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Y.D. More Investments Ltd.

Initial Rating Report | June 2020

This credit rating report is a translation of a report that was written in Hebrew for a debt issued in Israel. The binding version is the Hebrew.

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Y.D. More Investments Ltd.

Series Rating	A3.il	Outlook: Stable

Midroog assigns A3.il rating with a stable outlook to bonds which Y.D. More Investments Ltd. (hereinafter: the "Company") is to issue for a par value of up to NIS 80 million. The proceeds of the offering will be used for the Company's ongoing needs, which include, among other things, the growth of its medium to long term savings business.

Company's Profile

The Company was incorporated and registered in Israel on May 24, 2006 under the Companies Law, as a private company limited by shares. On July 24, 2017, the Company became a public company as this term is defined in the Companies Law. The Company's principal shareholders are the Meirov family (41.93% of equity), the Levy family (21.47%) and the public (36.60%).

The Company is a holding company engaging through investees in a range of activities connected with the Israeli capital market. The Group has several main business activities – management of mutual funds, management of investment portfolios and management of provident funds – that are included as reportable business segments in the Company's financial statements. As of the first quarter of 2020, the brokerage business also is reported as a separate segment. Additionally, the Company operates in the hedge fund sector and as of 2019 it owns a pension insurance agency. These latter activities do not meet the quantitative thresholds based on which the Group's reportable segments are determined, and therefore they have been grouped together under the category of other segments. Mr. Yosi Levy and Mr. Eli Levy are co-CEOs of the Company.

Summary Rating Rationale

The rating reflects the Company's limited business profile, in view of its size and low product diversification. The Company’s financial profile is supported by good coverage ratios for the rating category and by a relatively low leverage ratio, even after taking into account the pro forma results of the bond offering. However, profitability rates during the forecast period are expected to decline due to the continued implementation of the Company's growth strategy in the provident fund segment.

The Company manages assets worth NIS 22 billion as of June 10, 2020, which are exposed to various exogenous factors affecting customer tastes. The Company’s product diversification is fairly low and includes a significant component of products with exposure to short-term market changes, with the mutual fund segment accounting for 75% of total managed assets as of that date (87% as of December 31, 2019). This bias is reflected in strong volatility in the volume of the Company's managed assets since the beginning of the year, due to the coronavirus pandemic. The Company has been implementing a growth strategy in the provident and study fund segment, after laying the foundation for this business in recent years, with a significant growth apparent since the beginning of 2020 in the Company's assets in this segment. We foresee within the forecast period, in light of the Company's strategy, a continued increase in the share of the provident and study fund segment in the mix of revenues and assets, a positive factor for improving the business profile and revenue stability. The Company is also working on the development of additional business activities, including foreign security brokerage services, hedge funds and a pension insurance agency, which are expected to further diversify the Company's sources of income.

Midroog's baseline scenario for 2020-2021 foresees a persisting challenging business environment, due to a high level of competition in some of the operating segments, which we expect will continue to weigh on management fees, as well as high volatility in the capital markets. Along with this, the economic environment will be negatively impacted by the contraction in the GDP,[1] at a rate of 4.5% in 2020, due to the effects of the coronavirus pandemic. In 2021, the economy is expected to recover, with GDP growth projected at 6.8%. Additionally, the rise in unemployment rates and the resulting effect on the average wage will adversely affect the growth in the volume of deposits mainly in medium to long term mandatory products.

Under this scenario we foresee a certain degree of stability in the volume of managed assets in 2020 relative to 2019, with a decrease in mutual fund assets contrasted with an increase in provident and study fund assets. In 2021, we foresee a growth of 20%-24% in managed assets, mainly attributable to the provident and study fund business. Accordingly, we estimate that the share of provident and study fund assets will increase to 30% of the Company's total managed assets by the end of 2021, with a commensurate effect on the volume of mutual fund assets.

Our estimates under this scenario are for a marginal increase in revenues in 2020 and significant growth in 2021, with the main growth stemming from activity in the provident and study fund segment. Concurrently, we estimate that expenses in the forecast period will continue to grow in line with the continued growth in managed assets, primarily in respect of payroll expenses and a significant increase in payments to agents. As a result, the Company's profitability rate is expected to decline compared with previous years, ranging between 15% and 17% in the forecast period, which is reasonable for the rating.

Taking into account the pro forma results of the bond offering, we estimate the leverage ratio (equity/total assets) in the forecast period to be in the range of 40%-45%, with no significant growth expected in the capital buffer in this period due to the expected distribution of dividends at a high rate from the net profit. The FFO generated by the Company in the forecast years is expected to decrease somewhat, in view of our assessment of a decline in profitability. Alongside the expected increase in leverage, the gross debt/FFO ratio is expected to be in the range of 2.5-4.0, which is good for the rating, while the gross debt/EBITDA ratio is expected to be in the range of 2.0-2.5, which is good for the rating and indicates high financial flexibility.

The Company's liquidity profile is above par, supported by a significant component of unrestricted liquid assets (excluding the balances required for regulatory purposes), which also serve as an immediate safety buffer against any unexpected deterioration in the cash-flow generating capability and in access to funding.

Among the additional rating considerations, Midroog takes into account the Company's relatively expansive profit distribution policy, at a rate of at least 80% of the net profit, which we regard as adversely impacting the Company's financial profile. Midroog likewise includes in the additional considerations the high dependence of the Company's cash flows on the mutual fund segment, until the provident fund segment becomes firmly established.

[1] The GDP growth forecast for 2020-2021 is based on the Bank of Israel forecast of May 2020.

Rating Outlook

The stable rating outlook reflects our assessment that the Company's financial profile and key indicators will be maintained within the range of Midroog's baseline scenario. At the same time, we note the current high level of uncertainty over the impact of the coronavirus-induced economic crisis on the economic environment in general, and on the investment house sector and the Company in particular.

Factors that could lead to a rating upgrade:

- Ongoing, significant growth in the Company's revenues and total managed assets.
- Improved diversification of the significant business lines.
- Presentation of higher profitability relative to Midroog's baseline scenario over time.

Factors that could lead to a rating downgrade:

- Deterioration in the business profile, reflected in reduced Company revenues.
- Ongoing significant decrease in the profitability ratios, beyond our assessments in the baseline scenario.

Y.D. More Investments Ltd. – Key Financial Indicators (NIS in millions)

	30.03.2020	31.03.2019	2019	2018	2017	2016
Unrestricted liquidity reserves [1]	39	25	19	21	16	18
Gross adjusted financial debt [2]	3	3	4	1	6	4
Equity attributable to Company shareholders	72	64	70	63	67	14
Total assets	112	91	98	85	87	40
Revenues	55	41	182	169	152	83
Profit before tax	9	12	45	59	48	22
EBITDA	12	12	46	61	48	23
FFO	8	7	27	39	36	14
Total managed assets at end of period	22,060 [3]	21,473	24,852	19,633	21,090	13,786

Midroog adjusted ratios

Equity/total assets	64%	70%	72%	75%	77%	35%
Liquid assets/gross debt	1130%	818%	522%	631%	282%	310%
Earnings before income tax	17%	29%	25%	35%	31%	26%
EBITDA/revenues	22%	29%	25%	36%	32%	27%
Gross debt/EBITDA [2] [4]	0.1x	0.0x	0.1x	0.1x	0.1x	0.3x
Gross debt/FFO [2] [4]	0.1x	0.1x	0.1x	0.1x	0.2x	0.4x

** The Company applies IFRS 16 as of 2019. The comparative figures for previous periods were not adjusted retrospectively.*
(1) Cash and cash equivalents net of balances required for regulatory purposes.
(2) Adjusted financial debt includes lease liabilities and bank loans.
(3) As of June 10, 2020.
(4) Refers to the last 12 months from the cut-off point.

Detailed Rating Considerations

A CERTAIN IMPROVEMENT IS EXPECTED IN THE BUSINESS PROFILE, WHICH, HOWEVER, WILL REMAIN LIMITED BY THE COMPANY'S SIZE AND RELATIVELY LOW PRODUCT DIVERSIFICATION; THE BUSINESS ENVIRONMENT IS EXPECTED TO BE CHALLENGING

The Company manages assets worth NIS 22 billion as of June 10, 2020, compared with NIS 19 billion as of March 31, 2020 and NIS 25 billion as of December 31, 2019. The mix of managed assets[2] consists mainly of mutual funds (NIS 16.5 billion equivalent to 75% of total managed assets), provident and study funds (NIS 2.5 billion equivalent to 11% of total assets), and managed portfolios (NIS 3.0 billion equivalent to 14% of total managed assets). The Company also operates in the foreign securities brokerage services sector as well as in the hedge fund sector and it owns a pension insurance agency.

We note that the spread of the coronavirus has caused great volatility in the financial markets, with a resulting negative impact on the volume of assets managed by the Company. Consequently, due to value impairments and redemptions, the value of the Company's managed assets fell in the first quarter of 2020 by NIS 6 billion. At the same time, the decline in the value of assets was moderated by the market recovery at the end of March 2020 as well as by the significant growth recorded in the Company's provident fund assets since the beginning of the year and especially in recent months.

Product diversification is fairly low and includes a significant component of products with exposure to short-term market changes, primarily in the mutual fund segment. This bias is also reflected in strong volatility in the volume of the Company's managed assets due to the coronavirus pandemic. We note that the mutual fund market is highly competitive, with a comparatively large number of competitors, and is subject to intensive regulation. Redemptions and capital-raising in the market are greatly influenced by investment advice, which relies on the banks' internal rating systems that factor in, among other parameters, returns, risks and volatility.

The volume of the Company's managed assets in the provident and study fund segment is still low compared to the leading companies in the market, garnering the Company only a marginal market share in this segment. We believe that the share of this segment will continue to grow, in light of the Company's focused strategy of increasing activity in the segment, which has already led to relatively significant growth in the segment's managed assets in the course of the year, to NIS 2.5 billion as of June 10, 2020. The Company's strategy stems from its aspiration to diversify its sources of income and seeks to channel the knowledge and goodwill it has acquired in the fields of research and investment to this line of business. During the years 2019-2020 the Company strengthened the management tier in this area and significantly expanded the workforce in the provident fund company, in addition to which it built a marketing and distribution network vis-à-vis the sales agents. Our estimate within the forecast period, in light of the Company's strategy, of an increase in the share of the provident and study fund segment in the mix of revenues and assets is a positive factor for improving the business profile and revenue stability. We note that the provident fund sector has benefited from regulatory support in recent years (Amendment 190, Savings Plan for Each Child and investment provident fund), resulting in steady growth in managed assets in the sector. The sector is dominated by several major players, with competition focused on

[2] As of June 10, 2020.

management fees and on achieving high rates of return on investments. In recent years the market has been characterized by a continuous decline in management fee rates, and while we estimate that competition will remain at a high level within the forecast period, we foresee a certain degree of stabilization in management fee rates in the sector.

The Company is working on the development of other lines of business, including foreign security brokerage services, hedge funds and a pension insurance agency, which are expected to further diversify the Company's sources of income. We note that revenues from brokerage services in securities trading increased in the first quarter of the year due to the growth in trading volumes and in the number of transactions in light of the high volatility in the capital markets.

Midroog's baseline scenario for 2020-2021 foresees a persisting challenging business environment in the investment house and financial asset management market, due to a high level of competition in some of the operating segments, which we expect will continue to weigh on management fees, as well as high volatility in the capital markets. Along with this, according to Bank of Israel assessments[3], the economic environment will be negatively impacted by the contraction in the GDP, at a rate of 4.5% in 2020, due to the effects of the coronavirus pandemic. In 2021, the economy is expected to recover, with GDP growth projected at 6.8%. Additionally, the rise in unemployment rates and the resulting effect on the average wage will adversely affect the growth in the volume of deposits mainly in medium to long term mandatory products.

In short-term instruments (mutual funds), we foresee a decrease in the volume of assets mainly in 2020 relative to 2019, given the typically short-term investment horizon of these instruments and the large volumes of redemptions in times of crisis and market volatility, as demonstrated in March of this year. Consequently, the share of these instruments in the Company's business mix is expected to decline, but to remain at a high 60%-70% of total managed assets in the forecast years (compared with 87% in 2019).

In the provident and study fund segment we foresee continued organic growth in light of the Company's growth strategy in this segment, along with continued expansion of the Company's workforce, strengthening of the distribution and operating systems and increased marketing expenses. We consider that the relatively low volume of managed assets at this stage confers a certain degree of flexibility and may present the Company with a small-scale advantage in terms of investments, although this advantage is likely to diminish as the Company grows. In our judgment, capital market volatility has a lesser effect on the provident and study fund segment, due to its characteristic long-term investment horizon; however, we expect the rise in unemployment rates and the resulting effect on wages to adversely affect the amounts of deposits in this segment. Accordingly, we estimate that provident and study fund assets will increase to 30% of the Company's total managed assets by the end of 2021, with a commensurate effect on the volume of mutual fund assets.

In sum total, under the baseline scenario we foresee a certain degree of stability in the volume of managed assets in 2020 relative to 2019, with a decrease in mutual fund assets contrasted with an increase in provident and study fund assets, as well as significant growth of 20%-24% in managed assets in 2021, mainly attributable to the provident fund business.

[3] Macroeconomic Forecast of the Bank of Israel's Research Division – May 2020.

We note that this forecast involves a high level of uncertainty at this stage, in view of the realization of a risk event in the form of the spread of the coronavirus in Israel and the uncertainty over its prolongation and the resultant impact on the local economy and increased volatility in the capital markets.

EXPECTED DECLINE IN PROFITABILITY RATES IN THE FORECAST PERIOD, IN VIEW OF HIGHER EXPENDITURES ON DEVELOPING THE PROVIDENT FUND BUSINESS AND CHANGING THE MIX OF ASSETS

The Company has good revenue generating capability for its mix of activities (average revenues/managed assets ratio of 0.80% in the years 2017-2019), its main activity in those years deriving from the mutual trust segment. The Company's management fee rates have been trending downward over the years.

The Company's profitability rate (measured as the profit margin before income tax) fell in 2019 to 25% (compared with 35% in 2018), continuing to decline in the first quarter of 2020 (17%), mainly due to higher expenditures on the development and advancement of the long-terms savings business, inter alia through significant expansion of the workforce, building of a distribution and recruitment system, signing of an agreement for the receipt of operating services, investment in product branding and promotion, etc.

Based on our above estimate of the volume of assets, we foresee a marginal increase in revenues in 2020 and significant growth of 15%-20% in 2021, with the main growth stemming from activity in the provident and study fund segment. Along with this, we foresee a decrease in management fees in some of the segments, in view of aggressive competition and regulatory changes that encourage price pressures. Additionally, an increase is expected in the forecast years in revenues from some of the additional activities, and mainly in the brokerage segment. We note that this scenario does not take into account the acquisition of new activities.

Concurrently, expenses in the forecast period are expected to rise further, mainly due to the continued consolidation of the provident fund business, comprising mainly payroll expenses and agents' commissions, in light of the expected increase in provident fund assets. The growth in these expenses will be somewhat moderated by a drop in direct expenses derived from the volume of assets (e.g. distribution and operating commissions), as well as by cost-cutting measures taken by the Company in 2020 (mainly wage reductions in the second quarter, in insignificant amounts). Under this scenario the Company's profitability rate is expected to decline compared with previous years, ranging between 15% and 17% in the forecast period, which is reasonable for the rating.

RELATIVELY MODERATE LEVERAGE THAT IS ABOVE PAR FOR THE RATING CATEGORY AND RELATIVELY QUICK COVERAGE RATIOS TAKING INTO ACCOUNT THE PRO FORMA RESULTS OF THE BOND OFFERING

The Company's equity stood at NIS 72 million as of March 31, 2020, equivalent to 64% of total assets as of that date. Taking into account the pro forma results of the bond offering, we estimate that the leverage ratio in the forecast period will be in the range of 40%-45%, a buffer that can be expected to absorb losses relatively well. The leverage ratio is above par, considering the significant scope of liquidity reserves and other liquid assets as well as the absence of intangible assets. Midroog does not foresee a significant increase in the capital buffer, in light of the expected distribution of dividends at a rate of at least 80% of the net profit, in accordance with the Company's policy.

Under our baseline scenario, we estimate EBITDA to be in the range of NIS 30-40 million per year in the years 2020-2021 (compared with NIS 46 million in 2019), with the amount positioned in the current year in the lower segment of the range. FFO generated by the Company in the short to medium term is expected to decline, in light of our assessment of reduced profitability, amounting to between NIS 20 and 25 million per year. Along with the expected increase in leverage, the gross debt coverage/FFO ratio is expected to be in the range of 2.5-4.0, which is good for the rating.

GOOD FINANCIAL FLEXIBILITY AND LIQUIDITY PROFILE

Following the raising of the bonds, the gross debt/EBITDA ratio is expected to be in the range of 2.0-2.5 in the forecast years – a good ratio for the rating, indicating high financial flexibility. The Company's liquidity profile is above par, supported by a significant component of unrestricted liquid assets (even excluding the balances required for regulatory purposes), which also serve as an immediate safety buffer against any unexpected deterioration in the cash-flow generating capability and in access to funding. Taking into account the pro forma results of the bond offering, the balance of unrestricted liquid assets is expected to comprise 130%-140% of the total gross debt in the forecast years, which is above par for the rating. The Company has additional financial assets, including mainly investments in hedge funds and an investment in the Electra Real Estate Fund amounting to NIS 22 million as of March 31, 2020. We note that there are no encumbrances on the Company's assets, including the offices owned by it, which have a book value of NIS 14 million, a factor contributing to the Company's financial flexibility.

The FCF generating potential is low in the forecast years, in view of the expected distribution of dividends at a high rate from the net profit, and since we do not assume a significant growth in the volume of investments in these years, as against an expected debt principal of NIS 16 million beginning in 2021.

Additional Rating Considerations

THE EXPANSIVE DISTRIBUTION OF DIVIDENDS WEAKENS THE FINANCIAL POLICY

In accordance with its policy in recent years, the Company is expected to distribute 80% of its net profit as dividends to the shareholders. We consider this distribution rate to be indicative of a financial policy that does not adequately balance between the Company's shareholders and its debt holders, considering also the relatively limited free cash flow generated by the Company and its growth plans for the coming years.

THE COMPANY'S EXPOSURE TO THE MUTUAL FUND SEGMENT IMPACTS NEGATIVELY ON THE BUSINESS PROFILE

In determining the rating, additional negative consideration was given to the high concentration of the Company's business in the mutual fund sector, a highly competitive sector with a relatively volatile level of assets. We consider the Company's strategy to increase the share of the provident and study fund business as a positive factor enabling the diversification and expansion of its activity into the medium-long term savings sector. The Company bases this strategy on its success in achieving a high positioning in the mutual fund market and on its investment management and research infrastructure. The Company also expanded its management, operating and marketing systems specifically in the provident fund segment, which has already resulted in significant growth in provident and study fund assets since the beginning of 2020. In our estimation, the Company's strategy for consolidating its position in the provident fund market still requires proof positive in the short to medium term.

Related Reports

Methodology for Rating Investment Companies– November 2015

Financial Statement Adjustments and Presentation of Main Financial Measures in Corporate Rating – May 2020

Table of Affinities and holdings

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Date of rating report:	June 25, 2020
Rating commissioned by:	Y.D. More Investments Ltd.
Rating paid for by:	Y.D. More Investments Ltd.

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