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DS Brokerage Ltd.

Harel Investments
Response To Q1/12 Results

Meir Slater
073-7012696
meirs@ds-invest.co.il

Knowing how to take advantage of market uptrends

- **Harel Investments' results for the first quarter of 2012 were very strong. The company recorded comprehensive profit of NIS 287 million, reflecting returns to capital of 35%.** The high returns to capital rate was a direct result of both the uptrend that took place in the market during the first quarter, and the CPI, which remained unchanged. However, not all companies are able to translate a positive market environment into very strong results, as can be seen in the statements of Clal (returns to capital of 15%), and in the profit forecast of Migdal (16%-17%).

- **The primary sources of profit** were life insurance, general insurance and nostro profits, all of which performed strongly due to market increases. Less strong results were recorded in the areas of pension, health and finance.

Harel Insurance – Comprehensive Profit Q1-12			
Millions of NIS	**Q1-12**	**Q4-11**	**Q1-11**
Life insurance	159.5	89.3	53.9
Pension	9.9	9.2	8.3
Provident	14.3	(10.3)	19.1
Health	44.6	57.4	40.3
General insurance	107.4	34.4	9.6
Insurance companies abroad	(1.5)	(10.8)	(3.7)
Finances	5.5	5.3	11.0
Other	109.5	72.3	(22.3)
Profit before tax	**449.2**	**246.7**	**116.2**
Tax income (expenses)	(161.6)	(132.1)	(37.4)
Comprehensive profit	**287.7**	**114.7**	**78.8**
Minority (minority losses)	.4	0.1	(0.)
Comprehensive profit to shareholders	**287.3**	**114.6**	**78.8**

- **Life insurance** recorded high profits of NIS 160 million, primarily as a result of a high financial margin in guaranteed-return policies. Due to the fact that Harel has the lowest rate of designated bonds, approx. 50% only, it reaps more benefits when the CPI is low and the market trend is positive. The company has debts of only NIS 18 million in variable management fees as of April 30, 2012.

- **Pension results** were somewhat weak, recording profit of NIS 10 million - lower than the average profitability during 2011, which stood at NIS 11 million. The weak results resulted from the repayment of management fees to members.

- **In contrast, provident activities** recorded respectable results, showing an improvement over the previous three quarters. The profit levels in this segment have not yet returned to the levels that were seen a year ago, although the previous downtrend has now been stopped.

- **Health insurance results** appear solid, with profit of NIS 45 million, although the majority of this increase was due to the influence of the capital market. Losses were recorded in underwriting activities in respect of collective insurance policies, particularly in the long term care insurance segment. This trend, which is market-wide, may continue affecting the companies for a long time to come.

- **General insurance** recorded very strong results, with profit of NIS 107 million, primarily thanks to the capital market and the CPI, although the underwriting area also recorded a strong quarter.

- **General insurance activities abroad** continue to record losses, albeit relatively minor this time.

- **Finances** recorded weak results, in an direct continuation of the trend from the two previous quarters, when the market declines began. Management fees shrank by 20% relative to the corresponding period.

- **Nostro profits** were exceptionally positive, and contributed greatly to profit. Some of the profit (NIS 40 million before tax) resulted from a value increase in a single real estate investment. The nostro profits demonstrate the company's heightened sensitivity to the capital market. **Accordingly, a significant trend in the opposite direction may take place during the coming quarter.**

- **Harel Insurance has a capital surplus of approx. NIS 572 million.** Only half a year ago, the capital surplus was NIS 160 million. However, the insurance company cannot yet distribute dividends, since its capital surplus is lower than 15%.

In summary, as we have noted in the past, Harel has become highly sensitive to capital market trends, perhaps even being the most sensitive of all insurance companies. However, profits were exceptionally strong relative to the other companies, with at least part of them being one-time occurrences. **The capital ratio at which the company is currently traded is currently 0.68, and is the lowest of all large insurance companies.**

Change in Recommendation	
Change in Price	
Change in Forecast	

Target Price	NIS 180
Recommendation	Outperform
Current Price	120.8
Previous Recommendation	Outperform
Previous Target Price	NIS 180

Market Value (Millions of NIS)	2,560
12 Month High	NIS 191.8
12 Month Low	NIS 114.6
Floating Amount	50%
Weight in the Tel Aviv 100 Index	0.75%

Current Majority Capital Ratio	0.84
LTM PE Ratio	46.3

Embedded Value for 2011

- As we explained in our response to the results of Clal Insurance, we analyze EV in terms of the difference between years, rather than analyzing the value itself.

Embedded Value as of December 31, 2011 - Harel Including Dikla				
Millions of NIS	**Life and Health Insurance**	**Pension**	**Capital Adjustment for Pension Investment**	**Total**
Adjusted equity	2,014	41	(266)	1,789
Change vs. 2010	*-12.6%*	*83.0%*	*10.8%*	*-14.3%*
VIF	4,426	1,338		5,764
Change vs. 2010	*10.3%*	*37.6%*		*15.6%*
Required capital cost	(184)	(3)		(187)
EV 2011	6,256	1,376	(266)	7,366
Change vs. 2010	*1.4%*	*38.6%*	*10.8%*	*6.4%*

- On the bottom line, the EV of Harel and Dikla grew by 6.4%.
- The decline in adjusted equity resulted from a change in the value's opening balance. Without the aforementioned change, the scope of equity remained unchanged.
- The increase in EV resulted from an increase in embedded value arising mainly from new business - VNB.
- Similarly to Clal, the change in assumptions detracted from embedded value, albeit in a lower scope than the contribution of new business.

Value of New Business for 2011			
Millions of NIS	**Life and Health Insurance**	**Pension**	**Total**
VNB before capital cost	529	156	685
Change vs. 2010	*44.9%*	*100.0%*	*54.6%*
Required capital cost	(12)	-	(12)
VNB	517	156	673
Change vs. 2010	*46.8%*	*102.6%*	*56.8%*

- The strongest point in the embedded value report was the value of new business. Harel's VNB grew by 57%, surpassing the VNB of Clal in absolute terms (NIS 414 million).
- The increase in VNB resulted not only from health insurance but also from life insurance activities. This value reflect the company's focus on more profitable business areas, particularly individual life insurance.
- **In summary, Harel's embedded value was the strongest in all the years since its publication relative to all other companies. This year's EV is the best ever recorded by the company.** The company is currently traded at an EV ratio of 0.35.

Notes, Warnings and Full Disclosure Regarding the Analysis Report

Notes Regarding the Analysis Report

1. Recommendation Index

   - **Buy** – The stock is expected to outperform the Tel Aviv 100 Index by 20% or more during the coming 12 months.
   - **Outperform** – The stock is expected to outperform the Tel Aviv 100 Index by 10% - 20% during the coming 12 months.
   - **Market perform** – The stock is expected to produce results ranging between outperform of 10% and underperform of 10% relative to the Tel Aviv 100 Index during the coming 12 months.
   - **Underperform** – The stock is expected to underperform the Tel Aviv 100 Index by 10% - 20% during the coming 12 months.
   - **Sell** – The stock is expected to underperform the Tel Aviv 100 Index by 20% or more during the coming 12 months.

2. The method used to assess the value of insurance companies and to determine target prices includes the use of two models in parallel: The dividend discount model (DDM) and the net asset value model (NAV), while also incorporating evaluation using capital ratios and P/E ratios, and comparing the different stocks in the sector.

3. Main risks which may significantly affect the target prices of insurance companies:

   - Declines in capital markets in Israel and around the world.
   - Decline in the state of the economy.
   - Decline in the health of individuals in the economy.
   - Decline in the economic situation of individuals in the economy.
   - Increase in life expectancy.
   - Increase in the severity of the global economic crisis.
   - Financial risks – exchange rate changes, interest changes, inflation.
   - Legislative and regulatory changes which may adversely affect the business activities of insurance companies.

4. Graph of company stock and changes in recommendations during the previous three years. Target prices per share refer to the 12 month period following the date each recommendation was given.

Harel Investments
Target Price -------- Harel ---------

Date	Share Price	Target Price	Recommendation
March 11, 2012	114.9	180	Outperform
February 21, 2012	133.7	200	Outperform
May 29, 2011	177.6	250	Outperform
January 12, 2011	235.2	250	Market perform
November 25, 2010	204.5	228	Outperform
June 17, 2010	181.0	228	Buy
March 1, 2010	193.8	265	Buy

* Note – Stock graphs are displayed after adjustment for dividend distributions, whereas target prices are not retroactively adjusted for dividend payments, and refer to the situation as it existed on the date each recommendation was given.

Details of the Analysis Report Preparer

Meir Slater, ID no. 033618505.
Of 23 Yehuda Halevi St., Tel Aviv.
Holder of Investment Marketing License no. 9421.
Education: Certified Public Accountant.
Master's in Business Administration with a Specialization in Finance – Bar Ilan University.
Bachelor's in Economics and Accounting – Hebrew University.
Professional Experience: 2009 – Present: Senior Analyst at DS Brokerage.
2006 – 2009: Analyst at Prisma Investment House.

Details of the Authorized Corporation in which the Analysis Report Preparer is Employed

DS Brokerage Ltd.
23 Yehuda Halevi Ltd., Tel Aviv.
Tel: 03-684-3336; Fax: 073-701-2685

Full Disclosure of the Analysis Report Preparer

The analysis report preparer is not aware of any conflict of interest existing as of the analysis report's date of publication.

Full Disclosure of DS Brokerage Ltd. (hereinafter: the **"Authorized Corporation")**

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Declaration of Independent Judgment

I, Meir Slater, holder of license number 9421, hereby declare that the opinions presented in this analysis report accurately reflect my personal opinions about the securities reviewed herein, and about the corporation that issued these securities.

May 23, 2012	**Meir Slater**
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