

Alrov (Israel) Bloomberg: ALRO IT

Four Reasons, One Conclusion Mamilla, Switzerland, Banks, Protalix. BUY, 145 ILS PT

After a long period we are returning to recommend shares of Alrov with a Buy recommendation, at 145 ILS, 40% higher than the share is traded as of this morning.

Following are the key reasons for our recommendation:

Mamilla:

- The commercial Mamilla Center.** The shopping center at the Mamilla Center in Jerusalem is gaining momentum. As of today, almost all the area is leased, except for the office tower which has not yet been completed, with rental income of 35 m. ILS a year, will go up to 40-45 m. ILS during 2010. In our opinion, there is a potential of 150 m. ILS profit in the center.
- The new hotel in the Mamilla Center** just opened and is very successful. After the test run period which produced, as expected, good results, we expect the hotel will become profitable in the coming months, and starting next year will contribute \$10 m. a year. We believe the hotel has a profit potential of 100-150 m. ILS.
- Luxury housing in Mamilla Center.** To date over 50% were sold for 170 m. ILS, with a 90 m. ILS profit. The value of the remaining units for sale is 220 m. ILS, and we expect a profit potential of at least 125 m. ILS.

Europe:

- Rent yielding Real Estate in Europe** – profit and cash flow. The company's real estate in Europe includes assets in Switzerland and France. These assets yield a free cash flow of \$20-25 m. a year (after principal and interest), and are not yet revaluated in the financial reports. The balance of the potential profit from these assets is estimated at 540 m. ILS (400 m. ILS without minority interest).
- Potential in hotels abroad:** projects at the initial stage to build luxury hotels in Paris and Amsterdam. These are not yet expressed in the potential for creating value.

Banks & Protalix:

- An increase in the securities portfolio.** Alrov's securities portfolio totaled 600 m. ILS at the end of 2Q09, mostly because of Bank Leumi and Bank Hapoalim shares. Since that time, the portfolio value increased by 280 m. ILS.
- Investment in Protalix.** The company holds 6 m. shares of Protalix, valued at \$50 m., 100 m. ILS (115%) more than at the end of the second quarter.

Other

- Low debt in Israel.** At first glance one could think that the company is highly leveraged. However it is important to note three points: a) Most of the assets were not revaluated, i.e. the debt ratio is very low. b) Most of the debt is in non-recourse loans against assets in Europe, which leaves a substantial cash flow surplus. c) The low bond yield (4.6%) supports our estimates.
- Dividend.** The company is distributing dividends at the rate of 30% of its net profit. In our opinion, the total dividend expected to be distributed over the next 12 months totals 80-100 m. ILS, representing a 6%-7% return.
- Attractive pricing.** The models outlined below result in a price of 85 ILS per Alrov Real Estate share, and 145 ILS per Alrov Israel share.

Conclusion: Buy Alrov (Israel) with a 145 ILS Price Target.

Update

- Rating**
- Price target**
- Forecast**

Key figures

Rating	Buy
Price target	145 NIS
Current price (NIS)	104
Market cap (m' NIS)	1420
12-mo. high (NIS)	109.00
12-mo. low (NIS)	13.61
12-mo. change	190%
12-mo. change TA25	39%

Previous rating NA
Previous PT NA

Updated Valuation Models

Alrov Israel

Alrov - Revaluation Equity Model		
Equity	993	Ex-Minority Rights
Addition to fair value		
Increase in securities portfolio	266	LUMI investment
Increase in venture capital	77	Protalix
Investment real estate in Israel	99	
Increase due to Alrov's share in real estate	842	87%
Total before tax	1,284	
Tax	-257	20%
Total addition to capital	1,027	
Capital after revaluation	2,020	

HQ expenses	-77	12mm ILS/yr
Total fair value	1,943	
Value per share	₪ 143	
Share Price	102.2	
Difference	39.7%	

Total Shares Outstanding	13,614,537
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Notes

Addition due to securities portfolio

Leumi Shares	
Book value on 30.06.09	530 FX rate 30.9
Current Value	796 current FX
Addition to Leumi Shares	266

Additions due to venture capital investments

Book value on 30.06.09	131 mostly PLX
Current value	230 PLX
Addition to fair value	99
Share holders share	77 78%

Alrov Real Estate Assets

Alrov Real Estate - Revaluation Equity Model		
Equity	976	Share holders share, not including minority rights for 30.06.09
Cancellation of deferred tax	61	Influence of reduced tax rate on deferred taxes
Addition to fair value		
Hotel and commercial areas in Mamilla center	214	capitalization rate of 10%
Apartments in Mammila center	126	Profit expectation of 36%
Investment real estate in Israel	196	According to note 13 in annual report
Real estate abroad	404	According to note 13 in annual report
Investment in Hotels abroad	0	In spite of the potential , we did not include in the model
Increase in securities portfolio	28	Investment in bank Hapoalim shares
Total before tax	968	
Tax	-194	20%
Total additions to capital	836	
Capital after revaluation	1,812	

HQ Expenses	-64	According to 10 Million ILS and a multiplier of 8 after tax
Total fair value	1,748	
Valur per share	₪ 86	
Share Price	60.0	
Difference	42.5%	

Total Shares Outstanding	20,438,015
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Notes

Revaluation of the Mamilla Project

Only Metzudat David (David Citadel Hotel) was revalued and the following refers only to the commercial areas and to the new hotel

Total cost of the project	586	
Expected rent from the commercial areas	45	Current rent 30-35
Expected operating surplus from hotel	35	the hotel passed the breakeven point and is expected to contribute \$10 Million annually
Total cost of the project	80	
Fair value	800	based on capitalizatic 10%
Additions to fair value	214	before tax

Expected additions to Mamilla apartments

Cost	224	not including sold apartments at a profit of 173 potential profit	92	53%
Value of apartments	350			
Potential profit	126	36%		

Additions due to real estate investments in Israel

Fair value	636	based on capitalization rate of 8%-9%, note 13C in annual report
Value in balance sheet	440	based on historical value, not revaluated
Addition to fair value	196	

Additions due to Investment Real Estate abroad

Fair Value	2,922	based on capitalization rate of 4.5% - 5.2% in Switzerland which make up the bulk of the assets, note 13C in annual report
Value in balance sheet	2,384	Based on historical value - not revaluated
Addition to fair value	538	
share holders equity	404	75%

Assets abroad

Fifteen assets in Switzerland		
Annual rent	CHF 35.6	
Cost	CHF 589	
Represents a return of	6.0%	
Debt	CHF 535	for assets refinancing
Interest	1.9%	Basic interest with insurance for an increase up to 2.7% (cost of insurance 0.4%) + 1.25% margin
Margin	4.1%	

Cash flow from assets in Switzerland

Revenues	CHF 35.6
Interest	CHF 10.2
Principas	CHF 5.0
Net Cash Flow	CHF 20.4

Fourteen assets in France

Annual rent	6.0 €	
cost	69.0 €	
represents a return of	8.7%	
Debt	63.5 €	
Interest	4.1%	46 million at 5% and 16 million at an interest (0.5%) + 1% margin
Margin	4.6%	

Cash flow from assets in France

revenues	6.0 €
Interest	2.6 €
Principal	1.0 €
Net cash Flow	2.4 €

Addition for Poalim bank Shares

Book Value on 30.06.09	77	exchange rate on 30.1	₪ 10.46 Total shares (M)	7
Current Value	105	current exchange rate	₪ 14.33	
Addition for Poalim bank Shares	28			

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Warning notes and full disclosure concerning this analysis

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b. Full disclosure by the author of this analysis

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

c. Notes on the analysis

1. Scale of recommendations
 - a. **Buy** – the stock is expected to out perform TA100 by 20% or more in 12 months.
 - b. **Outperform** - the stock is expected to out perform TA100 by 10% to 20% in 12 months.
 - c. **Marketperform** – the stock is expected to out perform/ under perform TA100 by 10 % in 12 months.
 - d. **Underperform** – the stock is expected to under perform TA100 by 10% to 20% in 12 months.
 - e. **Sell** – the stock is expected to under perform TA100 by 20% or more in 12 months.

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