

Africa Israel

(Bloomberg Ticker: AFIL IT)

The company's London-listed subsidiary, AFI Development, issued an update yesterday that focused on the advances being made in its major projects. Our take: nothing of substance was conveyed in the report.

Cautious optimism?

AFI Development's chief executive, Alexander Khaldey, stated that in the final months of 2009, he saw signs of recovery in the market.

For our part, we're inclined to say, 'Progress? Yes. Material progress? No.'

Is there a newsworthy story here?

Not in our view. The details are as follows:

- The company reports that it resumed working on its main projects. That's old news. The construction of Mall of Russia (part of the Moscow City project) was never mothballed. Construction at Tverskaya Mall site was and remains on low flame. The next stage in the Ozerkovskaya project requires additional financing. In short, progress can at best be described as slow, and the CEO's update was virtually identical with the one he issued two months ago.
- Mall of Russia's opening has been postponed once again, this time until the end of the year, rather than the middle. This project comprises the main test facing the company. As of the present, some 40% of the shopping and entertainment center's available space has been leased out—up from the 35% level mentioned in the previous update. Progress has been slow and faces challenges. The company has reached an understanding with the Moscow municipality to the effect that AFIL will do infrastructure work at the Moscow City project and will receive part of the municipality's 25% stake in the complex as payment. What will this entail in terms of costs? What percentage of the municipal stake will AFIL receive? No answers have been provided.
- **Tverskaya Mall in Moscow continues to move ahead, but slowly.** The project is complex in terms of engineering, and while representing major potential for the company, it also bears significant risks. AFIL has already sunk around \$80m into the project, and is currently in negotiations with the Moscow municipality regarding the latter's participation in the project's development costs. This project wasn't highlighted in the company's update, but we recommend that investors focus closely on the risks it entails, not just the potential.
- **Progress in additional projects.** The update mentioned other projects the company is involved in, including Ozerkovskaya Embankment, Paveletskaya business park, and (for the first time) Kalinina. Cautious optimism is all well and good. But the three projects are fall smaller than the two main mentioned previously.

In sum: AFIL has reiterated that the market has stabilized. That said, challenges aren't lacking. As of this morning, AFI Development (AFID) shares were trading at \$2.10. Last November, they traded at \$2.30.

Selling pressure risk

Our NAV model, which prices in the market value of AFI Development (AFID) suggests AFIL is worth less than NIS 20/share – indicating a problematic risk/return profile.

When in March of this year Africa Israel completes the terms of its settlement vis-à-vis bondholders, the company's creditors will receive 88,000,000 shares of AFID, arousing real concern that these new shareholders will begin unwinding their positions in the stock. Its listing on London's main stock exchange will increase the stock's liquidity.

Africa Israel's stock may also come under pressure if large numbers of investors choose to reduce their exposure to the company. The per-share value of the stock bondholders will be receiving is NIS 36.

Summing up: Risks would still seem to outweigh rewards. Plenty of challenges still face the company. Accordingly, we're maintaining our Sell rating on the stock.

Is the Russian winter over? Slow progress, high risk

Updates

- Rating
- Price target
- Forecast

Key figures

Rating	Sell
Price target (NIS)	NA
Current price (NIS)	48

NAV Value/share	17
12-mo. Change	37%
12-mo. Change TA-25	72%
12-mo. high (NIS)	86.5
12-mo. low (NIS)	30.1
Daily volume (m' NIS)	
Free float	25%
Previous rating	Sell
Previous price target	NA

AFIL vs TA-25 Index (1 year)



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Warning notes and full disclosure concerning this analysis

a. Details on the author of the analysis

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b. Full disclosure by the author of this analysis

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

c. Notes on the analysis

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

2. The model we've used in establishing a price target for AFIL is based on the value of its properties, whereby commercial properties have been assessed on the basis of a multiple of net operating income and properties the company is developing have been valued using the discounted cash flow method.

3. The principal risks with the potential to materially affect our price target for AFIL include:

- A downturn in the global real estate market generally, and that in Eastern Europe in particular.
- The failure of the company to meet the targets it's set itself in projects being developed, including compliance with such parameters as time schedules, sales or rental targets, and construction budgets.
- Difficulties in attaining financing to further the company's expansion. In AFIL's main business lines, the availability of capital is of critical importance if the company hopes to achieve its objectives.
- A decline in the value of the company's properties, either associated with an increase in cap rates, which serve as a key parameter in setting the value of properties in general, or a fall in the price that capital markets are willing to attribute to real estate holding companies based on their underlying assets.

d. Independent Judgment

I, Yuval Ben Zeev, License Number 5380, declare that the opinions stated in this analysis faithfully represent my personal opinions about the shares reviewed and the corporation which issued these shares.

Yuval Ben Zeev

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