 102 | 77 |
| Total Equity ILS Mil | — | — | — | — | — | — | 30 | 34 | 170 | 182 | 179 |
| Debt/Equity | — | — | — | — | — | — | — | 0.02 | 0.70 | 0.56 | 0.43 |

## Valuation

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Price/Earnings | — | — | — | — | — | — | — | — | 24.3 | 7.9 | 16.4 |
| P/E vs. Market | — | — | — | — | — | — | — | — | 1.5 | 0.7 | 0.8 |
| Price/Sales | — | — | — | — | — | — | — | — | 0.9 | 0.3 | 1.3 |
| Price/Book | — | — | — | — | — | — | — | — | 1.9 | 0.6 | 1.9 |
| Price/Cash Flow | — | — | — | — | — | — | — | — | 4.4 | 1.8 | — |

## Valuation Analysis

| | Current | 5 Yr Avg | Ind | Mkt |
|---|---|---|---|---|
| Price/Earnings | 16.4 | — | 33.7 | 20.7 |
| Forward P/E | — | — | — | 16.4 |
| Price/Cash Flow | — | — | 5.6 | 7.1 |
| Price/Free Cash Flow | — | — | 9.5 | 18.0 |
| Dividend Yield % | — | — | 0.5 | 2.1 |
| Price/Book | 1.9 | — | 2.3 | 2.2 |
| Price/Sales | 1.3 | — | 1.9 | 1.2 |
| PEG Ratio | — | — | — | 1.8 |

## Quarterly Results

| **Revenue** ILS Mil | Jun 08 | Sep 08 | Dec 08 | Mar 09 |
|---|---|---|---|---|
| Most Recent Period | 76.7 | 82.5 | 80.0 | 70.0 |
| Prior Year Period | 66.5 | 67.5 | 68.4 | 70.8 |
| **Rev Growth** % | Jun 08 | Sep 08 | Dec 08 | Mar 09 |
| Most Recent Period | 15.2 | 22.2 | 17.0 | -1.1 |
| Prior Year Period | -25.7 | -22.3 | -17.0 | -73.8 |
| **Earnings Per Share** ILS | Jun 08 | Sep 08 | Dec 08 | Mar 09 |
| Most Recent Period | 0.06 | 0.14 | 0.26 | 0.48 |
| Prior Year Period | 0.14 | 0.16 | 0.06 | 0.06 |

## Industry Peers by Market Cap

| | Mkt Cap USD Mil | Rev ILS Mil | P/E | ROE% |
|---|---|---|---|---|
| 012 Smile.Communicat | 397 | 278 | 16.4 | 13.0 |
| Hutchison Whampoa, L | — | — | — | — |
| TeliaSonera AB | — | — | — | — |

## Major Fund Holders

| | % of shares |
|---|---|
| Fidelity Nasdaq Composite Index | 0.01 |
| | — |
| | — |

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

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## Management & Ownership

### Management Activity

| Name | Position | Shares Held | Report Date* | InsiderActivity |
|---|---|---|---|---|
| NA | NA | NA | NA | NA |

*Report date represents the date on which the owner's common shares held was audited.

### Fund Ownership

| Top Owners | Morningstar Rating | % of Shares Held | % of Fund Assets | Change (k) | Portfolio Date |
|---|---|---|---|---|---|
| Fidelity Nasdaq Composite Index | QQQ | 0.01 | 0.01 | 0 | 31 Aug 2009 |

| Concentrated Holders | Morningstar Rating | % of Shares Held | % of Fund Assets | Change (k) | Portfolio Date |
|---|---|---|---|---|---|
| NA | | NA | NA | NA | NA |

### Institutional Transactions

| Top 5 Buyers | Morningstar Rating | % of Shares Held | % of Fund Assets | Shares Bought/ Sold (k) | Portfolio Date |
|---|---|---|---|---|---|
| NA | | NA | NA | NA | NA |

| Top 5 Sellers | Morningstar Rating | % of Shares Held | % of Fund Assets | Shares Bought/ Sold (k) | Portfolio Date |
|---|---|---|---|---|---|
| NA | | NA | NA | NA | NA |

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## Industry Focus: Communication Services

Imari Love
Stock Analyst

AMPU allows us to gain a tighter grasp on the economic reality of the industry.

### Looking at Telcos through a Different Lens

23 September 2009

Investors that have ever looked at a mobile telecommunications firm have undoubtedly come across the terms "ARPU," "churn," and maybe even "cost per gross add." Although these figures have become standards by which mobile firms are measured and compared, they often paint an inconsistent or imperfect story. We believe there is a better and simpler way to evaluate wireless firms around the world. In this article, we look at common wireless metrics and a measure we use that pulls all these figures together, and highlight a handful of wireless stocks from around the globe we believe are attractive.

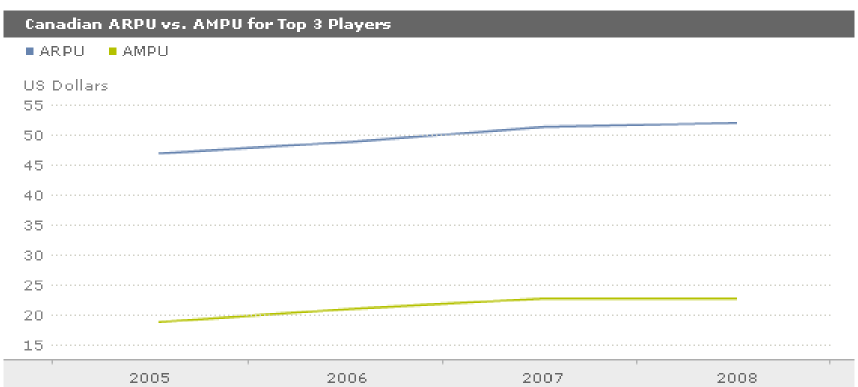
### Commonly Used Telecom Terms

One of the most frequently used metrics when analyzing wireless carriers is ARPU. Short for average revenue per user, ARPU is the average monthly wireless service revenue for a quarter or year--as defined by each carrier--divided by the average number of customers served during the period in question. Wireless service revenues are primarily a function of usage and pricing, two variables that can fluctuate significantly over time as conditions change. As investors (rather than consumers), we love high ARPUs, all else equal, but falling ARPU isn't always a bad thing. Investors tend to jump to the conclusion that falling ARPU means the competitive landscape is getting tougher and carriers are losing pricing power, but several other, more benign factors are often also at work, including regulation (changes in interconnect rates, for example), the economy (recession-based thriftiness), and customer mix (lower-income users adopting service). In addition, carriers tend to become more efficient as a market matures, and some degree of the cost savings gained is likely to be passed on to consumers.

Another commonly used measure called churn is defined as the percentage of a carrier's customer base that disconnects service each month. Churn serves as a basic measure of customer loyalty. Of course, customer stickiness can be overrated, if a firm has to pay too much for that loyalty. This is one reason why it's important to keep a close eye on the cost per gross customer addition, sometimes called CPGA. This figure measures the average cost of attracting new customers. If a firm has to buy growth by pumping too many resources into promotions and handset subsidies, profitability is sure to suffer. CPGA unfortunately isn't consistently reported across the wireless industry, and many carriers don't provide the figure at all.

### AMPU Brings All of Those Concepts Together

The major problems with the measures discussed above are that none can be viewed in isolation, and changes from quarter to quarter can obscure true operating performance. Maintaining high ARPU is a bad trade-off, for example, if the result is higher churn and the need to spend more on acquiring customers to grow. Low churn is bad if it comes at the cost of uneconomically low ARPU or retention costs. Low CPGA could indicate that a firm has opened the gates to customers with bad credit that can't get service elsewhere, setting up painful churn down the road, or that pricing is too aggressive. The best management teams in the industry strike a balance between customer growth and retention, pricing, and--ultimately--profitability. It can be




Source: Company Reports and Morningstar Data

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## Industry Focus: Communication Services

difficult, for example, to let churn rise when others in the market are offering unsustainably low prices because investors immediately notice higher churn at the next quarterly earnings announcement. The effects of heavy discounting, on the other hand, could take several quarters to show up in a firm's financials as pricing resets across the customer base.

To cut through these issues, we've defined a measure we call AMPU, or the average margin per user. We calculate AMPU by dividing a firm's monthly earnings before interest, taxes, depreciation, and amortization for a given period by the average number of customers served during that period. One might think that ARPU and AMPU would tend to move in the same direction, but a quick look at the U.S. wireless industry during the last few years demonstrates that this is not always the case. The average ARPU among the five largest U.S. carriers has declined about 10% during the last five years as data usage has failed to offset declining voice prices, but average AMPU has actually ticked up modestly. Without the troubles that Sprint Nextel S has faced during this period--which have resulted in the firm operating horribly inefficiently--the industry's performance would look even better.

Verizon Wireless VZ stands out as the industry's clear leader, with the highest AMPU (nearly $24 in the most recent quarter) in the group. More importantly, the firm has increased AMPU at a very consistent pace during the last several years despite fluctuations in other metrics. For example, churn has ticked up steadily during the last several quarters, with ATT 's T introduction of Apple 's AAPL iPhone likely a key contributor. Verizon Wireless has ramped up smartphone offers of its own, such as a buy one-get one BlackBerry offer, but it has predominantly stuck to its network-quality marketing message without being overly promotional. This tact should serve the firm well over time, especially if and when it gains access to the iPhone, as well.

We've seen similar trends up in Canada, where three players-- Rogers RCI , Telus TU , and BCE BCE --have a dominant oligopoly and competition has always been rational. Ultimately, the firms have prioritized profits over market share and have been able to avoid messy price wars. Given the fact that the country has fallen into recession, the firms have begun pushing lower-priced service offerings, and that has cut into ARPU of late. AMPU, however, has held steady as the firms have found ways to reduce costs to offset lower prices. For the most part, regulators have also been friendly to Canada's Big Three. New spectrum was auctioned off last summer, and new entrants are on the way. However, we don't believe these firms will have the scale, distribution channels, or network infrastructure to disrupt the economic landscape on a nationwide level.

Rogers is currently our favorite telecom firm in Canada. During the last few years the firm's AMPU has gone from worst to first among its rivals. Rogers' 2004 acquisition of Microcell gave it the spectrum and tower density needed to deliver the best network in the country. As the lone network utilizing GSM technology in Canada, Rogers has been the only firm capable of offering many integrated handsets, including the iPhone. The firm also has an advantage when it comes to roaming, and it is able to build a stickier and more profitable customer base.

In Europe, where ARPU and AMPU are both generally heading lower, the magnitude of the drop-off in each can shed light on the industry's underlying fundamentals. In most countries, ARPUs have declined faster than AMPUs, as firms again have had some success in cutting costs to offset lower prices. This cost-cutting has enabled margins to hold up better than pricing. Again, looking solely at ARPUs, the European wireless telecom industry appears to be struggling more than it is, particularly because much of the price compression has been from European Union regulators' mandated fee cuts for roaming and interconnection charges, rather than from customers using their phones less.

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## Industry Focus: Communication Services

France Telecom FTE , the incumbent phone company in France and Poland, is our favorite European carrier. Besides being the largest wireless operator in these countries, it also has extensive wireless assets in the U.K., Spain, and elsewhere. We particularly like its wireless operation in France, where it has almost half of the market and faces only two significant rivals. These three operators all behave rationally, and each is quite profitable. This relatively benign competitive environment has enabled France Telecom to maintain fairly stable ARPUs and AMPUs.

In Asia, the situation is similar to that of Europe where ARPUs, on average, are declining at a steeper rate than AMPUs, but the situation here is less clear-cut. In developed markets such as Japan and Korea, firms have been able to maintain margins despite lower ARPUs because of increased cost efficiency. On the other hand, emerging markets such as China and India are facing situations where AMPUs are falling at faster rates than ARPUs. Although carriers in these countries are seeing strong subscriber growth, new users typically come from less-affluent income segments and have much lower usage patterns, explaining why ARPUs have been declining consistently. Furthermore, intense competition in these markets has compelled wireless providers to engage in aggressive marketing activities, which has chipped away at profitability.

As a result of this divergence between developed and emerging markets in Asia, NTT DoCoMo DCM , the largest wireless provider in Japan, is our favorite in the region. The company generates the highest margin in the country because of its scale advantages. Although ARPUs have been declining in the last two years, DoCoMo's AMPU remains one of the highest in the world. The firm is a technology leader and has consistently introduced innovative wireless features to satisfy the tech-savvy appetites of its customers, helping the firm build an extremely loyal customer base.

Ultimately, a firm is worth the sum of all of its future earnings (not revenues), discounted back to a net present value. Although ARPU, churn, and CPGA are still valuable metrics, we believe AMPU is a more accurate gauge of a telecom firm's economic efficiency.