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Alony-Hetz Properties & Investments Ltd.

April 18, 2024

Research Update

Outlook Revised To Negative On Potential Deviation From A Leverage Level Commensurate with the Rating; 'ilAA-' Rating Affirmed

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Rating Action Overview

- In the past year, the value of the asset portfolio of Alony-Hetz Properties and Investments Ltd. ("Alony-Hetz" or "the Company") decreased by about 14% to about NIS 13 billion. This decrease was largely due to sharp negative revaluations in the Company's non-tradable real estate companies. On the other hand, in 2023 the Company invested about NIS 443 million in the portfolio.
- As a result, the portfolio's LTV (loan to value) ratio increased to about 45% currently from about 35% at the time of our last surveillance in May 2023. A further decrease in the value of the companies in Alony-Hetz's asset portfolio may lead to its leverage exceeding the level commensurate with the current rating.
- On the other hand, the Company has maintained a stable dividend flow from its major assets, as well as moderate financial flexibility, supported by over 50% tradable assets in its portfolio. The Company's liquidity remained 'adequate', supported by the tradability of its two major holdings, good access to the capital market and a large share of unencumbered assets.
- Therefore, on April 18, 2024, we affirmed our 'ilAA-' rating on Alony-Hetz Properties & Investments Ltd. and on its bonds and revised our outlook to negative.
- The negative outlook reflects our assessment that in the next 12 months there is uncertainty regarding the Company's ability to reduce its leverage, as the latter depends on the value of the Company's asset portfolio and in particular on the value of its non-tradable assets, on the scope of the Company's investments and on its ability to implement deleveraging measures.
- We acknowledge a high degree of uncertainty regarding the scope, duration and effects of the war in Israel. If the conflict expands to additional fronts, it could significantly increase the adverse risk to macroeconomic parameters in Israel and capital market volatility. There are already concerns that Israel's main economic indicators may be weaker than expected (see Israel Outlook Revised To Negative On Geopolitical Risks; 'AA-' Ratings Affirmed, published on October 24, 2023). As the situation evolves, we will update our assumptions and estimates accordingly.

Rating Action Rationale

In the past year, the value of Alony-Hetz's portfolio decreased by about 14% to about NIS 13 billion. This decrease was largely due to a substantial decrease in the value of the Company's non-tradable subsidiaries that operate in the real estate sector in the U.S. and the U.K,, against the backdrop of higher capitalization rates mainly in the second half of 2023, inter alia due to a high interest rate environment and the effects of remote work and a potential reduction in demand for rental spaces in the office segment. Alony-Hetz's share in the negative revaluations recorded in its non-tradable affiliates amounted to about NIS 2.6 billion in 2023 (including a positive revaluation of about NIS 133 million in Amot Investments Ltd. ["Amot", (ilAA/Stable/ilA-1+)]). This follows a negative revaluation of about 0.8 billion NIS in 2022 (company share, including a positive revaluation of about 538 million NIS in Amot). In the Company's tradable affiliates, the value of the holding in Amot decreased by about 16% since our previous surveillance, mainly due to the decrease in share value, but also due to the sale of 12 million shares in November 2023. At the same time, the value of the Company's other tradable holding, Energix - Renewable Energies Ltd. ("Energix", ilA/Stable), increased by about 18%.

The Company's leverage increased due to the decrease in portfolio value and continued investment. The decrease in portfolio value was partially offset by investments of about NIS 443 million Alony-Hetz made in its affiliates in 2023, mainly about NIS 117 million in Carr (as part of a dividend reinvestment plan - DRIP) and about NIS 274 million in Brockton Everlast, including the conversion of a bridging loan to equity. The Company's net financial debt increased to about NIS 5.8 billion currently (after periodic repayment of the bond series in the first quarter of 2024) from about NIS 5.2 billion at the time of our last surveillance. The negative revaluation and continued investments increased the Company's leverage to an LTV ratio of about 45% currently from about 35% at the time of our last surveillance. If the value of the Company's portfolio decreases further, for example due to an additional decrease in the value of non-tradable holdings or to capital market volatility, it may consistently raise the leverage above 45%, a level that in our opinion is not commensurate with the current rating. According to the Company, it has several courses of action to support deleveraging back to about 40%, including the sale of assets and holdings in unencumbered tradable shares, recourse of foreign assets lower in quality than its core assets to financing entities in cases where the liability value exceeds the assets' book value, taking in holding partners and equity issuance. In addition, the Company recently announced a change in its dividend policy, which includes lowering the regular payout ratio to about 0.72 NIS per share from about NIS 1.28 per share and stopping the distribution of additional dividends. This move in itself is expected to save about NIS 130 million per year and support the Company's equity.

On the other hand, the Company's financial profile continues to be supported by a high and stable dividend flow from its portfolio. Alony-Hetz continues to maintain a large and stable cash flow from its affiliates, as it has over the years. The Company received about NIS 690 million in dividends and management fees in 2023, with most of the dividends provided by its tradable affiliates – Amot and Energix (~NIS 344 million and ~NIS 127 million, respectively). As a result, the Company's coverage ratio remained high at about 3.2x in 2023. We estimate that several of the affiliates' dividend policy supports continued receipt of a consistently large cash flow, and therefore that the Company's coverage ratio will remain stable and high in the next two years and continue to support the rating.

The asset portfolio continues to be characterized by adequate liquidity and tradability and extensive geographic spread, and its average credit quality remains adequate. We believe Alony-Hetz's business profile continues to be supported by adequate liquidity and tradability. Thanks to the holding in Amot and Energix, the share of unencumbered tradable shares in the portfolio is relatively high (currently ~60%), which provides Alony-Hetz with moderate financial flexibility, according to our assessment. In addition, the portfolio's credit quality remains adequate despite the losses recorded in 2023 in non-tradable affiliates. The main companies in the portfolio are characterized by stable operating performance over the years. Among other things, Amot records consistent NOI (net operating income) growth over the years and stable occupancy rates, and Energix has recorded consistent growth in both revenues and grid-connected output in recent years. The business profile is also supported by the Company's strategy of investing in leading markets in low-risk countries (Israel, the U.K. and the U.S., rated 'A+' and above) and by geographical, asset and tenant diversification at the affiliates' level.

On the other hand, the business profile is still constrained by the relative concentration of the asset portfolio and is adversely affected by low industry diversification. We estimate that Alony-Hetz's investment portfolio has become more concentrated in the past year, due to the changing weight of the holdings following the decline in the value of non-tradable affiliates. Amot Investments is still the main company in the asset portfolio and constitutes about 30% of its value, compared to about 31% at the time of our last surveillance, but the three largest investments, Amot, Energix and Brockton Everlast, make up about 82% of the portfolio value, compared to about 75% at the time of our last surveillance. In addition, we estimate that the liquidity of the shares in the portfolio is not high, due to the holding of controlling interests. We estimate that Alony-Hetz can partly divest some of its holdings without losing control over subsidiaries, but believe that the holding of controlling interests adversely affects its willingness to sell shares when deleveraging requires it. Our business risk assessment is also adversely affected by low industry diversification, as most of the Company's affiliates, about 70%, operate in the income-producing real estate sector. This low diversification is, however, partly mitigated by our assessment that income-producing real estate is a relatively low-risk segment, with less volatile cash flows compared with other real estate segments.

Outlook

The negative outlook reflects the potential deviation from a leverage level commensurate with the rating and the uncertainty regarding Alony-Hetz's ability to deleverage in the next 12 months. Deleveraging depends, among other things, on the value of the Company's portfolio in general and on the value of its non-tradable assets in particular, on the extent of the Company's investments in the subsidiaries and on its ability to implement deleveraging actions, including its updated dividend policy.

Downside Scenario

We will lower the rating if the Company's LTV ratio consistently exceeds 45%. A material deterioration in subsidiaries' performance, which would adversely affect our assessment of the portfolio's credit quality and dividend receipts, or a material deterioration in the Company's liquidity, may also exert negative pressure on the rating.

Upside Scenario

We will consider changing the outlook back to stable if the Company's leverage decreases and we estimate that it will remain consistently and comfortably below 45%, while maintaining at least adequate liquidity and financial flexibility, supported by the Company's financial policy and by our assessment that the dividend policy of the company and its subsidiaries will remain balanced.

Base-Case Scenario

Key Assumptions

- Slow GDP growth of about 0.5% in Israel in 2024 and an improvement to about 5% growth in 2025. The inflation rate will be about 2.8% in 2024 and about 2.0% in 2025.
- About 2.5% GDP growth in the U.S. in 2024 and about 1.5% growth in 2025. The inflation rate will be about 2.8% in 2024 and about 2.0% in 2025.
- Slow GDP growth of about 0.3% in the U.K. in 2024 and about 1.4% growth in 2025. The inflation rate will be about 3.0% in 2024 and about 2.3% in 2025.
- General and administrative expenses and tax payments of about NIS 50 million - NIS 60 million per year.
- Annual dividend and management fee receipts from subsidiaries of about NIS 600 million - NIS 700 million.

- No material composition changes in the portfolio, alongside continued investment in affiliates. We estimate that any substantial investment beyond our base case scenario will be accompanied by a capital flow that will balance the potential increase in leverage.
- Dividend distribution of about NIS 129 million in accordance with the Company's updated dividend policy.

Under our base case scenario, the expected adjusted ratios for the upcoming year are as follows:

- Coverage Ratio (dividends received + management fees + interest income)/(interest and tax expenses + G&A expenses) comfortably above 0.7x in 2024.
- LTV ratio of 40%-45% in 2024.

Company Description

Alony-Hetz Properties & Investments Ltd. is a public company traded on the Tel Aviv Stock Exchange. The Company's main holdings are in tradable companies Amot Investments Ltd., which operates in the income-producing real estate in Israel, and Energix-Renewable Energies Ltd., which operates in Israel, the U.S. and Poland. The Company's portfolio also includes holdings in non-tradable companies in the income-producing real estate sector in the U.S. (Carr Properties) and the U.K. (Brockton Everlast Inc). About 14.5% of Alony-Hetz shares are held by Mr. Nathan Hetz. The remaining shares are held by institutional investors and the public.

Liquidity

We examine the Company's liquidity on a stand-alone basis. We estimate the Company's liquidity as ‘adequate’, based on our assessment that the ratio between the Company’s sources and uses will exceed 1.2x in the 12 months beginning January 1, 2024. The Company’s liquidity is underpinned by committed credit facilities maturing in over 12 months totaling NIS 550 million and by stable dividend receipts. Alony-Hetz's liquidity assessment and financial flexibility are also supported by its good access to the capital market and by its holding of a large amount of unencumbered tradable shares.

Following are the Company’s main sources and uses for the 12 months beginning in January 1, 2024, according to our liquidity scenario:

Principal Liquidity Sources	Principal Liquidity Uses
• About NIS 1 billion in cash and cash equivalents. • Annual dividend and management fee receipts of about NIS 574 million. • Undrawn committed credit facilities maturing in over 12 months of NIS 550 million.	• Debt maturities (principal, interest and fees) of about NIS 840 million. • General & administrative expenses and taxes of about NIS 50 million - NIS 60 million. • Investments of about NIS 259 million (executed in the first quarter of 2024). • Dividend distribution of about NIS 129 million in accordance with company policy (about a quarter of this amount was distributed in the second quarter of 2024).

Covenant Analysis

The Company has several covenants vis-a-vis bond holders, banks and financial institutions with whom the Company has signed an agreement of credit facility allocation. We understand that the Company has sufficient headroom on its financial covenants, and we estimate that it will maintain sufficient headroom in the short term.

Modifiers

Liquidity: Neutral

Management and governance: Neutral

Comparable ratings analysis: Positive

Environmental, Social, And Governance

ESG factors have an overall neutral influence on our credit analysis of Alony-Hetz Properties & Investments Ltd.

Recovery Analysis

Rationale

- We are affirming our 'ilAA-' issue rating, identical to the issuer rating, on Alony-Hetz Properties & Investments Ltd.'s unsecured bond series (Series 9, 10, 11, 12, 13, 15). The recovery rating for unsecured debt is '3'.

Simulated default assumptions

- Simulated year of default: 2029

- Material negative revaluations of the Company's holdings, due, among other things, to a deep recession in the countries of operation, will lead to a deterioration in the energy and real estate industries due to slower business activity and to a material drop in demand for real estate space, and thus to a sharp drop in occupancy rates and rents, to increased competitive pressures and price drop in private consumption markets, and to material slowdown in government infrastructure investments.
- The Company will be liquidated, an assessment based on the fact that there is no activity at the holding company level and its entire value at the time of default will be based on the shares it holds.
- Creditors will attempt to liquidate part or all of the Company's holdings in subsidiaries, an assessment supported by the low synergy between the holdings and the possibility of selling part of the holdings in Amot or in Energix without losing the controlling share.
- On the path of deterioration to the hypothetical default, the Company will refinance its debt and utilize 85% of its available credit facilities.
- On the day of default, the market value of the Company’s portfolio and its cash reserves will decrease to the amount of the debt due to a sharp decrease in the market value of affiliated companies. In our opinion, a situation whereby the NAV (net asset value) nears zero will bring the company closer to a default event. We also assume an additional 30% reduction in share value at liquidation.

Simplified Waterfall

- Gross enterprise value according to DAV method: about NIS 4.3 billion
- Administrative costs: 5%
- Enterprise value available for secured debt: about NIS 4.1 billion
- Total unsecured debt (unrated): about NIS 486 million
- Net value available for unsecured debt: about NIS 3.6 billion
- Total unsecured debt: about NIS 5.8 billion
- Unsecured debt recovery expectation: 50%-70%
- Unsecured recovery rating (1 to 6): 3

All debt amounts include six months' prepetition interest.

Mapping Recovery Percentages To Recovery Ratings			
Recovery expectations (%)	**Description**	**Recovery rating**	**Notching above/below issuer rating**
100%	Full recovery	1+	+3 notches
90%-100%	Very high recovery	1	+2 notches
70%-90%	Substantial recovery	2	+1 notch
50%-70%	Meaningful recovery	3	0 notches
30%-50%	Average recovery	4	0 notches
10%-30%	Modest recovery	5	-1 notch
0%-10%	Negligible recovery	6	-2 notches

Recovery ratings are capped in certain countries to adjust for reduced creditor recovery prospects in these jurisdictions. Recovery ratings on unsecured debt issues are generally also subject to caps (see Step 6, paragraphs 90-98 of Recovery Rating Criteria For Speculative-Grade Corporate Issuers, December 7, 2016, for further detail). ICR--Issuer credit rating.

Related Criteria And Research

- Principles Of Credit Ratings, February 16, 2011
- Methodology: Industry Risk, November 19, 2013
- Country Risk Assessment Methodology And Assumptions, November 19, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, December 16, 2014
- Methodology: Investment Holding Companies, December 1, 2015
- Recovery Rating Criteria For Speculative-Grade Corporate Issuers, December 7, 2016
- Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Group Rating Methodology, July 1, 2019
- Environmental, Social, And Governance Principles In Credit Ratings, October 10, 2021
- Methodology For National And Regional Scale Credit Ratings, June 8, 2023
- Corporate Methodology, January 7, 2024
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, January 7, 2024
- Sector-Specific Corporate Methodology, April 4, 2024
- S&P Global Ratings Definitions, June 9, 2023

Ratings List

Alony-Hetz Properties & Investments Ltd.	Rating	Date when the rating was first published	Date when the rating was last updated
Issuer rating(s)			
Long term	ilAA-/Negative	01/10/2001	31/05/2023
Issue rating(s)			
Senior Unsecured Debt			
Series 9,10	ilAA-	18/05/2015	31/05/2023
Series 15	ilAA-	28/08/2022	31/05/2023
Series 11	ilAA-	23/07/2019	31/05/2023
Series 12	ilAA-	23/07/2019	31/05/2023
Series 13	ilAA-	08/08/2022	31/05/2023
Issuer Credit Rating history			
Long term			
April 18, 2024	ilAA-/Negative		
May 18, 2015	ilAA-/Stable		
December 17, 2014	ilA+/Positive		
February 21, 2013	ilA+/Stable		
January 17, 2010	ilA/Stable		
June 11, 2009	ilA/Negative		
August 14, 2008	ilA/Stable		
May 25, 2008	ilAA-/Watch Pos		
December 05, 2007	ilAA-/Negative		
December 19, 2006	ilAA-/Stable		
July 28, 2005	ilAA-		
June 23, 2002	ilA+		
June 23, 2002	ilA		
October 18, 2001	ilA-		

Additional details	
Time of the event	18/04/2024 13:23
Time when the event was learned of	18/04/2024 13:23
Rating requested by	Issuer

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