

PARTNER COMMUNICATIONS CO LTD  
Form 6-K  
March 08, 2006

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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 6-K**

**REPORT OF FOREIGN PRIVATE ISSUER  
PURSUANT TO RULE 13a-16 OR 15a-16 OF  
THE SECURITIES EXCHANGE ACT OF 1934**

Report on Form 6-K dated March 8, 2006

**Partner Communications Company Ltd.**

(Translation of Registrant's Name Into English)

8 Amal Street  
Afeq Industrial Park  
Rosh Ha'ayin 48103  
Israel

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(Address of Principal Executive Offices)

(Indicate by check mark whether the registrant files or will file annual reports  
under cover of Form 20-F or Form 40-F.)

Form 20-F  Form 40-F

(Indicate by check mark whether the registrant by furnishing the  
information contained in this Form is also thereby furnishing the information to the  
Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.)

Yes  No

(If Yes is marked, indicate below the file number assigned to the  
registrant in connection with Rule 12g3-2(b): 82-\_\_\_\_\_)

**This Form 6-K is incorporated by reference into the Company's Registration Statement on Form F-3 filed with the Securities and Exchange Commission on December 26, 2001 (Registration No. 333-14222).**

Enclosure: 2005 Annual Report.

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**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

2005 ANNUAL REPORT

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**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

2005 ANNUAL REPORT

TABLE OF CONTENTS

|  | <b>Page</b> |
|--|-------------|
| <b><u>REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u></b>  | 2           |
| <b>CONSOLIDATED FINANCIAL STATEMENTS:</b>  |             |
| <u>Balance sheets as of December 31, 2004 and 2005</u>   | 3-4         |
| <u>Statements of operations for the years ended December 31, 2003, 2004 and 2005</u>   | 5           |
| <u>Statements of changes in shareholders' equity (capital deficiency) for the years ended</u><br><u>December 31, 2003, 2004 and 2005</u> | 6           |
| <u>Statements of cash flows for the years ended December 31, 2003, 2004 and 2005</u>   | 7-8         |
| <u>Notes to financial statements</u>   | 9-40        |

The amounts are stated in New Israeli Shekels (NIS) in thousands.

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**Kesselman & Kesselman**  
Certified Public Accountants (Isr.)  
Trade Tower, 25 Hamered Street  
Tel Aviv 68125 Israel  
P.O Box 452 Tel Aviv 61003  
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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders of

**PARTNER COMMUNICATIONS COMPANY LTD.**

We have audited the consolidated balance sheets of Partner Communications Company Ltd. and its subsidiary (collectively the Company ) as of December 31, 2004 and 2005 and the related consolidated statements of operations, of changes in shareholders' equity (capital deficiency) and of cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States), and with auditing standards generally accepted in Israel, including those prescribed by the Israeli Auditors (Mode of Performance) Regulations, 1973. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2004 and 2005 and the consolidated results of its operations, changes in shareholders' equity (capital deficiency) and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States.

Tel-Aviv, Israel  
March 7, 2006

Kesselman & Kesselman  
Certified Public Accountants (Israel)

**PARTNER COMMUNICATIONS COMPANY LTD.**  
(An Israeli Corporation)  
CONSOLIDATED BALANCE SHEETS

|   | December 31         |           |   |
|---|---------------------|-----------|---|
|   | 2004                | 2005      | 2005  |
|   | New Israeli shekels |           | Convenience<br>translation<br>into<br>U.S. dollars<br>(note 1a) |
|   | In thousands        |           |   |
| <b>Assets</b>   |                     |           |   |
| <b>CURRENT ASSETS:</b>  |                     |           |   |
| Cash and cash equivalents   | 4,611               | 4,008     | 871   |
| Accounts receivable (note 13):  |                     |           |   |
| Trade   | 625,220             | 795,156   | 172,747   |
| Other   | 70,158              | 97,128    | 21,101  |
| Inventories   | 101,656             | 209,323   | 45,476  |
| Deferred income taxes (note 10)   | 255,503             | 65,361    | 14,200  |
|   |                     |           |   |
| T o t a l current assets  | 1,057,148           | 1,170,976 | 254,395   |
| <b>INVESTMENTS AND LONG-TERM RECEIVABLES:</b>                                   |                     |           |   |
| Accounts receivable - trade (note 13)   | 96,687              | 189,013   | 41,062  |
| Funds in respect of employee rights upon retirement (note 7)                    | 69,128              | 75,443    | 16,390  |
|   |                     |           |   |
|   | 165,815             | 264,456   | 57,452  |
|   |                     |           |   |
| <b>FIXED ASSETS</b> , net of accumulated depreciation and amortization (note 3) | 1,843,182           | 1,768,895 | 384,292   |
|   |                     |           |   |
| <b>LICENSE AND DEFERRED CHARGES</b> , net of accumulated amortization (note 4)  | 1,325,592           | 1,321,167 | 287,023   |
|   |                     |           |   |
| <b>DEFERRED INCOME TAXES</b> (note 10)  | 94,442              | 86,505    | 18,793  |
|   |                     |           |   |
| T o t a l assets  | 4,486,179           | 4,611,999 | 1,001,955   |

Date of approval of the financial statements: March 7, 2006

**Amikam Cohen**  
Chief Executive Officer

**Alan Gelman**  
Chief Financial Officer

**Moshe Vidman**  
Director

|  | December 31         |                  |   |
|--|---------------------|------------------|---|
|  | 2004                | 2005             | 2005  |
|  | New Israeli shekels |                  | Convenience translation into U.S. dollars (note 1a) |
| In thousands   |                     |                  |   |
| <b>Liabilities and shareholders' equity</b>  |                     |                  |   |
| <b>CURRENT LIABILITIES:</b>  |                     |                  |   |
| Current maturities of long-term liabilities (notes 5, 13d)   |                     | 34,464           | 7,487   |
| Accounts payable and accruals:   |                     |                  |   |
| Trade  | 552,377             | 665,542          | 144,589   |
| Other (note 13)  | 307,364             | 231,480          | 50,289  |
| Related party - trade  |                     | 10,513           | 2,284   |
| Dividend payable   |                     | 44,996           | 9,775   |
| <b>T o t a l</b> current liabilities   | <b>859,741</b>      | <b>986,995</b>   | <b>214,424</b>                                      |
| <b>LONG-TERM LIABILITIES:</b>  |                     |                  |   |
| Bank loans, net of current maturities (note 5)   | 1,185,088           | 665,974          | 144,682   |
| Notes payable (note 6)   | 753,900             | 2,022,257        | 439,335   |
| Liability for employee rights upon retirement (note 7)   | 92,808              | 102,238          | 22,211  |
| Other liabilities (note 13d)   | 7,567               | 19,184           | 4,168   |
| <b>T o t a l</b> long-term liabilities   | <b>2,039,363</b>    | <b>2,809,653</b> | <b>610,396</b>                                      |
| <b>COMMITMENTS AND CONTINGENT LIABILITIES (note 8)</b>   |                     |                  |   |
| <b>T o t a l</b> liabilities   | <b>2,899,104</b>    | <b>3,796,648</b> | <b>824,820</b>                                      |
| <b>SHAREHOLDERS' EQUITY (note 9):</b>  |                     |                  |   |
| Share capital - ordinary shares of NIS 0.01 par value: authorized - December 31, 2004 and 2005 - 235,000,000 shares; issued and outstanding - December 31, 2004 - 184,037,221 shares and December 31, 2005 - 152,528,288 shares issued | 1,840               | 1,525            | 331   |
| Less - receivables in respect of shares  | (2,260)             |                  |   |
| Capital surplus  | 2,362,027           | 2,401,160        | 521,651   |
| Deferred compensation  | (23,650)            | (12,735)         | (2,766)   |
| Accumulated deficit  | (750,882)           | (1,574,599)      | (342,081)   |
| <b>T o t a l</b> shareholders' equity  | <b>1,587,075</b>    | <b>815,351</b>   | <b>177,135</b>                                      |
|  | <b>4,486,179</b>    | <b>4,611,999</b> | <b>1,001,955</b>                                    |

The accompanying notes are an integral part of the financial statements.

**PARTNER COMMUNICATIONS COMPANY LTD.**  
(An Israeli Corporation)  
CONSOLIDATED STATEMENTS OF OPERATIONS

|  | Year ended December 31               |                  |                  |   |
|--|--------------------------------------|------------------|------------------|---|
|  | 2003                                 | 2004             | 2005             | 2005  |
|  | New Israeli shekels                  |                  |                  | Convenience<br>translation<br>into<br>U.S. dollars<br>(note 1a) |
|  | In thousands (except per share data) |                  |                  |   |
| <b>REVENUES - net:</b>   |                                      |                  |                  |   |
| Services   | 4,117,887                            | 4,615,781        | 4,619,932        | 1,003,679   |
| Equipment  | 349,832                              | 524,956          | 503,007          | 109,278   |
|  | <u>4,467,719</u>                     | <u>5,140,737</u> | <u>5,122,939</u> | <u>1,112,957</u>  |
| <b>COST OF REVENUES:</b>   |                                      |                  |                  |   |
| Services   | 2,586,707                            | 2,885,077        | 3,022,480        | 656,633   |
| Equipment  | 549,749                              | 729,937          | 743,872          | 161,606   |
|  | <u>3,136,456</u>                     | <u>3,615,014</u> | <u>3,766,352</u> | <u>818,239</u>  |
| <b>GROSS PROFIT</b>  | 1,331,263                            | 1,525,723        | 1,356,587        | 294,718   |
| <b>SELLING AND MARKETING EXPENSES</b>  | 314,008                              | 325,244          | 272,900          | 59,287  |
| <b>GENERAL AND ADMINISTRATIVE EXPENSES</b>   | 162,387                              | 181,133          | 180,781          | 39,275  |
|  | <u>854,868</u>                       | <u>1,019,346</u> | <u>902,906</u>   | <u>196,156</u>  |
| <b>OPERATING PROFIT</b>  | 854,868                              | 1,019,346        | 902,906          | 196,156   |
| <b>FINANCIAL EXPENSES, net (note 13)</b>   | 321,710                              | 260,545          | 345,448          | 75,048  |
| <b>LOSS ON IMPAIRMENT OF INVESTMENTS<br/>IN NON-MARKETABLE SECURITIES (note 2)</b> | 3,530                                |                  |                  |   |
|  | <u>529,628</u>                       | <u>758,801</u>   | <u>557,458</u>   | <u>121,108</u>  |
| <b>INCOME BEFORE TAX</b>   | 529,628                              | 758,801          | 557,458          | 121,108   |
| <b>TAX BENEFIT (TAX EXPENSES) (note 10)</b>  | 633,022                              | (287,248)        | (202,898)        | (44,080)  |
|  | <u>1,162,650</u>                     | <u>471,553</u>   | <u>354,560</u>   | <u>77,028</u>   |
| <b>NET INCOME FOR THE YEAR</b>   |                                      |                  |                  |   |
| <b>EARNINGS PER SHARE ("EPS"):</b>   |                                      |                  |                  |   |
| Basic  | 6.39                                 | 2.57             | 2.19             | 0.48  |
| Diluted  | 6.34                                 | 2.56             | 2.17             | 0.47  |
| <b>WEIGHTED AVERAGE NUMBER OF<br/>SHARES OUTSTANDING:</b>                          |                                      |                  |                  |   |
| Basic  | 181,930,803                          | 183,389,383      | 161,711,125      | 161,711,125   |
| Diluted  | 183,243,157                          | 184,108,917      | 163,617,272      | 163,617,272   |

The accompanying notes are an integral part of the financial statements.





## PARTNER COMMUNICATIONS COMPANY LTD.

(An Israeli Corporation)

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (CAPITAL DEFICIENCIES)

|  | Share capital    |        |   |                 |                       |                     | Total       |
|--|------------------|--------|---|-----------------|-----------------------|---------------------|-------------|
|  | Number of shares | Amount | Receivables in respect of shares issued | Capital surplus | Deferred compensation | Accumulated deficit |             |
| (In thousands)   |                  |        |   |                 |                       |                     |             |
| <b>New Israeli Shekels:</b>  |                  |        |   |                 |                       |                     |             |
| <b>BALANCE AT DECEMBER 31, 2002</b>  | 181,595,222      | 1,816  |   | 2,293,270       | (6,385)               | (2,385,085)         | (96,384)    |
| <b>CHANGES DURING THE YEAR ENDED DECEMBER 31, 2003:</b>  |                  |        |   |                 |                       |                     |             |
| Exercise of options granted to employees   | 1,100,352        | 11     | (4,374)                                 | 7,754           |                       |                     | 3,391       |
| Income tax benefit in respect of exercise of options granted to employees  |                  |        |   | 730             |                       |                     | 730         |
| Deferred compensation related to employee stock option grants  |                  |        |   | 2,666           | (2,666)               |                     |             |
| Amortization of deferred compensation related to employee stock option grants net of deferred compensation with respect to stock options forfeited |                  |        |   | (1,365)         | 6,542                 |                     | 5,177       |
| Net income   |                  |        |   |                 |                       | 1,162,650           | 1,162,650   |
| <b>BALANCE AT DECEMBER 31, 2003</b>  | 182,695,574      | 1,827  | (4,374)                                 | 2,303,055       | (2,509)               | (1,222,435)         | 1,075,564   |
| <b>CHANGES DURING THE YEAR ENDED DECEMBER 31, 2004:</b>  |                  |        |   |                 |                       |                     |             |
| Exercise of options granted to employees   | 1,341,647        | 13     | 2,114                                   | 23,671          |                       |                     | 25,798      |
| Income tax benefit in respect of exercise of options granted to employees  |                  |        |   | 3,440           |                       |                     | 3,440       |
| Deferred compensation related to employee stock option grants  |                  |        |   | 32,560          | (32,560)              |                     |             |
| Amortization of deferred compensation related to employee stock option grants net of deferred compensation with respect to stock options forfeited |                  |        |   | (699)           | 11,419                |                     | 10,720      |
| Net income   |                  |        |   |                 |                       | 471,553             | 471,553     |
| <b>BALANCE AT DECEMBER 31, 2004</b>  | 184,037,221      | 1,840  | (2,260)                                 | 2,362,027       | (23,650)              | (750,882)           | 1,587,075   |
| <b>CHANGES DURING THE YEAR ENDED DECEMBER 31, 2005:</b>  |                  |        |   |                 |                       |                     |             |
| Repurchase of Company's shares (including purchase cost of NIS 17,591,000)   | (33,317,933)     | (333)  |   |                 |                       | (1,091,508)         | (1,091,841) |
| Exercise of options granted to employees   | 1,809,000        | 18     | 2,260                                   | 34,875          |                       |                     | 37,153      |
| Income tax benefit in respect of exercise of options granted to employees  |                  |        |   | 4,820           |                       |                     | 4,820       |
| Deferred compensation related to employee stock option grants  |                  |        |   | 2,638           | (2,638)               |                     |             |
| Amortization of deferred compensation related to   |                  |        |   |                 |                       |                     |             |

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|  | <u>Share capital</u> |              |              |                  |                 |                    |                |
|--|----------------------|--------------|--------------|------------------|-----------------|--------------------|----------------|
| employee stock option grants net of<br>deferred<br>compensation with respect to stock options<br>forfeited   |                      |              |              | (3,200)          | 13,553          |                    | 10,353         |
| Dividend   |                      |              |              |                  |                 | (86,769)           | (86,769)       |
| Net income   |                      |              |              |                  |                 | 354,560            | 354,560        |
| <b>BALANCE AT DECEMBER 31, 2005</b>  | <b>152,528,288</b>   | <b>1,525</b> | <b>-,-</b>   | <b>2,401,160</b> | <b>(12,735)</b> | <b>(1,574,599)</b> | <b>815,351</b> |
| <b>Convenience translation into u.s. dollars (note<br/>1a):</b>  |                      |              |              |                  |                 |                    |                |
| <b>BALANCE AT JANUARY 1, 2005</b>  | <b>184,037,221</b>   | <b>399</b>   | <b>(491)</b> | <b>513,149</b>   | <b>(5,137)</b>  | <b>(163,129)</b>   | <b>344,791</b> |
| <b>CHANGES DURING THE YEAR ENDED<br/>DECEMBER 31, 2005:</b>  |                      |              |              |                  |                 |                    |                |
| Repurchase of Company's shares (including<br>purchase cost of \$3,900,000)   | (33,317,933)         | (72)         |              |                  |                 | (237,130)          | (237,202)      |
| Exercise of options granted to employees   | 1,809,000            | 4            | 491          | 7,577            |                 |                    | 8,072          |
| Income tax benefit in respect of exercise of<br>options granted to employees   |                      |              |              | 1,047            |                 |                    | 1,047          |
| Deferred compensation related to employee<br>stock<br>option grants  |                      |              |              | 573              | (573)           |                    |                |
| Amortization of deferred compensation<br>related to<br>employee stock option grants net of<br>deferred compensation with respect to stock<br>options forfeited |                      |              |              | (695)            | 2,944           |                    | 2,249          |
| Dividend   |                      |              |              |                  |                 | (18,850)           | (18,850)       |
| Net income   |                      |              |              |                  |                 | 77,028             | 77,028         |
| <b>BALANCE AT DECEMBER 31, 2005</b>  | <b>152,528,288</b>   | <b>331</b>   | <b>-,-</b>   | <b>521,651</b>   | <b>(2,766)</b>  | <b>(342,081)</b>   | <b>177,135</b> |

The accompanying notes are an integral part of the financial statements.

**PARTNER COMMUNICATIONS COMPANY LTD.**  
(An Israeli Corporation)  
CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | Year ended December 31 |                  |                  |   |
|--|------------------------|------------------|------------------|---|
|  | 2003                   | 2004             | 2005             | 2005  |
|  | New Israeli shekels    |                  |                  | Convenience<br>translation<br>into U.S.<br>dollars<br>(note 1a) |
|  | In thousands           |                  |                  |   |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                        |                  |                  |   |
| Net income for the year  | 1,162,650              | 471,553          | 354,560          | 77,028  |
| Adjustments to reconcile net income to net cash provided by operating activities:        |                        |                  |                  |   |
| Depreciation and amortization  | 536,871                | 558,222          | 683,503          | 148,490   |
| Loss on impairment of investments in non-marketable securities                           | 3,530                  |                  |                  |   |
| Amortization of deferred compensation related to employee stock option grants, net       | 5,177                  | 10,720           | 10,353           | 2,249   |
| Liability for employee rights upon retirement  | 15,540                 | 16,302           | 9,430            | 2,049   |
| Deferred income taxes  | (633,752)              | 283,807          | 198,079          | 43,033  |
| Income tax benefit in respect of exercise of options granted to employees                | 730                    | 3,440            | 4,820            | 1,047   |
| Accrued interest, exchange and linkage differences on (erosion of) long-term liabilities | (67,438)               | (10,258)         | 108,411          | 23,552  |
| Erosion of security deposit  | 8,877                  |                  |                  |   |
| Amount carried to deferred charges   |                        |                  | (13,820)         | (3,002)   |
| Capital loss (gain) on sale of fixed assets  | (7,829)                | (391)            | 493              | 107   |
| Changes in operating asset and liability items:  |                        |                  |                  |   |
| Decrease (increase) in accounts receivable:  |                        |                  |                  |   |
| Trade  | 22,721                 | (225,860)        | (262,262)        | (56,976)  |
| Other  | (5,557)                | (13,615)         | (26,970)         | (5,859)   |
| Increase (decrease) in accounts payable and accruals:                                    |                        |                  |                  |   |
| Related parties  |                        |                  | 10,513           | 2,284   |
| Trade  | (93,444)               | 135,600          | 112,857          | 24,518  |
| Other  | 47,541                 | 41,613           | (75,884)         | (16,486)  |
| Increase (decrease) in asset retirement obligations                                      | 1,228                  | 464              | (92)             | (20)  |
| Decrease (increase) in inventories   | 34,647                 | 1,205            | (107,667)        | (23,391)  |
| Net cash provided by operating activities  | <u>1,031,492</u>       | <u>1,272,802</u> | <u>1,006,324</u> | <u>218,623</u>  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                        |                  |                  |   |
| Purchase of fixed assets   | (350,344)              | (609,795)        | (498,851)        | (108,374)   |
| Proceeds from sale of fixed assets   | (12,309)               | 552              | 16               | (3)   |
| Withdrawal of security deposit   | (98,917)               |                  |                  |   |
| Purchase of additional spectrum  | (121,388)              | (53,969)         | (41,542)         | (9,025)   |
| Funds in respect of employee rights upon retirement                                      | (16,263)               | (10,404)         | (6,315)          | (1,372)   |
| Net cash used in investing activities  | <u>(376,769)</u>       | <u>(673,616)</u> | <u>(546,692)</u> | <u>(118,768)</u>  |



**PARTNER COMMUNICATIONS COMPANY LTD.**  
(An Israeli Corporation)  
CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Year ended December 31 |           |             |   |
|---|------------------------|-----------|-------------|---|
|   | 2003                   | 2004      | 2005        | 2005  |
|   | New Israeli shekels    |           |             | Convenience translation into U.S. Dollars (note 1a) |
|   | In thousands           |           |             |   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                        |           |             |   |
| Repayment of capital lease  |                        |           | (1,893)     | (411)   |
| Repurchase of company's shares (including purchase cost of NIS 17,591,000 (\$ 3,900,000)) |                        |           | (1,091,841) | (237,202)   |
| Issuance of notes payable under a prospectus, net of issuance costs                       |                        |           | 1,929,223   | 419,123   |
| Redemption of notes payable   |                        |           | (793,100)   | (172,301)   |
| Proceeds from exercise of stock options granted to employees                              | 3,391                  | 25,798    | 37,153      | 8,072   |
| Dividend paid   |                        |           | (41,773)    | (9,075)   |
| Long-term bank loans received   | 240,000                |           | 359,000     | 77,993  |
| Repayment of long-term bank loans   | (895,700)              | (624,147) | (857,004)   | (186,185)   |
| Net cash used in financing activities   | (652,309)              | (598,349) | (460,235)   | (99,986)  |
| <b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                                   |                        |           |             |   |
|   | 2,414                  | 837       | (603)       | (131)   |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>                                     |                        |           |             |   |
|   | 1,360                  | 3,774     | 4,611       | 1,002   |
| <b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>   |                        |           |             |   |
|   | 3,774                  | 4,611     | 4,008       | 871   |
| <b>SUPPLEMENTARY DISCLOSURE OF CASH FLOW INFORMATION - cash paid during the year:</b>     |                        |           |             |   |
| Interest  | 287,629                | 179,205   | 235,854     | 51,239  |
| Advances to income tax authorities  | 3,750                  | 4,900     | 30,840      | 6,700   |

**Supplementary information on investing and financing activities not involving cash flows**

At December 31, 2003, 2004 and 2005, trade payables include NIS 65.7 million, NIS 103.8 million and NIS 90.3 million (\$ 19.6 million), respectively, in respect of acquisition of fixed assets. In addition, at December 31, 2004 and 2005 trade payables include NIS 13.8 million and NIS 27.7 million (\$6.0 million) in respect of acquisition of additional spectrum, respectively.

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At December 31, 2005, dividend payable of approximately NIS 45 million (\$9.8 million) is outstanding.

These balances are recognized in the cash flow statements upon payment.

During 2005, the Company has undertaken a capital lease with respect to fixed assets in the amount of NIS15.8 million (\$ 3.4 million)

**The accompanying notes are an integral part of the financial statements.**

**PARTNER COMMUNICATIONS COMPANY LTD.**  
(An Israeli Corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 1      SIGNIFICANT ACCOUNTING POLICIES:**

**a.      General:**

**Nature of operations:**

- 1) Partner Communications Company Ltd. ( the Company ) operates a mobile telecommunications network in Israel. The Company launched its 3G network on December 1, 2004. As of April 20, 2005, the Company is a subsidiary of Hutchison Telecommunications International Limited ( HTIL ).
- 2) The Company was incorporated on September 29, 1997, and operates under a license granted by the Ministry of Communications to operate a cellular telephone network for a period of 10 years beginning April 7, 1998. The Company commenced full commercial operations on January 1, 1999.

The Company paid a one-time license fee of approximately new Israeli shekels (NIS) 1.6 billion which is presented under license and deferred charges . The Company is entitled to request an extension of the license for an additional period of six years and then renewal for one or more additional six year periods. Should the license not be renewed, the new license-holder is obliged to purchase the communications network and all the rights and obligations of the subscribers for a fair price, as agreed between the parties or as determined by an arbitrator.

In December 2001, the Company was awarded additional spectrum (2G band (1800MHz) and third generation (3G) UMTS band (1900MHz and 2100MHz)). Following the award of the above spectrum, the Company s license was amended and extended through 2022.

In consideration for the above additional spectrum the Company paid NIS 180 million (\$ 39 million) for the 2G spectrum, and is committed to pay NIS 220 million (\$ 48 million) for the 3G spectrum in six installments through 2006, of which approximately NIS 198 million (approximately \$43 million) was paid as of December 31, 2005.

Under the terms of the amended license, the Company provided a guarantee in NIS equivalent of \$ 10 million to the State of Israel to secure the Company s adherence to the terms of the license.

**Use of estimates in the preparation of financial statements**

The preparation of financial statements in conformity with generally accepted accounting principles ( GAAP ) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting years. Actual results could differ from those estimates.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (continued):**

**a. General (continued):**

**Functional currency and reporting currency**

The functional currency of the Company and its subsidiary is the local currency New Israeli Shekels - NIS. The consolidated financial statements have been drawn up on the basis of the historical cost of Israeli currency and are presented in NIS.

**Convenience translation into U.S. dollars ( dollars or \$ )**

The NIS figures at December 31, 2005 and for the year then ended have been translated into dollars using the representative exchange rate of the dollar at December 31, 2005 (\$1 = NIS 4.603). The translation was made solely for convenience. The translated dollar figures should not be construed as a representation that the Israeli currency amounts actually represent, or could be converted into, dollars.

**Accounting principles**

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

**b. Principles of consolidation:**

- 1) The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary (together the Group).
- 2) Intercompany balances between the Company and its subsidiary have been eliminated.

**c. Inventories**

Inventories of cellular telephones (handsets) and accessories are stated at the lower of cost or estimated net realizable value. Cost is determined on the first-in, first-out basis.

The Company determines its allowance for inventory obsolescence and slow moving inventory, based upon expected inventory turnover, inventory aging and current and future expectations with respect to product offerings.

**d. Non-marketable securities**

These investments are stated at cost, less provision for impairment losses, see note 2.



**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):**e. Fixed assets:**

- 1) These assets are stated at cost.
- 2) Direct consultation and supervision costs and other direct costs relating to setting up the Company's communications network and information systems for recording and billing calls are capitalized to cost of the assets.

During 2004, costs incurred relating to the 3G network, prior to the launch of the network, in the amount of NIS 23.4 million were capitalized.

- 3) Interest costs in respect of loans and credit which served to finance the construction or acquisition of fixed assets incurred until installations of the fixed assets are completed are capitalized to cost of such assets.
- 4) Assets are depreciated by the straight-line method, on basis of their estimated useful life.

Annual rates of depreciation are as follows:

|  | %                      |
|--|------------------------|
| Communications network                                   | 10 - 20<br>(mainly 15) |
| Computers, hardware and software for information systems | 15-33                  |
| Vehicles   | 20                     |
| Office furniture and equipment                           | 7-15                   |

Leasehold improvements are amortized by the straight-line method over the term of the lease (including reasonably assured option periods), or the estimated useful life of the improvements, whichever is shorter.

- 5) Fixed assets leased by the Company under capital leases are classified as the Company's assets and are recorded, at the inception of the lease, at the lower of the asset's fair value or the present value of the minimum lease payments.
- 6) Computer Software Costs

The cost of internal-use software is capitalized in accordance with Statement of Position (SOP) No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. Subsequent additions, modifications or upgrades to internal-use software are capitalized only to the extent that they allow the software to perform a task it previously did not perform. Software maintenance and training costs are expensed in the period in which they are incurred. Capitalized computer software costs are amortized using the straight-line method over a period of 5 to 7 years.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (continued):**

**f. License and deferred charges:**

1) License:

The license (see also 1a(2) above) is stated at cost and is amortized by the straight-line method over the utilization period of the license starting January 1, 1999.

Following the extensions of the license (as described in note 1a(2) above) the unamortized balance of the Company's existing license as well as the cost of the additional spectrum put into service are amortized on a straight-line basis over the period ending in 2022.

The costs relating to the 3G band are amortized as of December 1, 2004, by the straight-line method over the period ending in 2022.

Interest expenses which served to finance the license fee incurred until the commencement of utilization of the license were capitalized to cost of the license. During the years 2003 and 2004 NIS 10 million and NIS 8 million interest costs were capitalized to the cost of the license, respectively.

2) Deferred charges:

a) Costs relating to the obtaining of long-term credit lines are deferred and amortized using the effective interest rate determined for the borrowing transactions over the life of line of credit.

b) Issuance costs relating to Notes payable (see note 6) are amortized using the effective interest rate stipulated for the Notes.

**g. Impairment of long-lived assets**

The Company has adopted Statement of Financial Accounting Standards No. 144 (FAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets. FAS 144 requires that long-lived assets, including certain intangible assets, to be held and used by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Under FAS 144, if the sum of the expected future cash flows (undiscounted and without interest charges) of the long-lived assets is less than the carrying amount of such assets, an impairment loss would be recognized, and the assets written down to their estimated fair values.

**h. Cash equivalents**

The Company considers all highly liquid investments, which include short-term bank deposits (up to 3 months from date of deposit) that are not restricted as to withdrawal or use, to be cash equivalents.

**i. Comprehensive income**

The Company has no comprehensive income components other than net income.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1      SIGNIFICANT ACCOUNTING POLICIES** (continued):

**j.      Revenue recognition**

Revenues from services primarily consist of charges for airtime, roaming and value added services provided to the Company's customers, are recognized upon performance of the services, net of credits and adjustments for services discounts. Revenues from pre-paid calling cards are recognized upon customer's usage of the cards. Revenues from sale of handsets and accessories are recognized upon delivery and the transfer of ownership to the subscriber.

Emerging Issues Task Force ( EITF ) Issue 00-21, Revenue Arrangements with Multiple Deliverables addresses the accounting, by a vendor, for contractual arrangements in which multiple revenue-generating activities will be performed by the vendor. It is effective prospectively for all arrangements entered into in fiscal periods beginning after June 15, 2003. EITF Issue 00-21 addresses when and, if so, how an arrangement involving multiple deliverables should be divided into separate units of accounting. The Company adopted EITF Issue 00-21 in the year ended December 31, 2003. The adoption had no impact on its financial position and results of operations. Based on EITF 00-21, the Company determined that the sale of handsets with accompanying services constitutes a revenue arrangement with multiple deliverables. Accordingly consideration received for handsets, up to their fair value, that is not contingent upon the delivery of additional items (such as the services), is recognized as equipment revenues, when revenue recognition criteria for the equipment as stated above are met. Consideration for services is recognized as services revenues, when earned.

**k.      Concentration of credit risks      allowance for doubtful accounts**

The Company's revenues are derived from a large number of customers. Accordingly, the Company's trade balances do not represent a substantial concentration of credit risk. An appropriate provision for doubtful accounts is included in the accounts of the Company. The allowance charged to expenses (including bad debts), determined as a percentage of specific debts doubtful of collection, based upon historical experience, for the years ended December 31, 2003, 2004 and 2005 totaled NIS 15,601,000, NIS 21,256,000 and NIS 28,739,000 (\$ 6,244,000) (see note 13a), respectively.

The cash and cash equivalents as of December 31, 2005 are deposited mainly with leading Israeli banks. Therefore, in the opinion of the Company, the credit risk inherent in these balances is remote.

During 2003 and 2004, the Company factored most of its long-term trade receivables resulting from sales of handsets. The factoring was made through clearing companies, on a non-recourse basis. The sale of accounts receivable was recorded by the Company as a sales transaction under the provisions of Statement of Financial Accounting Standards No.140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities .

The resulting costs were charged to financial expenses-net , as incurred. During the years ended December 31, 2003, 2004 and 2005, the Company factored NIS 295,827,000, NIS 331,611,000 and NIS 7,834,000 (\$1,702,000), respectively, from long-term trade receivables.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (continued):**

**l. Handsets warranty obligations**

The provision for handsets warranty obligations is calculated at the rate of 1.5%-3.5% of the cost of the handsets sold, see note 13c. The Company has entered into several agreements under which the supplier does not provide any warranty but rather provides additional handsets to satisfy its warranty obligation. In these cases, the Company provides for warranty costs at the same time as the revenues are recognized.

**m. Advertising expenses**

Advertising expenses are charged to the statement of operations as incurred. Advertising expenses for the years ended December 31, 2003, 2004 and 2005 totaled NIS 99,061,000, NIS 115,909,000 and NIS 97,651,000 (\$ 21,215,000), respectively.

**n. Deferred income taxes**

Deferred taxes are determined utilizing the asset and liability method, based on the differences between the amounts presented in these financial statements and those taken into account for tax purposes, in accordance with the applicable tax laws. Valuation allowances are provided if, based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized (see note 10d).

Deferred tax assets and liabilities are presented as current or long-term items in accordance with the nature of assets or liabilities to which they relate. Deferred tax assets in respect of carryforward tax losses are presented as current or long-term assets, according to their expected utilization date.

**o. Foreign currency transactions and balances**

Balances in, or linked to, foreign currency are stated on the basis of the exchange rates prevailing at balance sheet dates. For foreign currency transactions included in the statements of operations, the exchange rates at transaction dates are used. Transaction gains or losses arising from changes in the exchange rates used in the translation of such balances are carried to financial income or expenses.

**p. Derivative financial instruments ( derivatives )**

The Company has adopted FAS 133, as amended, which establishes accounting and reporting standards for derivatives, including certain derivatives embedded in other contracts, and for hedging activities. Under FAS 133, all derivatives are recognized on the balance sheet at their fair value. On the date that the Company enters into a derivative contract, it designates the derivative, for accounting purposes, as: (1) hedging instrument, or (2) non-hedging instrument. Any changes in fair value are to be reflected as current gains or losses or other comprehensive gains or losses, depending upon whether the derivative is designated as a hedge and what type of hedging relationship exists. Changes in fair value of non-hedging instruments are carried to financial expenses-net on a current basis. To date, the Company did not have any contracts that qualify for hedge accounting under FAS 133.

The Company occasionally enters into commercial (foreign currency) contracts in which a derivative instrument is embedded . This embedded derivative is separated from the host contract and carried at fair value when (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract and (2) a separate, stand-alone instrument with the same terms would qualify as a derivative instrument (see note 12).

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1      SIGNIFICANT ACCOUNTING POLICIES (continued):**

**q.      Earning Per Share (EPS)**

Basic EPS is computed by dividing net income by the weighted average number of shares outstanding during the years.

Diluted EPS reflects the increase in the weighted average number of shares outstanding that would result from the assumed exercise of employee stock options, calculated using the treasury-stock-method.

**r.      Stock based compensation**

The Company accounts for employee stock based compensation under the intrinsic value model in accordance with Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees ( APB 25 ) and related interpretations. In accordance with FAS 123 Accounting for Stock-Based Compensation ( FAS 123 ), the Company discloses pro forma data assuming the group had accounted for employee stock option grants using the fair value-based method defined in FAS 123. As to the Recently issued revised FAS 123, see t. below. Compensation cost for employee stock option plans is charged to shareholders' equity, on the date of grant of the options, under deferred compensation costs and is then amortized over the vesting period using the accelerated method of amortization.

The weighted average fair value of options granted using the Black & Scholes option-pricing model during 2003, 2004 and 2005 is NIS 26.96, NIS 18.98 and NIS 21.36 (\$4.64), respectively. The fair value of each option granted is estimated on the date of grant based on the following weighted average assumptions: weighted average dividend yield of 0%; expected volatility of 62%, 55% and 58%, respectively; risk-free interest rate: 2003 4.5%, 2004 4%, 2005 3.5%; weighted expected life: 2003 9 years; 2004 and 2005 5 years.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

The following table illustrates the effect on net income and EPS assuming the Company had applied the fair value recognition provisions of FAS 123 to its stock based employee compensation:

|  | Year ended December 31,             |          |          |                                      |
|--|-------------------------------------|----------|----------|--------------------------------------|
|  | 2003                                | 2004     | 2005     | 2005                                 |
|  | NIS                                 |          |          | Convenience translation into dollars |
|  | In thousands, except per share data |          |          |                                      |
| Net income, as reported  | 1,162,650                           | 471,553  | 354,560  | 77,028                               |
| Add: stock based employee compensation expense-net, included in reported net income - net of income taxes                      | 3,313                               | 10,122   | 8,023    | 1,743                                |
| Deduct: stock based employee compensation expense-net, determined under fair value method for all awards - net of income taxes | (12,225)                            | (29,879) | (30,978) | (6,730)                              |
| Pro-forma net income   | 1,153,738                           | 451,796  | 331,605  | 72,041                               |
| Earning per share:   |                                     |          |          |                                      |
| Basic - as reported  | 6.39                                | 2.57     | 2.19     | 0.48                                 |
| Basic - pro forma  | 6.34                                | 2.46     | 2.05     | 0.45                                 |
| Diluted - as reported  | 6.34                                | 2.56     | 2.17     | 0.47                                 |
| Diluted - pro-forma  | 6.31                                | 2.46     | 2.03     | 0.44                                 |

**s. Asset retirement obligations**

The Company has adopted as of January 1, 2003 FAS 143 Accounting for Asset Retirement Obligations ( FAS 143 ). FAS 143 requires that an asset retirement obligation (ARO) associated with the retirement of a tangible long lived asset be recognized as a liability in the period in which it is incurred and becomes determinable (as defined by the standard), with an offsetting increase in the carrying amount of the associated asset. The cost of the tangible asset, including the initially recognized ARO, is depreciated such that the cost of the ARO is recognized over the useful life of the asset.

The ARO is recorded at fair value, and the accretion expense will be recognized over time as the discounted liability is accreted to its expected settlement value. The fair value of the ARO is measured using expected future cash out flows discounted at the Company's credit-adjusted risk-free interest rate.

The Company is subject to asset retirement obligations associated with its cell sites operating leases. These lease agreements contain clauses requiring restoration of the leased site at the end of the lease term, creating asset retirement obligations, see also

note 13d.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1      SIGNIFICANT ACCOUNTING POLICIES** (continued):

**t.      Recently issued accounting pronouncements:**

1)      FAS 123 (revised 2004) Share-based Payment

In December 2004, the Financial Accounting Standards Board ( FASB ) issued the revised Statement of Financial Accounting Standards ( FAS ) No. 123, Share-Based Payment (FAS 123R), which addresses the accounting for share-based payment transactions in which the company obtains employee services in exchange for (a) equity instruments of the company or (b) liabilities that are based on the fair value of the company's equity instruments or that may be settled by the issuance of such equity instruments. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC's interpretation of FAS 123R.

FAS 123R eliminates the ability to account for employee share-based payment transactions using APB Opinion No. 25 Accounting for Stock Issued to Employees, and requires instead that such transactions be accounted for using the grant-date fair value based method. This Statement will be effective for public companies at the beginning of their next fiscal year that begins after June 15, 2005 (first quarter of 2006 for the Company). Early adoption of FAS 123R is encouraged. This Statement applies to all awards granted or modified after the Statement's effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the Statement's effective date shall be recognized on or after the effective date, as the related services are rendered, based on the awards grant-date fair value as previously calculated for the pro-forma disclosure under FAS 123.

The Company expects that upon the adoption of FAS 123R, as of January 1, 2006, the Company will apply the modified prospective application transition method, as permitted by the Statement. Under such transition method, upon the adoption of FAS 123R, the Company's financial statements for periods prior to the effective date of the Statement will not be restated.

Compensation expense for outstanding awards for which the requisite service had not been rendered as of the effective date will be recognized over the remaining service period using the compensation cost calculated for pro-forma disclosure purposes under FAS 123. At December 31, 2005, unamortized compensation expenses related to outstanding unvested options, as determined under FAS 123, that the Company expect to record during 2006 was approximately NIS 20 million (net of forfeited rate).



**PARTNER COMMUNICATIONS COMPANY LTD.** (An Israeli Corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1      SIGNIFICANT ACCOUNTING POLICIES** (continued):

**t.      Recently issued accounting pronouncements** (continued):

- 2)      FAS 154 Accounting Changes and Error Corrections      a replacement of Accounting Principles Board Opinion ( APB ) No. 20 and FASB Statement No. 3.

In June 2005, the Financial Accounting Standards Board issued FAS No. 154,

"Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20

and FASB Statement No. 3". This Statement generally requires retrospective application to prior periods      financial statements of changes in accounting principle. Previously, Opinion No. 20 required that most voluntary changes in accounting principle were recognized by including the cumulative effect of changing to the new accounting principle in net income of the period of the change.

FAS 154 applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This Statement shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 (Year 2006 for the company). The Company does not expect the adoption of this statement will have a material impact on the Company's results of operations, financial position or cash flows.

**NOTE 2      INVESTMENTS IN NON-MARKETABLE SECURITIES**

The Company and its subsidiary had entered into agreements with a number of technological companies in the early stages of development of cellular products (hereafter      the start-up companies). Under the agreements, the Group supplied infrastructure and support services which the start-up companies need to develop their products, in consideration of options and shares in those companies.

Based on the financial position of the companies, management is of the opinion that the fair value of the securities granted to the Group, on the grant date and as of December 31, 2005 is not material.

The Group's holdings in the start-up companies (current and fully diluted) do not exceed 15% of the share capital of any one of them and does not give the Group significant influence over any one of them. Therefore, the investments therein are presented on a cost basis.

During 2003, the Company recorded an impairment loss of approximately NIS 3.5 million, in respect of the above investments.

As of December 31, 2004 and 2005, the balance of these investments was fully impaired.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 3 FIXED ASSETS:**

- a. Composition of fixed assets net, is as follows:

|   | December 31      |                  |  |
|---|------------------|------------------|--|
|   | 2004             | 2005             | 2005                                       |
|   | NIS              |                  | Convenience<br>translation<br>into dollars |
|   | In thousands     |                  |  |
| Communications network                                      | 3,059,305        | 3,428,612        | 744,865                                    |
| Computers, hardware and software for<br>information systems | 607,283          | 707,776          | 153,764                                    |
| Office furniture and equipment                              | 37,069           | 37,699           | 8,190                                      |
| Vehicles  | 2,121            | 427              | 93   |
| Leasehold improvements                                      | 194,417          | 212,102          | 46,079                                     |
| Cellular telephones - base stock                            | 6,309            | 6,309            | 1,371                                      |
|   | <u>3,906,504</u> | <u>4,392,925</u> | <u>954,362</u>                             |
| Less - accumulated depreciation and amortization            | <u>2,063,322</u> | <u>2,624,030</u> | <u>570,070</u>                             |
|   | <u>1,843,182</u> | <u>1,768,895</u> | <u>384,292</u>                             |

Depreciation and amortization in respect of fixed assets totaled NIS 469,205,000, NIS 482,390,000 and NIS 575,606,000 (\$125,050,000) for the years ended December 31, 2003, 2004 and 2005, respectively.

- b. Fixed assets include interest expenses, direct consultation and supervision costs and other direct costs of establishing the cellular communications network and information systems, which were capitalized (before commencing full commercial operations or utilization of the related fixed assets) in respect of:

|   | December 31    |                |   |
|---|----------------|----------------|---|
|   | 2004           | 2005           | 2005  |
|   | NIS            |                | Convenience<br>translation<br>into<br>dollars |
|   | In thousands   |                |   |
| Communications network                                      | 96,939         | 96,939         | 21,060  |
| Computers, hardware and software for<br>information systems | 15,920         | 15,920         | 3,459   |
|   | <u>112,859</u> | <u>112,859</u> | <u>24,519</u>                                 |
| Less - accumulated depreciation                             | <u>75,597</u>  | <u>83,096</u>  | <u>18,053</u>                                 |

|                     | December 31 |        |       |
|---------------------|-------------|--------|-------|
|                     |             |        |       |
| Depreciated balance | 37,262      | 29,763 | 6,466 |

c. As to pledges on the fixed assets see note 11.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 4 LICENSE AND DEFERRED CHARGES:**

|  | December 31      |                  |  |
|--|------------------|------------------|--|
|  | 2004             | 2005             | 2005                                       |
|  | NIS              |                  | Convenience<br>translation into<br>Dollars |
|  | In thousands     |                  |  |
| <b>License</b> (note 1a(2))              | 1,992,455        | 2,047,843        | 444,893                                    |
| Less - accumulated amortization          | 693,823          | 773,079          | 167,951                                    |
|  | <u>1,298,632</u> | <u>1,274,764</u> | <u>276,942</u>                             |
| <b>Deferred charges</b> - in respect of: |                  |                  |  |
| Obtaining long-term credit lines         | 55,996           | 69,816           | 15,168                                     |
| Notes payable                            | 22,017           | 34,265           | 7,444                                      |
|  | <u>78,013</u>    | <u>104,081</u>   | <u>22,612</u>                              |
| Less - accumulated amortization          | 51,053           | 57,678           | 12,531                                     |
|  | <u>26,960</u>    | <u>46,403</u>    | <u>10,081</u>                              |
|  | <u>1,325,592</u> | <u>1,321,167</u> | <u>287,023</u>                             |

License amortization expenses for the years ended December 31, 2003, 2004 and 2005 totaled NIS 58,408,000, NIS 63,931,000 and NIS 79,255,000 (\$17,218,000), respectively.

Amortization expenses on deferred charges for the years ended December 31, 2003, 2004 and 2005 totaled NIS 9,258,000 NIS 11,901,000 and NIS 28,642,000 (\$ 6,222,000), respectively 2005 includes NIS 11,064,000 (\$2,404,000) in respect of the redemption of the Notes, see also note 6b.

The expected license amortization expenses for the next five years are as follows:

|                         | NIS          | Convenience<br>translation into<br>dollars |
|-------------------------|--------------|--|
|                         | In thousands |  |
| Year ended December 31: |              |  |
| 2006                    | 79,255       | 17,218                                     |
| 2007                    | 79,255       | 17,218                                     |
| 2008                    | 79,255       | 17,218                                     |
| 2009                    | 79,255       | 17,218                                     |
| 2010                    | 79,255       | 17,218                                     |



**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 5 LONG-TERM BANK LOANS**

On April 14, 2005 the Company entered into a new \$550 million bank credit facility. The facility is divided into two tranches: a six year \$450 million term loan facility ( Facility A ) and a six year \$100 million revolving loan facility ( Facility B ), and is secured by a first ranking floating charge on the Company's assets. Bank Hapoalim B.M., Bank Leumi Le-Israel B.M. and Israel Discount Bank Ltd. are providing the facility, in which United Mizrahi Bank Ltd. is also participating. The new credit facility replaced the Company's previous facility.

With effect May 1, 2005, the Company exercised an option to reduce Facility A to \$150 million (in addition to an advance of approximately \$25 million carried over from the Company's previous facility, which on balance sheet date, was reduced to \$18 million), and to change the final maturity date of both facilities to September 1, 2009. As a result, the total maximum availability under the new credit facility is approximately \$268 million.

The amount drawn from Facility A is to be repaid in yearly installments with a final maturity of September 1, 2009. Facility B may be drawn and repaid until September 1, 2009.

The credit facility is a dollar denominated facility, and advances may be drawn in different currencies, see c. below.

a. Status of the credit facility at December 31, 2005 is as follows:

|                        | Total<br>availability | Amounts<br>drawn | Amounts<br>available for<br>drawing |
|------------------------|-----------------------|------------------|-------------------------------------|
| US Dollars in millions |                       |                  |                                     |
| Facility A             | 168                   | 140              | 28                                  |
| Facility B             | 100                   | 12               | 88                                  |
|                        | <u>268</u>            | <u>* 152</u>     | <u>116</u>                          |

b. The amounts outstanding, classified by linkage terms and interest rates, are as follows:

|  | December 31, |                  | December 31    |  |
|--|--------------|------------------|----------------|--|
|  | 2005         | 2004             | 2005           | 2005                                       |
| Weighted<br>average<br>interest rates                            | Amount       |                  |                |  |
| %  | NIS          |                  |                | Convenience<br>translation<br>into dollars |
| In thousands   |              |                  |                |  |
| In NIS - linked to the Israeli<br>consumer price index (CPI) (1) | 5.8          | 358,088          | 337,283        | 73,274                                     |
| In NIS - unlinked (2)  | 5.5          | 827,000          | 359,000        | 77,993                                     |
|  |              | <u>1,185,088</u> | <u>696,283</u> | <u>* 151,267</u>                           |
| Less - current maturities  |              |                  | 30,309         | 6,585                                      |

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| December 31, | December 31 |         |
|--------------|-------------|---------|
| 1,185,088    | 665,974     | 144,682 |

(1) Linkage terms apply both to principal and interest.

(2) The loans bear interest at the on-call rate (a varying inter-bank rate in Israel), prime rate or fixed unlinked rate.

\* The difference between the amounts displayed is the difference in exchange rates between the date the amounts were drawn and that at the balance sheet date.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 5 LONG-TERM BANK LOANS (continued):**

- c. Facilities A and B, may be drawn in NIS or US dollars, provided that the amount of principal outstanding in US dollars under the credit facility with respect to each participating lender shall not exceed 10% of that lender's total commitment unless otherwise agreed in advance.
- d. There is a range of options as to how interest is calculated on borrowings under the credit facility. These options include fixed and variable rates, based upon the lending rates of each participating banks with a margin of 0.85%.
- e. The total commitments under the Facilities will be reduced during each of the following years to the following amounts:

|              |      | US Dollars in millions |     |       |
|--------------|------|------------------------|-----|-------|
|              |      | A                      | B   | Total |
| December     | 2006 | 161                    | 100 | 261   |
|              | 2007 | 104                    | 100 | 204   |
|              | 2008 | 50                     | 100 | 150   |
| September 1, | 2009 | 0                      | 0   | 0     |

- f. Under the credit facility the Company is required, inter alia, to fulfill certain operational conditions and to maintain certain financial ratios. If the Company defaults on the covenants, the banks are entitled to demand early repayment of the credit facility in whole or in part. Under the credit facility, the Company has undertaken not to make distributions to its shareholders, including dividends, unless it complies with certain financial ratios specified in the Agreement or as otherwise agreed by the banks. The Company believes that it is in compliance with all covenants stipulated in the credit facility.
- g. As to pledges to secure loans and liabilities and other restrictions placed with respect thereto, see note 11.

**NOTE 6 NOTES PAYABLE:**

- a. On March 31, 2005, the Company completed an offering of NIS 2,000 million of unsecured notes, which were issued at their NIS par value. The notes have been registered in Israel and are traded on the Tel-Aviv stock exchange (TASE). Of these notes approximately NIS 36.5 million were purchased by Partner Future Communications 2000 Ltd., ( PFC ) a wholly owned subsidiary of the Company.

The net proceeds from the offering were approximately NIS 1,929 million (approximately \$419 million) after deducting the notes purchased by PFC, commissions and offering expenses.

The principal amount of the Notes is payable in 12 equal quarterly installments, beginning June 30, 2009 until March 31, 2012. The Notes bear NIS interest at the rate of 4.25% per annum, linked to the Israeli Consumer Price Index, which is payable quarterly on the last day of each quarter, commencing June 30, 2005.



**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 6**      **NOTES PAYABLE** (continued)

On December 31, 2005, the Notes closing price was 101.63 points par value.

Commission fees and offering expenses in respect of the offering of the Notes totaled approximately NIS 34 million. These expenses are presented as deferred charges and the amortization in respect thereof is included in financial expenses, net.

- b. On August 10, 2000, the Company completed an offering of \$ 175 million of unsecured 13% Senior Subordinated Notes due 2010, which were issued at their dollar par value. The notes were registered under the U.S. Securities Act of 1933.

On August 15, 2005, the Company exercised its right to redeem the notes at a redemption price of 106.5% of their dollar par value according to the option stipulated in the Notes document. As a result of the redemption of the Notes the Company has recognized as financial expenses an amount of approximately NIS 63 million (approximately \$ 14), which after tax resulted in a decrease of the Company's net income of NIS 42 million.

**NOTE 7**      **LIABILITY FOR EMPLOYEE RIGHTS UPON RETIREMENT:**

- a. Israeli labor laws and agreements require payment of severance pay upon dismissal of an employee or upon termination of employment in certain other circumstances. The Company's severance pay liability to its employees, mainly based upon length of service and the latest monthly salary (one month's salary for each year worked), is reflected by the balance sheet accrual under the liability for employee rights upon retirement. The Company records the liability as if it was payable at each balance sheet date on an undiscounted basis. The liability is partly funded by purchase of insurance policies and the amounts funded are included in the balance sheet under investments and long-term receivables, as funds in respect of employee rights upon retirement. The policies are the Company's assets and under labor agreements, subject to certain limitations, they may be transferred to the ownership of the beneficiary employees.
- b. The severance pay expenses for the years ended December 31, 2003, 2004 and 2005 were approximately NIS 20 million, NIS 27 million and NIS 24 million (approximately \$ 5 million), respectively.
- c. Cash flows information regarding the company's liability for employee rights upon retirement:
  - 1. The Company expects to contribute NIS 21 million (\$ 4.6 million) in respect of severance pay in 2006.
  - 2. Due to the relatively young age of the Company's employees, benefit payments to employees reaching retirement age in the next 10 years, are not material. The amounts were determined based on the employees' current salary rates and the number of service years that will accumulate upon their retirement date. These amounts do not include amounts that might be paid to employees who will cease working for the Company before their normal retirement age.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 8 COMMITMENTS AND CONTINGENCIES:**

**a. Commitments:**

1) Royalty Commitments

The Company is committed to pay royalties to the Government of Israel on its income from cellular services as defined in the Regulations (see below), which includes all kinds of income of the Company from the granting of Bezeq services under the license including airtime, roaming services and non-recurring connection fees, but excluding income transferred to another holder of a communications license and deducting bad debts, payments to another communication licensee in respect of interconnection, payments for roaming services to foreign operators and expenses related to the sale of equipment.

On June 18, 2001, the Knesset's Finance Committee approved the Telecommunications (Royalties) Regulations, 2001 (hereafter the Regulations). The principal change to the old regulations was the reduction of the percentage of royalties payable by mobile phone companies from 8% to 5% in 2001, 4.5% in 2002, 4% in 2003 and 3.5% in 2004 and thereafter. In addition, the basis in respect of which the royalties are paid has been expanded (as described above). During 2004, a further redaction was approved; accordingly, the rate of royalty payments paid by cellular operators will be reduced annually by 0.5%, starting January 1st 2006, to a level of 1%.

The royalty expenses for the years ended December 31, 2003, 2004 and 2005 were approximately NIS 119,387,000, NIS 120,131,000 and NIS 122,599,000 (\$ 26,635,000), respectively, and are included under cost of services revenues.

2) Under the Telegraph Regulations the Company is committed to pay an annual fixed fee for each frequency used. The Company paid a total amount of approximately NIS 31 million, NIS 31 million and NIS 47 million, for the year 2003, 2004 and 2005, respectively. Under the above Regulations should the Company choose to return a frequency such payment is no longer due.

3) Operating leases

The Company has entered into operating lease agreements as follows:

- a) Lease agreements for its headquarters facility in Rosh Haayin for a fifteen-year period (until 2018). The Company has an option to shorten the lease periods by 3.5 to 8.5 years. The rental payments are linked to the Israeli CPI.
- b) Lease agreements for service centers and retail stores for a period of two to five years. The Company has an option to extend the lease periods for up to twenty additional years (including the original lease periods). The rental payments are linked partly to the dollar and partly to the Israeli CPI. Some of the extension options include an increase of the lease payment in a range of 2%-10%.
- c) Lease agreements in respect of cell sites throughout Israel are for periods of two to three years. The Company has an option to extend the lease periods up to ten years (including the original lease periods). The rental payments fees are partly linked to the dollar and are partly linked to the Israeli CPI. Some of the extension options include an increase of the lease payment in a range of 2%-10%.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 8 COMMITMENTS AND CONTINGENCIES (continued):**

- d) Operating lease agreements in respect of vehicles are for periods of three years. The rental payments are linked to the Israeli CPI.
- e) The minimum projected rental payments (including the payments in the periods of the reasonably assured option terms) for the next five years, at rates in effect at December 31, 2005, are as follows:

|                         | NIS          | Convenience<br>translation<br>into dollars |
|-------------------------|--------------|--|
|                         | In thousands |  |
| Year ended December 31: |              |  |
| 2006                    | 160,579      | 34,886                                     |
| 2007                    | 140,537      | 30,532                                     |
| 2008                    | 121,107      | 26,310                                     |
| 2009                    | 94,325       | 20,492                                     |
| 2010                    | 79,491       | 17,269                                     |
| 2011 and thereafter     | 329,477      | 71,579                                     |
|                         | 925,516      | 201,068                                    |

- f) The rental expenses for the years ended December 31, 2003, 2004 and 2005 were approximately NIS 163 million, NIS 176 million, and NIS 185 million (\$ 40 million), respectively.
- 4) At December 31, 2005, the Company is committed to acquire fixed assets, for approximately NIS 114 million (approximately \$ 25 million).
- 5) At December 31, 2005, the Company is committed to acquire handsets for approximately NIS 160 million (approximately \$ 35 million).
- 6) As to cost sharing agreement with Hutchison Telecommunications Limited, see note 14c.
- 7) The Company has signed on January 22, 2006, an agreement with MED I.C.- 1 (1999) Ltd ( Med 1 ) to purchase the transmission business activity of MED 1, for a consideration of approximately \$15 million, subject to certain adjustments. The transaction is subject to fulfillment of the closing conditions.

**b. Contingent Liabilities:**

- 1) On April 8, 2002, a claim was filed against the Company, together with a motion to certify this claim as a class action, alleging a variety of consumer complaints. The amount of the claim against the Company is estimated at approximately NIS 545 million plus additional significant amounts relating to other alleged damages. Only preliminary hearings have taken place. The Company submitted its response to the amended motion to certify the claim as a class action on August 1, 2005. A hearing is scheduled to May 16, 2006.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 8 COMMITMENTS AND CONTINGENCIES (continued):**

At this stage, and until the claim is recognized as a class action, the Company and its legal council are unable to evaluate the probability of success of such claim, and therefore no provision has been made.

In addition the Company and its legal council are of the opinion that even if the request to recognize this claim as a class action is granted, and even if the plaintiff's arguments are accepted, the outcome of the claim will be significantly lower than the abovementioned amount.

- 2) On April 13, 2003, a claim was filed against the Company and other cellular telecommunication companies, together with a request to recognize this claim as a class action, for alleged violation of antitrust law, alleging that no fee should have been collected for incoming SMS messages or alternatively, that the fee collected is excessive and that it is a result of illegal co-operation between the defendants. The amount of the claim against all the defendants is estimated at approximately NIS 90 million (or according to the claimant's response NIS 100 million per year until 1.3.2005). The Company filed its response on October 1, 2003. The claimants have filed their response to the Company's response on July 12, 2005. A hearing is scheduled for April 26, 2006.

At this stage, no hearings have taken place and unless and until the claim is recognized as a class action, the Company and its legal council are unable to evaluate the probability of success of such claim, and therefore no provision has been made.

- 3) The Company does not have building permits for many of its cell sites and as a result is involved in numerous legal actions (including criminal proceedings against officers and directors) relating to this issue.

Most of these proceedings have been settled under plea bargain arrangements, whereby the Company has paid fines of insignificant amounts.

Management, based upon current experience and the opinion of legal counsel, does not believe that these legal actions will result in significant costs to the Company. The accounts do not include a provision in respect thereof.

- 4) Section 197 of the Building and Planning Law states that a property owner has the right to be compensated by a local planning committee for reductions in property value as a result of a new building plan. On January 3, 2006, the National Council for Planning and Building published an interim decision conditioning the issuance of cell site permits by local planning and building councils upon indemnification, by the cellular operators, against reduction in property value. The Company provided to local authorities (24) letters of undertaking to provide such indemnifications for the benefit of the local authority within 30 days from the enactment of a law or a final court decision requiring such indemnifications. Management, based on the opinion of legal counsel, cannot at this date, determine the effect, if any, of the above letters of undertaking on the financial results and financial position of the Company.
- 5) The Company is a party to various claims arising in the ordinary course of its operations. Management, based upon the opinion of its legal counsel, is of the opinion that the ultimate resolution of these claims will not have a material effect on the financial position of the Company, its result of operations and cash flows. The accounts do not include a provision in respect thereof.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 9 SHAREHOLDERS EQUITY:**

**a. Share capital:**

The Company's shares are traded on the Tel-Aviv stock exchange (TASE), on the London Stock Exchange (LSE) and, in the form of American Depositary Receipts (ADRs), each represent one ordinary share, on the NASDAQ National Market (Nasdaq NM). During 2001, the Company listed its shares in the TASE according to the dual listing regulations. On December 31, 2005, the closing price per ADR on the Nasdaq NM was \$8.41; the Company's shares were quoted on that date on the TASE at NIS 38.73 (\$8.20).

Under the provisions of the license granted to the Company (note 1a(2)), restrictions are placed on transfer of Company shares and placing liens thereon. The restrictions include the requirement that the advance written consent of the Minister of Communications be received prior to transfer of 10% or more of the Company's shares to a third party.

On December 26, 2001, the Company filed a shelf registration statement on Form F-3 with the United States Securities and Exchange Commission for future offerings of its securities. Under the shelf registration, the Company can raise up to \$400 million from the issue of ordinary shares and debt securities.

On April 20, 2005, the Company repurchased approximately 33.3 million of its shares pursuant to an offer received from its founding Israeli Shareholders in February 2005. These shareholders held together approximately 22.5% of the Company's outstanding shares at the time of the offer. As a result of the repurchase, the collective shareholdings of the founding Israeli shareholders was reduced to approximately 5.4% of the Company's issued and outstanding share capital. The price per share at which these shares were acquired was NIS 32.2216 per share. The shares were cancelled pursuant to the repurchase. The excess of cost over its par value was charged to accumulated deficit.

**b. Employee stock option plans:**

- 1) **a.** On March 3, 1999, the Company's Board of Directors approved an employee stock option plan (hereafter the 1998 Plan), pursuant to which 5,833,333 ordinary shares were reserved for issuance upon the exercise of 5,833,333 options to be granted to key employees without consideration, of which 729,166 options were later cancelled. Through December 31, 2005 5,505,557 options have been granted pursuant to the 1998 Plan, of which 4,475,942 options have been exercised and 597,141 options have been forfeited (options forfeited were available for subsequent grants).

The options vest in five equal annual batches over a period of five years from the beginning of employment of each employee, unless otherwise provided in the grant instrument, provided the employee is still in the Company's employ. An option not exercised within 8 years from the date of its allotment shall expire. The exercise price per share of the options granted through December 31, 2000, which is denominated in dollars, is \$ 0.343. During 2002, the Company granted options under the 1998 Plan in accordance with the terms of the 2000 plan, including the exercise price, vesting schedule and expiration date (see b. below).

As of December 31, 2005 195,751 options of the 1998 Plan remain ungranted.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 9 SHAREHOLDERS EQUITY (continued):**

- b.** In October 2000, the Company's Board of Directors approved an employee stock option plan (hereafter the 2000 Plan), pursuant to which 4,472,222 ordinary shares were reserved for issuance upon the exercise of 4,472,222 options to be granted to employees without consideration. The options vest in four equal annual batches over a period of four years from the date of grant of the option, provided the employee is still in the Company's employ. The option holder may exercise all or part of his options at any time after the date of vesting but no later than the expiration of the exercise period, which will be fixed by the Employee Stock Option Committee and will not exceed ten years from the date of option grant.

The NIS denominated exercise price per share of the options, is equal to the market price of the Company's shares on the date on which the options are granted.

During November 2003, 419,930 options of this plan were transferred to options under the 2003 amendment Plan (see c. below).

Through December 31, 2005 5,317,555 options were granted pursuant to the 2000 Plan, of which 2,223,891 options have been exercised, 1,407,833 options were forfeited and 102,250 expired (options forfeited and expired were available for subsequent grants). As of December 31, 2005 244,820 options of the 2000 Plan remain ungranted.

- c.** On November 13, 2003, the Company's Board of Directors approved an amendment to the terms and provision of the 2000 Plan, in order to adjust the terms of the 2000 Plan to comply with new tax legislation that came into force in January 2003. On December 2003, the Company offered the employees, who received options under the 2000 plan, to exchange their unvested options, with the same amount of identical options, under the amended plan and to benefit from the capital gain's tax route pursuant to Section 102(b)(2) of the Israeli Income Tax Ordinance. Employees holding options to purchase 962,104 ordinary shares accepted this offer.

On December 30, 2003, the Company's Board of Directors approved the grant of 195,000 options (out of the 419,930 options that were transferred from the 2000 Plan) under the 2003 amended Plan with an exercise price of NIS 20.45 which was less than the market price on the date of grant. As of December 31, 2005 224,930 options of the 2003 amended Plan remain ungranted.

- d.** In July 2004, the Company's Board of Directors approved a stock option plan (hereafter the 2004 Plan), pursuant to which 5,775,000 ordinary shares were reserved for issuance upon the exercise of 5,775,000 options to be granted without consideration. The options will be granted to employees under the provisions of the capital gain's tax route provided for in Section 102 of the Israeli Income Tax Ordinance. The options vest in four equal annual batches, provided the employee is still in the Company's employ. The option holder may exercise all or part of his options at any time after the date of vesting but no later than the expiration of the exercise period, which will be fixed by the Employee Stock Option Committee and will not exceed ten years from the date of option grant.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 9 SHAREHOLDERS EQUITY (continued):**

Through December 31, 2005 5,614,000 options have been granted to Company's employees pursuant to the 2004 Plan, of which 257,500 options have been exercised and 500,750 options were forfeited.

As of December 31, 2005 661,750 options of the 2004 Plan remain ungranted.

The NIS denominated exercise price per share of the options, is equal to the average market price of the Company's shares for the 30 trading days preceding the day on which the options are granted, less 15%.

- e. The ordinary shares derived from the exercise of the options confer the same rights as the other ordinary shares of the Company.
- f. The plans are subject to the terms stipulated by Section 102 of the Israeli Income Tax Ordinance. Inter alia, these terms provide that the Company will be allowed to claim, as an expense for tax purposes, the amounts credited to the employees as a benefit in respect of shares or options granted under the plans, as follows:

Through December 31, 2003, the amount that the Company will be allowed to claim as an expense for tax purposes will be the amount of the benefit taxable in the hands of the employee.

From January 1, 2004, the amount that the Company will be allowed to claim as an expense for tax purposes, will be the amount of the benefit taxable as work income in the hands of the employee, while that part of the benefit that is taxable as capital gains in the hands of the employee shall not be allowable. All the above is subject to the restrictions specified in Section 102 of the Income Tax Ordinance.

The aforementioned expense for tax purposes will be recognized in the tax year that the employee is taxed, except as described below.

In December 2002, the Company signed an agreement with the tax authorities concerning the tax liabilities of its employees regarding the benefit arising from the options granted to them. According to the agreement, the individual tax rate on the taxable income received by the employees in connection with the benefit arising from the options will be reduced; in return, the Company will defer the deduction of such an expense, for a period of 4 years from the date it commences paying income taxes.

The agreement applies only to employees who have agreed to participate in the arrangement, and relates to (1) options that were exercised by December 31, 2002; and/or (2) options that vest by December 31, 2003 and are exercised by March 31, 2004. In each case, the Section 102 trustee must have held the options for a period of 24 months from the date on which they were granted.

## PARTNER COMMUNICATIONS COMPANY LTD.

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

## NOTE 9 SHAREHOLDERS EQUITY (continued):

- 2) Following is a summary of the status of the plans as of December 31, 2003, 2004 and 2005 and the changes therein during the years ended on those dates:

|  | Year ended December 31 |                                  |             |                                  |             |                                  |
|--|------------------------|----------------------------------|-------------|----------------------------------|-------------|----------------------------------|
|  | 2003                   |                                  | 2004        |                                  | 2005        |                                  |
|  | Number                 | Weighted average exercise price* | Number      | Weighted average exercise price* | Number      | Weighted average exercise price* |
|  |                        | NIS                              |             | NIS                              |             | NIS                              |
| Balance outstanding at beginning of year | 6,611,110              | 18.00                            | 5,340,970   | 19.95                            | 8,911,305   | 24.12                            |
| Changes during the year:                 |                        |                                  |             |                                  |             |                                  |
| Granted**                                | 195,000                | 20.45                            | 5,095,500   | 26.74                            | 518,500     | 32.75                            |
| Exercised                                | (1,100,352)            | 7.06                             | (1,341,647) | 17.67                            | (1,809,000) | 19.21                            |
| Forfeited                                | (304,538)              | 23.03                            | (169,768)   | 21.86                            | (525,750)   | 26.44                            |
| Expired                                  | (60,250)               | 26.28                            | (13,750)    | 27.35                            | (28,250)    | 21.49                            |
| Balance outstanding at end of year       | 5,340,970              | 19.95                            | 8,911,305   | 24.12                            | 7,066,805   | 25.85                            |
| Options exercisable at end of year       | 3,504,914              | 19.35                            | 3,424,675   | 21.29                            | 2,838,928   | 23.83                            |

\* Includes options under the 1998 Plan, the exercise price of which is weighted based on the applicable date's NIS dollar exchange rate.

\*\* Below market price.

The following table summarizes information about options outstanding at December 31, 2005:

| Range of exercise prices | Options outstanding                     |   |                                 | Options exercisable                     |                                 |
|--------------------------|---|---|---------------------------------|---|---------------------------------|
|                          | Number outstanding at December 31, 2005 | Weighted average remaining contractual life | Weighted average exercise price | Number exercisable at December 31, 2005 | Weighted average exercise price |
|                          |   | Years                                       | NIS                             |   | NIS                             |
| 1.58                     | 187,109                                 | 0.7   | 1.58                            | 187,109                                 | 1.58                            |
| 17.25-22.23              | 854,856                                 | 5.3   | 20.45                           | 700,354                                 | 20.42                           |
| 26.74                    | 4,341,500                               | 8.9   | 26.74                           | 743,375                                 | 26.74                           |
| 27.35                    | 1,169,090                               | 3.8   | 27.35                           | 1,169,090                               | 27.35                           |
| 30.73-33.72              | 514,250                                 | 9.2   | 32.77                           | 39,000                                  | 30.73                           |



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| Options outstanding |     |       | Options exercisable |       |
|---------------------|-----|-------|---------------------|-------|
| 7,066,805           | 7.4 | 25.85 | 2,838,928           | 23.83 |
| 30                  |     |       |                     |       |

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 9 SHAREHOLDERS EQUITY (continued):**

**c. Dividends**

On September 13, 2005, the Company's shareholders approved the distribution of a cash dividend in the amount of NIS 0.57 per share (approximately NIS 86.8 million (\$ 18.9 million)) to shareholders on record as of September 26, 2005.

On February 1, 2006, the Company's Board of Directors resolved and recommended the distribution of a cash dividend in the amount of NIS 0.65 per share (approximately NIS 100 million (\$ 22 million)) to shareholders on record as of April 10, 2006. The Dividend payment is subject to the approval of the Company's shareholders.

A cash dividend is paid in Israeli currency.

As to restrictions with respect to cash dividend distributions, see note 5f.

**NOTE 10 TAXES ON INCOME:**

**a. Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985**

Under this law, results for tax purposes are measured in real terms, having regard to the changes in the Israeli CPI. The Company and its subsidiary are taxed under this law.

**b. Tax rates applicable to income of the Company and its subsidiary**

The income of the company and its Israeli subsidiaries (other than income from approved enterprises, see c. below) is taxed at the regular rate. Through December 31, 2003, the corporate tax was 36%. In July 2004, Amendment No. 140 to the Income Tax Ordinance was enacted. One of the provisions of this amendment is that the corporate tax rate is to be gradually reduced from 36% to 30%. In August 2005, a further amendment (No. 147) was published, which makes a further revision to the corporate tax rates prescribed by Amendment No. 140. As a result of the aforementioned amendments, the corporate tax rates for 2004 and thereafter are as follows: 2004 35%, 2005 34%, 2006 31%, 2007 29%, 2008 27%, 2009 26% and for 2010 and thereafter 25%.

As a result of the changes in the tax rates, the company adjusted in each of the years 2004 and 2005 at the time the aforementioned amendments were made, its deferred tax balances, in accordance with the tax rates expected to be in effect in the coming years; the effect of the change has been carried to income on a current basis.

**c. Losses carried forward to future years**

At December 31, 2005, the Group had carryforward losses of approximately NIS 111 million (approximately \$ 24 million). The carryforward tax losses are linked to the Israeli CPI and can be utilized indefinitely.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 10 TAXES ON INCOME** (continued):**d. Deferred income taxes**

The major components of the net deferred tax asset, current and non-current, in respect of the balances of temporary differences and the related valuation allowance as of December 31, 2004 and 2005, are as follows:

|   | December 31    |                |  |
|---|----------------|----------------|--|
|   | 2004           | 2005           | 2005                                       |
|   | NIS            |                | Convenience<br>translation into<br>dollars |
|   | In thousands   |                |  |
| In respect of carryforward tax losses (see c. above)        | 239,894        | 33,566         | 7,292                                      |
| Subscriber acquisition costs                                | 39,976         | 31,233         | 6,786                                      |
| Allowance for doubtful accounts                             | 28,595         | 32,640         | 7,091                                      |
| Provisions for employee rights                              | 15,297         | 14,842         | 3,224                                      |
| Depreciable fixed assets                                    | (31,053)       | (25,533)       | (5,547)                                    |
| Amortized license   | 52,619         | 42,074         | 9,141                                      |
| Options granted to employees                                | 9,614          | 24,331         | 5,286                                      |
| Other   | 697            | 1,952          | 424  |
|   | <u>355,639</u> | <u>155,105</u> | <u>33,697</u>                              |
| Valuation allowance - in respect of carryforward tax losses | (5,694)        | (3,239)        | (704)                                      |
|   | <u>349,945</u> | <u>151,866</u> | <u>32,993</u>                              |

The changes in the valuation allowance for the years ended December 31, 2003, 2004, and 2005, are as follows:

|                              | 2003         | 2004         | 2005         | 2005                                       |
|------------------------------|--------------|--------------|--------------|--|
|                              | NIS          |              |              | Convenience<br>translation<br>into dollars |
|                              | In thousands |              |              |  |
| Balance at beginning of year | 823,072      | 8,555        | 5,694        | 1,237                                      |
| Utilization during the year  | (161,541)    | (2,107)      |              |  |
| Change during the year       | (652,976)    | (754)        | (2,455)      | (533)                                      |
|                              | <u>8,555</u> | <u>5,694</u> | <u>3,239</u> | <u>704</u>                                 |

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During 2004 and 2005, the Company utilized approximately NIS 700 million and approximately NIS 549 million (\$ 119 million) of its carryforward tax losses, respectively.

As of December 31, 2005, the Company would require approximately NIS 98 million of future taxable income in order to fully realize the carryforward tax losses assets.

A full valuation allowance was provided in respect of the wholly owned subsidiary, as it is more likely than not that its deferred tax assets will not be realized.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 10 TAXES ON INCOME** (continued):

- e. Following is a reconciliation of the theoretical tax expense, assuming all income is taxed at the regular tax rates applicable to companies in Israel (see b. above), and the actual tax expense:

|   | Year ended December 31 |          |         |                                      |
|---|------------------------|----------|---------|--------------------------------------|
|   | 2003                   | 2004     | 2005    | 2005                                 |
|   | NIS                    |          |         | Convenience translation into dollars |
|   | In thousands           |          |         |                                      |
| Income before taxes on income, as reported in the income statements   | 529,628                | 758,801  | 557,458 | 121,108                              |
| Theoretical tax expense   | 190,666                | 265,580  | 189,536 | 41,177                               |
| Increase in taxes resulting from adjustment to deferred tax balances due to changes in tax rates, see b above   |                        | 34,521   | 11,442  | 2,486                                |
| Difference between the basis of measurement of income reported for tax purposes and the basis of measurement of income for financial reporting purposes - net |                        | (10,124) | (86)    | (19)                                 |
| Decrease in taxes in respect of valuation allowance reversal  | (652,976)              |          |         |                                      |
| Decrease in taxes resulting from utilization, in the reported year, of carryforward tax losses for which deferred taxes were not created in previous years    | (161,541)              | (2,107)  |         |                                      |
| Other   | (9,171)                | (622)    | 2,006   | 436                                  |
| Taxes on income for the reported year   | (633,022)              | 287,248  | 202,898 | 44,080                               |

**f. Tax assessments:**

- 1) The Company has received final assessment through the year ended December 31, 2001.
- 2) The subsidiary has not been assessed for tax purposes since incorporation.

**NOTE 11 LIABILITIES SECURED BY PLEDGES AND RESTRICTIONS PLACED IN RESPECT OF LIABILITIES**

At December 31, 2005, balances of liabilities of the Company in the amount of NIS 696 million (\$ 151 million) under the Company's credit facility are pledged as a collateral by a first ranking floating charge on all of the Company's current or future business, property, rights and assets, other than the its license. The Company has also undertaken under the credit facility not to create or permit to subsist any further charges on its assets, with certain limited exceptions.



**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 12 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT:****a. Linkage of monetary balances:**

1) As follows:

|  | December 31, 2005  |                                 |           |
|--|--|---------------------------------|-----------|
|  | In or linked<br>to foreign<br>currencies<br>(mainly dollars) | Linked to<br>the Israeli<br>CPI | Unlinked  |
|  | In thousands   |                                 |           |
| <b>NIS:</b>                                      |  |                                 |           |
| Assets   | 628  | 56,348                          | 1,014,943 |
| Liabilities                                      | 186,865  | 2,363,203                       | 1,030,248 |
| <b>Convenience translation into<br/>dollars:</b> |  |                                 |           |
| Assets   | 136  | 12,242                          | 220,496   |
| Liabilities                                      | 40,596   | 513,405                         | 223,821   |

2) Data regarding the dollar exchange rate and the Israeli CPI:

|                                      | Exchange<br>rate of one<br>dollar | Israeli<br>CPI* |
|--------------------------------------|-----------------------------------|-----------------|
| At December 31:                      |                                   |                 |
| 2005                                 | NIS 4.603                         | 185.05 points   |
| 2004                                 | NIS 4.308                         | 180.74 points   |
| 2003                                 | NIS 4.379                         | 178.58 points   |
| 2002                                 | NIS 4.737                         | 182.01 points   |
| Increase (decrease) during the year: |                                   |                 |
| 2005                                 | 6.8%                              | 2.4%            |
| 2004                                 | (1.6)%                            | 1.2%            |
| 2003                                 | (7.6)%                            | (1.9)%          |

\* Based on the index for the month ending on each balance sheet date, on the basis of 1993 average = 100.

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 12 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued):****b. Derivative financial instrument foreign exchange risk management**

The Company enters into foreign currency derivative transactions in order to protect itself against the risk that the eventual dollar cash flows resulting from the anticipated payments in respect of purchases of handsets and capital expenditures in foreign currency will be affected by changes in exchange rates. In addition the Company enters into derivative transactions in order to protect itself against the increase in the CPI in respect of the principal of the CPI-linked Notes payable. However, these contracts do not qualify for hedge accounting under FAS 133.

The Company does not hold or issue derivative financial instruments for trading purposes.

As the counterparties to the derivatives are Israeli banks, the Company considers the inherent credit risks remote.

The notional amounts of foreign currency derivatives as of December 31, 2004 and 2005 are as follows:

|   | December 31   |       |  |
|---|---------------|-------|--|
|   | 2004          | 2005  | 2005                                       |
|   | NIS           |       | Convenience<br>translation<br>into dollars |
|   | (In millions) |       |  |
| Forward transactions for the changes in the Israeli CPI   |               | 1,500 | 326  |
| Forward transactions for the exchange of dollars into NIS | *1,094        | 129   | 28   |
| Embedded derivatives - dollars into NIS                   | 132           | 183   | 40   |

\* On August 2004, the Company entered into a forward transaction that hedged the Notes payable principal (\$ 175 million) until August 2005.

The derivative financial instruments are for a period of up to one year. As of December 31, 2005, the remaining contractual lives are for periods up to one year.



**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 12 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued):****c. Fair value of financial instruments**

The financial instruments of the Company as of December 31, 2005 consist mainly of non-derivative assets and liabilities (items included in working capital and long-term liabilities); the Company also has some derivatives, which are presented at their fair value.

In view of their nature, the fair value of the financial instruments included in working capital is usually identical or close to their carrying value. The fair value of long-term loans approximates the carrying value, since they bear interest at rates close to the prevailing market rates. Regarding the fair value of Notes payable see note 6.

The fair value of derivatives as of December 31, 2005, is a liability of approximately NIS 7 million (approximately \$1.5 million) and an asset of approximately NIS 5.1 million (approximately \$1.1 million) (December 31, 2004 a liability of approximately NIS 55.3 million).

**NOTE 13 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION:****a. Accounts receivable:**

|   | December 31  |          |  |
|---|--------------|----------|--|
|   | 2004         | 2005     | 2005                                       |
|   | NIS          |          | Convenience<br>translation<br>into dollars |
|   | In thousands |          |  |
| 1) Trade (current and long-term)              |              |          |  |
| The item is presented after the deduction of: |              |          |  |
| (a) Deferred interest income*                 | (16,968)     | (35,946) | (7,809)                                    |

\* Long-term trade receivables (including current maturities) as of December 31, 2004 and 2005 in the amount of NIS 184,706,000 and NIS 406,072,000 (\$ 88,219,000), respectively, bear no interest. These balances are in respect of handsets sold in installments (mostly 36 monthly payments).

Income in respect of deferred interest is the difference between the original and the present value of the trade receivable. The current amount is computed on the basis of the interest rate relevant to the date of the transaction (5% 5.4%) (2004 5% 5.9%).

(b) Allowance for doubtful accounts. The changes in the allowance for the years ended December 31, 2003, 2004, and 2005, are as follows:

|  | 2003         | 2004 | 2005 | 2005                                       |
|--|--------------|------|------|--|
|  | NIS          |      |      | Convenience<br>translation<br>into dollars |
|  | In thousands |      |      |  |
|  |              |      |      |  |

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|                              | 2003     | 2004     | 2005    | 2005    |
|------------------------------|----------|----------|---------|---------|
| Balance at beginning of year | 74,622   | 77,295   | 86,651  | 18,825  |
| Utilization during the year  | (12,928) | (11,900) | (6,590) | (1,432) |
| Change during the year       | 15,601   | 21,256   | 28,739  | 6,244   |
| Balance at end of year       | 77,295   | 86,651   | 108,800 | 23,637  |

36

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 13 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):**

2) Other:

|                         | December 31   |               |  |
|-------------------------|---------------|---------------|--|
|                         | 2004          | 2005          | 2005                                       |
|                         | NIS           |               | Convenience<br>translation<br>into dollars |
|                         | In thousands  |               |  |
| Government institutions | 24,183        | 51,340        | 11,154                                     |
| Prepaid expenses        | 14,248        | 13,386        | 2,908                                      |
| Sundry                  | 31,727        | 32,402        | 7,039                                      |
|                         | <u>70,158</u> | <u>97,128</u> | <u>21,101</u>                              |

**b. Accounts payable and accruals other:**

|   | December 31    |                |  |
|---|----------------|----------------|--|
|   | 2004           | 2005           | 2005                                       |
|   | NIS            |                | Convenience<br>translation<br>into dollars |
|   | In thousands   |                |  |
| Employees and employee institutions       | 87,537         | 81,501         | 17,706                                     |
| Provision for vacation and recreation pay | 22,844         | 22,827         | 4,959                                      |
| Value added tax                           | 45,830         | 38,332         | 8,328                                      |
| Income received in advance                | 53,019         | 58,655         | 12,743                                     |
| Accrued interest on long-term liabilities | 39,553         | 22,654         | 4,922                                      |
| Derivative instruments                    | 55,331         | 5,138          | 1,116                                      |
| Handsets warranty                         | 1,734          | 1,064          | 231  |
| Sundry                                    | 1,516          | 1,309          | 284  |
|   | <u>307,364</u> | <u>231,480</u> | <u>50,289</u>                              |

c. Provision for warranty the changes in the provision for warranty for the years ended December 31, 2003, 2004, and 2005, are as follows:

| 2003 | 2004 | 2005 | 2005 |
|------|------|------|------|
| NIS  |      |      |      |

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|  | 2003                | 2004    | 2005    | 2005  |
|--|---------------------|---------|---------|---|
|  |                     |         |         | <b>Convenience<br/>translation<br/>into dollars</b> |
|  | <b>In thousands</b> |         |         |   |
| Balance at beginning of year               | 2,589               | 2,053   | 1,734   | 377   |
| Product warranties issued for<br>new sales | 4,215               | 2,943   | 2,420   | 525   |
| Utilization during the year                | (4,751)             | (3,262) | (3,090) | (671)   |
| Balance at end of year                     | 2,053               | 1,734   | 1,064   | 231   |

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 13 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):****d. Other liabilities:**

1. Asset retirement obligations the changes in the asset retirement obligations for the years ended December 31, 2003, 2004 and 2005, are as follows:

|  | 2003         | 2004         | 2005         | 2005                                       |
|--|--------------|--------------|--------------|--|
|  | NIS          |              |              | Convenience<br>translation<br>into dollars |
|  | In thousands |              |              |  |
| Balance at January 1,                        | 4,665        | 6,367        | 7,567        | 1,644                                      |
| Liability incurred<br>during the year        | 626          | 833          | 682          | 148  |
| Liability settled during<br>the year         | (341)        | (271)        | (751)        | (163)                                      |
| Accretion expenses                           | 296          | 638          | 659          | 143  |
| Revision in the estimates<br>during the year | 1,121        |              |              |  |
| Balance at December 31,                      | <u>6,367</u> | <u>7,567</u> | <u>8,157</u> | <u>1,772</u>                               |

2. Capital lease:

|                                   | December 31, 2005 |   |
|-----------------------------------|-------------------|---|
|                                   | NIS               | Convenience<br>translation<br>into U.S<br>dollars |
|                                   | In thousands      |   |
| Total commitment                  | 17,018            | 3,697   |
| Less - deferred interest expenses | 1,836             | 399   |
| Long term lease                   | 15,182            | 3,298   |
| Less - current maturities         | 4,155             | 902   |
|                                   | <u>11,027</u>     | <u>2,396</u>                                      |

The lease is linked to the US dollar and bears interest at the rate of 5.75%. The lease (net of current maturities) mature in the following years after the balance sheet dates:

December 31

|             | NIS              | Convenience<br>translation<br>into U.S<br>dollars |
|-------------|------------------|---|
|             | NIS in thousands |   |
| Second year | 4,175            | 907   |
| Third year  | 4,486            | 975   |
| Fourth year | 2,366            | 514   |
|             | 11,027           | 2,396   |

**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 13 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):****e. Financial expenses, net:**

|   | Year ended December 31 |                |                |                                      |
|---|------------------------|----------------|----------------|--------------------------------------|
|   | 2003                   | 2004           | 2005           | 2005                                 |
|   | NIS                    |                |                | Convenience translation into dollars |
| In thousands  |                        |                |                |                                      |
| Financial income                                      | (1,952)                | (3,521)        | (5,934)        | (1,289)                              |
| Financial expenses                                    | 320,771                | 203,115        | 214,741        | 46,652                               |
| Expenses relating to the redemption of notes, note 6b |                        |                | 62,615         | 13,603                               |
| Derivative instruments                                | 59,580                 | 63,356         | (45,492)       | (9,883)                              |
| Exchange rate differences                             | (59,168)               | (8,978)        | 49,839         | 10,828                               |
| CPI Linkage differences                               | (4,554)                | 2,285          | 69,029         | 14,996                               |
| Factoring costs                                       | 17,111                 | 17,459         | 650            | 141                                  |
| Less - capitalized interest                           | (10,078)               | (13,171)       |                |                                      |
|   | <u>321,710</u>         | <u>260,545</u> | <u>345,448</u> | <u>75,048</u>                        |

**f. Diluted EPS**

Following are data relating to the net income and the weighted average number of shares that were taken into account in computing the basic and diluted EPS:

|   | Year ended December 31 |                |                  |                                      |
|---|------------------------|----------------|------------------|--------------------------------------|
|   | 2003                   | 2004           | 2005             | 2005                                 |
|   | NIS                    |                |                  | Convenience translation into dollars |
| In thousands  |                        |                |                  |                                      |
| Net income used for the computation of basic and diluted EPS (in thousands) | <u>1,162,650</u>       | <u>471,553</u> | <u>354,560</u>   | <u>77,028</u>                        |
| Weighted average number of shares used in computation of basic EPS          | 181,930,803            | 183,389,383    | 161,711,125      | 161,711,125                          |
| Add - net additional shares from assumed exercise of employee stock options | <u>1,312,354</u>       | <u>719,534</u> | <u>1,906,147</u> | <u>1,906,147</u>                     |

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Year ended December 31

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|  |             |             |             |             |
|--|-------------|-------------|-------------|-------------|
| Weighted average number of shares used in computation of diluted EPS | 183,243,157 | 184,108,917 | 163,617,272 | 163,617,272 |
|--|-------------|-------------|-------------|-------------|

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**PARTNER COMMUNICATIONS COMPANY LTD.**

(An Israeli Corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 14 TRANSACTIONS AND BALANCES WITH RELATED PARTIES:****a. Transactions with related parties:**

|  | Year ended December 31 |         |         |  |
|--|------------------------|---------|---------|--|
|  | 2003                   | 2004    | 2005    | 2005                                       |
|  | NIS                    |         |         | Convenience<br>translation<br>into dollars |
|  | In thousands           |         |         |  |
| Purchase of fixed assets from related party                          |                        | 4,678   |         |  |
| Acquisition of handsets from related parties                         | 203,675                | 380,721 | 180,412 | 39,194                                     |
| Financial expenses, mainly in respect of the Facility agreement, net | 67,906                 | 55,048  | 7,145   | 1,552                                      |
| Selling commissions, maintenance and other expenses                  | 7,458                  | 4,116   | 14,221  | 3,090                                      |
| Dividend   |                        |         | 44,996  | 9,775                                      |

As to the repurchase of Company's share, see note 9a. The transactions are carried out in the ordinary course of business. Management believes that such transactions were carried out under normal market conditions.

**b. Balances with related parties:**

|                           | December 31  |        |  |
|---------------------------|--------------|--------|--|
|                           | 2004         | 2005   | 2005                                       |
|                           | NIS          |        | Convenience<br>translation<br>into dollars |
|                           | In thousands |        |  |
| Cash and cash equivalents | 4,136        |        |  |
| Accounts receivable trade |              | 1,273  | 277  |
| Current liabilities       | 15,314       | 58,173 | 12,638                                     |
| Long-term liabilities     | 316,166      |        |  |

December 31

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**c. Cost sharing agreement**

The Company entered, on August 15, 2002, into a Cost Sharing Agreement (the Agreement ) with Hutchison Telecommunications Limited, or HTL, and certain of its subsidiaries (hereafter - the Hutchison group ). The principal purpose of the Agreement is to regulate the sharing of costs associated with various joint procurement and development activities relating to the roll out and operation of a 3G Business.

The Agreement sets out the basis upon which expenses and liabilities are paid or discharged by the Hutchison group companies in connection with the joint procurement or development activities. Under the Agreement, the Company has the right to decide, and give notice of, which of the joint projects it wishes to participate in. As of December 31, 2005, the Company had given notice of its participation in 7 projects. The Company s expected share in these projects in financial terms (including its share of joint expenses and liabilities) is not material.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Current Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Partner Communications Company Ltd.

BY: /S/ Alan Gelman

Alan Gelman  
Chief Financial Officer

Dated: March 8, 2006

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