**MIZRAHI TEFAHOT BANK LTD**

No. with the Registrar of Companies: 520000522

| To | Israel Securities Authority | To | Tel Aviv Stock Exchange Ltd | T125 (Public) | Date of transmission: August 5 2024 |
|---|---|---|---|---|---|
| | www.isa.gov.il | | www.tase.co.il | | Ref: 2024-01-083926 |

## Immediate Report on the Rating of Bonds/Rating of a Corporation or Rating Cessation

On August 5 2024, *Midroog* published:

⦿A rating report/notice *updated*

○A notice regarding rating cessation

1. Rating report or notice

☑ Corporation's rating: *Midroog Aaa.il stable*

Comments/Notice summary: *Rating affirmation*

Ratings history in the three years prior to the date of the rating/notice:

| Date | Rating subject | Rating | Comments/Notice summary |
|---|---|---|---|
| August 1 2023 | *Mizrahi Tefahot Bank Ltd* | *Midroog Aaa.il stable* | *Other Affirmation* |

| | | | |
|---|---|---|---|
| August 28 2022 | *Mizrahi Tefahot Bank Ltd* | *Midroog Aaa.il stable* | *Other Affirmation* |
| August 22 2021 | *Mizrahi Tefahot Bank Ltd* | *Midroog Aaa.il stable* | *Other Affirmation* |

Explanation: The ratings history should only detail the rating history of the company rating the subject of the immediate report

☑ Rating of the corporation's bonds:

| Name and type of security | Security number on the stock exchange | Rating company | Current rating | Comments/Notice summary |
|---|---|---|---|---|
| *Contingent convertible bonds* | 0 | Midroog | Midroog *Aa3.il stable* | Rating affirmation |

Ratings history for the three years prior to the rating/notice date:

| Name and type of security | Security number on the stock exchange | Date | Type of rated security | Rating | Comments/Notice summary |
|---|---|---|---|---|---|
| *Contingent convertible bonds* | 0 | *August 1 2023* | *Contingent convertible bonds (CoCo)* | *Midroog Aa3.il stable* | Rating affirmation |
| *Contingent convertible bonds* | 0 | *August 28 2022* | *Contingent convertible bonds (CoCo)* | *Midroog Aa3.il stable* | Rating affirmation |
| *Contingent convertible bonds* | 0 | *August 22 2021* | *Contingent convertible bonds (CoCo)* | *Midroog Aa3.il stable* | Rating affirmation |

Explanation: The ratings history should only detail the rating history of the company rating the subject of the immediate report

Attached rating report Midroog 05082024 isa.pdf

2. On _______, __________ announced that it would cease rating __________

**Details of the signatories authorized to sign on behalf of the corporation**

| | Signatory's Name | Position |
|---|---|---|
| **1** | *Hanan Kikozashvili* | *Other*<br>*Bank Secretary & Head of the Bank's Headquarters* |

Explanation: According to Regulation 5 of the Securities (Periodic and Immediate Reports) Regulations, 5730-1970, a report filed under these regulations shall be signed by those authorized to sign on behalf of the corporation. The position of the senior staff on the matter (in Hebrew) can be found on the ISA's website: Click here

The reference numbers of previous documents on the subject (reference does not constitute incorporation by reference):

***2023-01-088308***

Securities of a Corporation Listed for Trading on the Tel Aviv Stock Exchange

Form structure revision date: June 18 2024

Abbreviated Name: Mizrahi Tefahot

Address: 7 Jabotinsky Street, Ramat Gan, 52520 Tel:03-7559720 Fax:03-7559923

E-mail: mangment@umtb.co.il Company website: https://www.mizrahi-tefahot.co.il

Previous name of the reporting entity: United Mizrahi Bank Ltd

Name of the person reporting electronically: Kikozashvili Hanan Position: Bank Secretary Name of Employing Company: Mizrahi Tefahot Bank Ltd

Address: 7 Jabotinsky Street, Ramat Gan, 52520 Tel: 03-7559219 Fax: 03-7559923 E-mail: management@umtb.co.il

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# Mizrahi Tefahot Bank Ltd[1]

## Follow-Up | August 2024

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[1] Mizrahi Tefahot Bank Ltd holds approx. 4.9% of Midroog Ltd’s share capital via Mizrahi Tefahot Invest Ltd. The company’s shares lack any means of control.

| | | |
|---|---|---|
| Baseline credit assessment (BCA) for the bank | aa2.il | |
| Long-term deposits & bonds | Aaa.il | Outlook: stable |
| Contingent convertible bonds with contractual loss absorption mechanism (CoCo) | Aa3.il (hyb) | Outlook: stable |
| Short-term deposits/CP | P-1.il | - |

**Midroog is maintaining the baseline credit assessment (BCA) of Mizrahi Tefahot Bank Ltd (hereinafter: the "Bank") at aa2.il.**

**The rating of the Bank's long-term deposits and senior debt remains Aaa.il with a stable outlook, and they continue to embody the assumption of a high external support from the state, at two rating levels (notches) relative to the BCA.**

**The rating of the Bank's contingent convertible bonds with contractual loss absorption mechanism (CoCo) through a write-off or partial write-off (classified as tier 2 capital) remain at Aa3.il (hyb) with a stable outlook. This rating is one notch lower than the BCA and three notches below the senior debt and reflects the instrument's conditions, including the structural subordination and loss-absorption mechanisms of this instrument and without an assumption of external support.**

**Midroog is likewise maintaining a P-1.il rating for short-term deposits and a P-1.il rating for the commercial papers.**

## The main considerations for the baseline credit assessment (BCA) and the Bank's ratings

The Bank's baseline credit assessment (BCA) is supported by its good positioning in the local banking system (hereinafter: the "**System**"), which is based on a strong brand name, a significant market share and leadership in the housing credit sector, alongside a broad, dispersed customer base, which support the Bank's good profitability, despite the concentration of the income sources. The Bank is universal and provides its customers with a variety of banking and financial services, along with a comprehensive value proposition that appeals to a variety of public tastes. The Bank is characterized by a conservative risk management policy which supports the Bank's risk profile, as reflected also by the credit quality indicators, which stand out positively relative to the BCA. However, the Bank is characterized by a high credit concentration in the mortgage and real estate sectors relative to the capital buffer and relative to the BCA (on par with the System), which weighs down the Bank's risk profile; however, we note that the credit portfolio is backed by a substantial rate of collaterals, which is expected to mitigate the loss expected throughout the economic cycle.

The Bank's profitability metrics reflect an improvement trend in recent years, deriving *inter alia* from the implementation of the strategic plan, which includes increasing focus on the business sector, which is characterized by an excess financial margin, and from rising interests and inflation, which increased the financial margin, alongside high operational efficiency, that stand out positively over time and derive from the credit portfolio mix. The Bank is characterized by a capital buffer that is reasonable relative to the BCA, which was built over the years through revenue accumulation minus dividend distribution, optimization, and management of risk assets, and the asset mix. As of March 31, 2024, the Bank's tier 1 capital ratio – the main capital buffer against unexpected losses – stood at 10.6%, demonstrating an improvement over the 10.1% on March 31, 2023. At the same time, the Bank's leveraging is high relative to the BCA and the comparison group average[2], and hinders the Bank's risk profile, as reflected in the 6.3% equity-to-balance sheet ratio on March 31, 2023, compared with an average of approx. 7.2% in the comparison group, however it also reflects an improvement trend in the past year (approx. 5.7% on March 31, 2023). The Bank's liquidity profile is good relative to the BCA and supported by a comfortable, wide and dispersed source structure, based on a stable (retail) deposit rate and a substantial inventory of liquid assets. At the same time, the liquidity profile might be affected by a relatively high wholesale deposits component, which in our assessment is less stable throughout the economic cycle. Liquidity management is also supported by a liquidity coverage ratio (LCR) that is significantly higher the regulatory benchmark and supports the financial and business flexibility of the Bank.

In the baseline scenario for the years 2024-2025, Midroog is of the opinion that in the short-medium term, due to the consequences of the "Iron Swords" war (hereinafter: the "**War**"), there may be damage to the quality of the banking system's assets quality due to an increase in borrower risk. Accordingly, the proportion of problematic debts from the portfolio is expected to grow and move, in our estimation, in the approximate range between 2.0%-2.2% in the years 2024-2025. In addition, the Bank's profitability indicators will moderate, to a certain extent, relative to 2023, but they will continue to support the building of equity and the financial profile, with the core return on risk assets[3] and return on assets expected to move in the ranges between approx. 2.5%-2.9% and approx. 0.8%-0.9%, respectively. In addition, Midroog expects the capital buffer to continue to be built alongside continued growth in the credit portfolio, so that the core capital adequacy ratio will range approximately between 10.2%-10.5%.

[2] Bank Leumi Le-Israel Ltd, Bank Hapoalim Ltd, Discount Bank Ltd, and the First International Bank of Israel Ltd.

[3] Revenues before taxes and credit loss expenses to risk asset average.

We note that with regard to Midroog's extreme scenarios, the Bank's capital buffer absorbs unexpected losses well, in our assessment, which at this stage is expected to support its stability throughout the War.

In our assessment, liquidity management will continue to be challenging for both the bank and the system, due to a high interest rate environment, which may add and lead to a change in consumer preference following alternative investment routes for deposits, which yield an excess return on deposits and at a similar level of tradability. However, Midroog anticipates that the Bank's resource structure and good liquidity will remain so within the forecast range. The ratings of the Bank's long-term deposits and senior debt were set at two rating levels (notches) above the BCA, embodying our assumption of a high probability of external support from the state, if necessary. The rating of the Bank's contingent convertible bonds with contractual loss absorption mechanism (CoCo) through a write-off or partial write-off is one notch lower than the BCA and three notches below the senior debt, reflecting the instrument's conditions, including the structural subordination and loss-absorption mechanisms of this instrument and without an assumption of external support.

## Rating outlook

The stable outlook for the Bank's ratings reflect Midroog's assessment that the Bank will maintain an adequate financial profile in the forecast years, while keeping the risk metrics of the credit portfolio and the loss absorption buffers in a range that is appropriate for the rating.

At the same time, the War that erupted in Israel on October 7, 2023 led to a series of consequences, along with uncertainty regarding the anticipated scope and duration of the War, and its implications for the Israeli economy. For more information on the subject, you are hereby referred to "Consequences of the Iron Swords War on the Credit Repayment Capacity of Issuers Rated by Midroog – Special Report" (October 2023)[4].

## Factors that could lead to raising the BCA and the Bank's ratings:

- A significant improvement in the dispersion of the Bank's activity mix
- A significant improvement in the Bank's capital adequacy ratios

## Factors that could lead to lowering the BCA and the Bank's ratings:

- Substantial and ongoing damage to the Bank's business status
- A significant and ongoing worsening in the Bank's credit portfolio's quality
- An erosion of the capital buffer, profitability and the stability of the Bank, over time

[4] The report is published on Midroog's website.

Mizrahi Tefahot Bank Ltd, financial data and main ratios, in millions (ILS) and in percentages:

| ₪ Million | Mar 31 2024 | Mar 31 2023 | 2023 | 2022 | 2021 | 2020 |
|---|---|---|---|---|---|---|
| Loans to the public | 334,585 | 315,416 | 329,415 | 310,356 | 273,531 | 247,958 |
| Deposits from the public | 365,371 | 348,469 | 358,553 | 344,514 | 307,924 | 284,224 |
| Total equity attributed to the shareholders | 28,578 | 24,844 | 27,461 | 23,780 | 20,770 | 18,804 |
| Total assets | 450,683 | 434,110 | 448,204 | 428,292 | 392,271 | 360,140 |
| Revenue before taxes and credit loss expenses | 2319 | 2,389 | 9211 | 7,495 | 4,752 | 3,654 |
| Net profit attributed to the Bank's shareholders | 1272 | 1,367 | 4910 | 4,472 | 3,188 | 1,610 |
| (%) | | | | | | |
| Exposure to largest industry to tier 1 shareholders' capital | 140% | 144% | 140%% | 143% | 129% | 120% |
| Problem debts to gross loans to the public | 1.8% | 1.3% | 1.9%% | 1.3% | 1.3% | 1.5% |
| Problem debts to total shareholders' capital and provision for credit losses | 17.9% | 14.5% | 18.8% | 14.4% | 14.5% | 17.1% |
| Credit loss expenses [income] to average gross loan to the public [1] | 0.2% | 0.3% | 0.5% | 0.2% | (0.1%) | 0.5% |
| Net profit to asset average [1] | 1.1% | 1.3% | 1.1% | 1.1% | 0.8% | 0.5% |
| Revenue before taxes and credit loss expenses to risk weighted assets average [1] | 3.4% | 3.8% | 3.5% | 3.2% | 2.3% | 2.0% |
| Efficiency ratio | 35.5% | 37.6% | 37.7% | 45.2% | 54% | 53.9% |
| Tier 1 capital adequacy | 10.6% | 10.1% | 10.3% | 9.9% | 10.0% | 10.0% |
| Total shareholders' capital to total asset | 6.3% | 5.7% | 6.1% | 5.6% | 5.3% | 5.2% |
| Less stable finance resources [2] to asset total | 20.1% | 20.8% | 20.4% | 20.2% | 19.3% | 15.0% |
| Liquidity balances [3] to deposits from the public | 35% | 31% | 36% | 31% | 35% | 36% |

*[1] Calculated on an annual basis*

*[2] Financial institutions' deposits (wholesale), bonds and bonds deferred by up to one year and deposits from banks*

*[3] Cash and deposits at banks, US and Israel government bonds and assets backed by the US government*

## Details of the key considerations in the Bank's baseline credit assessment

### A good business profile which supports the Bank's income generation capability throughout the economic cycle due to the substantial weight of retail income, but with a bias to the housing loans sector

Mizrahi Tefahot Bank is the leading banking group by size in the housing loan sector over time, with a market share of approx. 35% of total housing credit; and the third largest in the local economy, with a market share of approx. 18% of all assets in the system and approx. 21% of total credit, as of March 31, 2024. Likewise, the business profile, as is the case with the rest of the major banks, is supported by it being a universal bank, which provides a wide range of financial and banking services, leaning on a broad and dispersed customer base alongside a comprehensive value proposition that appeals to a variety of public tastes. The Bank is characterized by a strong brand in the housing loans sector, which in our assessment constitutes a platform for growth in market shares, the retail customer base and as a result, in the income base, which support the establishment of its position as a leader in the retail field. All of these support the value proposition to the Bank's customers, and contribute, in our assessment, to the Bank's growth potential and profitability, as well as its ability to cope with changes in the business environment. We are of the opinion that in light of the changes in the banking industry's activity environment in recent years, customer needs for a fast, flexible and digital response have increased. We estimate that we will continue to see a trend of expansion in everything related to providing digital services in the banking system in general, and at Mizrahi Tefahot Bank in particular. Furthermore, we believe that the changes in the business environment and in particular, the launch of a credit database, the open banking reform, the granting of a license to a new digital bank, and other regulatory changes, will lead to a further intensification of competition in the retail sector, and will force the Bank to face new competitors as well, and improve the value proposition to customers in the face of developing threats.

The stability of the Bank's revenues, as assessed by Midroog, stands out positively relative to the BCA and positively affected by its focus on mortgage credit. Accordingly, the weight of the Bank's retail revenues[5] is significant, constituting approx. 93% on average between 2021 and 2023, which is outstandingly positive relative to the comparison group, contributes to the revenue generation ability and moderates activities' volatility.

[5] Net income from interest and non-interest revenues in accordance with regulatory activity sectors, which include the household, private banking (including housing), and small and micro business sectors, excluding financial management revenues.

In contrast, the Bank is characterized by a relatively low rate of commission revenues, which constituted approx. 16% on average between 2021 and 2023, which we have characterized as stable throughout the economic cycle. This figure is low relative to the comparison group average (approx. 23% on average between 2021 and 2023) and hinders the stability of the Bank's revenues. In addition, the dispersion of the Bank's income sources is limited, in our assessment, and rests on two main legs[6] over time, as reflected in the average revenue mix for the years 2021-2023, which includes approx. 76% from the housing loans sector and approx. 17% from small and micro businesses.

**The risk management policy supports the Bank's risk profile; on the other hand, the credit concentration relative to the capital buffer is still relatively high**

The Bank's risk management system is encompassing and includes a number of anchors and control circles, which support the formulation of risk management policies, in determining the Bank's risk appetite (in consistence with its strategy) and in monitoring and controlling risks. Credit risks are managed using statistical rating models (consumer credit) and expert evaluations (business credit). In our assessment, the Bank takes a conservative credit policy in the housing credit segment, which includes relatively strict restrictions on the business credit portfolio, underwriting processes, monitoring and management of collaterals, while this policy is also expressed by good risk indicators relative to the credit portfolio, that support the BCA. We note that the overall exposure over time to large borrowers, who constitute over 5% of the Bank's tier 1 capital (approx. ₪4.1 billion as of December 31, 2023) is estimated by Midroog at approx. 8% as of December 31, 2023[7] and it is reasonable relative to the BCA. We note that the rate calculated above may be biased upward because the data in the financial report refer to a cross-section of the liability of those borrowers, whereas this ratio is an estimate calculated by Midroog. On the other hand, the Bank is characterized by high sectoral credit concentration relative to the BCA, as it is measured in relation to the capital buffer, which hinders the Bank's risk profile. Accordingly, the largest industry out of the Bank's tier 1 capital is the real estate and construction industry, which constituted 140% on March 31, 2024, but which is low relative to the comparison group average on that date (approx. 180%).

[6] An activity sector that constitutes over 15% of the net revenue total (external interest and non-interest income), excluding financial management revenues.

[7] The ratio was calculated as follows: according to Note 30 to the annual financial report, Midroog calculated according to the relative part the balance sheet liability included in the range between ₪1,200 million and ₪1,600 million, where the amount equal to about 5% of the Bank's equity as of December 31, 2023 is in its middle part, plus the balance sheet liability of the upper range. For the purpose of calculating the ratio, the above liability sum was divided by the tier 1 capital on December 31, 2023. It should be noted that the liability ranges in the aforementioned note also refer to liability for off-balance sheet credit; therefore, the ratio obtained according to Midroog's estimate has an upward bias.

The Bank’s market risks are estimated by the VaR model under conservative assumptions, similar to the entire system, and as a complementary action to the risk assessment, a number of stress scenarios (including holistic scenarios) at varying degrees of severity are examined by the Bank. In Midroog’s assessment, the Bank's market risk appetite is adequate relative to the BCA, as reflected in the VaR limit of the Bank’s total activity to a one-month investment prospect, established by the Board of Directors, of approx. 9% of the shareholders’ capital, which is reasonable for the BCA but high relative to the comparison group.

**The quality of the credit portfolio stands out positively relative to the BCA; however, a challenging macro-economic environment and the consequences of the War are expected to pressure credit portfolio quality metrics in the forecast range**

The Bank is characterized by a high-quality credit portfolio, which supports its future profitability, as well as the capital buffer’s accumulation potential, as reflected in the risk indicators which are good relative to the BCA. Accordingly, as of March 31, 2024, the proportion of problem debts relative to the credit to the public amounted to a rate of approx. 1.8% (approx. 1.5% on average between 2021-2023), and stands out positively compared with an average rate of approx. 2.2% in the comparison group on that date. Furthermore, the rate of debts which are non-accumulating or in arrears for over 90 days out of the total gross credit to the public has remained without significant change compared to previous years and stood at approx. 1.1%.

We are of the opinion that the Bank’s exposure to the mortgage and real estate industries is relatively high and amounts in aggregate at approx. 75% of the Bank’s liabilities[8] on March 31, 2024, while the comparison group was characterized by a much lower exposure rate of approx. 52% on that date. Exposure to the real estate industry alone (without mortgages) in Israel – which is characterized by us as relatively high level of risk, in view of homogeneous characteristics and due to high exposure relative to the capital absorption buffer, constitutes approx. 11% of the Bank’s total liabilities (approx. 12.0% including credit to foreign operations) and substantially low relative to the comparison group. The exposure to the mortgage portfolio constitutes approx. 63% for that date, and it is characterized by the Bank’s conservative underwriting processes, as reflected in the maintenance of a high repayment capability, which supports a low probability of failure. Accordingly, the average LTV rate in the Bank’s housing loans portfolio amounted to approx. 54.9% as of March 31, 2024 (a rate reflecting the LTV when the credit was granted), with the share of the loans that had a relatively high leveraging rate (an LTV rate of over 75% of the total housing credit) being low and amounting to 0.9% of the portfolio for the first quarter of 2023.

[8] Credit to the public.

In addition, the average repayment rate from disposable income in the housing credit portfolio[9] amounted to approx. 26.3% on March 31, 2024, reflecting a relatively low level of risk.

Midroog's base scenario regarding the quality of the Bank's credit portfolio is based on a number of exogenous macroeconomic influences[10], including: (1) A GDP growth of approx. 1.5% in 2024 and approx. 4.2% in 2025; (2) An unemployment rate in the range between 3.8%-4.0%; (3) An interest rate environment in the range between 4.0%-4.5%; (4) An inflation rate in the Bank of Israel's upper range; (5) Continued competition on the part of the non-bank debt market in the consumer and business portfolio. In this scenario, Midroog projects that in 2024-2025, the Bank's credit portfolio will grow at a rate between approx. 7%-9%. We estimate that this growth will be supported by a continued maintenance of significant market shares in retail credit, and particularly in housing loans, alongside growth in the credit volumes to the business sector and international operations, in accordance with the Bank's strategic plan.

Midroog is examining the development of the Bank's credit portfolio quality in the short and medium term, based also on a number of leading macroeconomic indicators. In view of the War's consequences, we are of the opinion that in the short-medium term, there may be damage to the quality of the system's assets due to an increase in borrower risk. Accordingly, the rate of problem debts in the credit portfolio is expected to rise, and move in our assessment in the range of approx. 2.0%-2.2% in the forecast years, with the rate of problem debts out of the absorption buffers (shareholders' capital and provision for credit losses) projected to move around 20% in the forecast years. Moreover, we are assuming a credit loss expenditure rate of between approx. 0.2%-0.4% out of the credit portfolio. This scenario takes into account moderation in the recovery rates and increase in the write-off rate relative to 2023.

**The Bank's profitability stands out positively relative to the BCA, in view of a base interest level and inflationary environment that are both high relative to recent years, but it is expected to moderate somewhat in the forecast range due to the War's consequences**

The Bank's profitability metrics reflected a significant and ongoing improvement trend in recent years, which, among other things, was the result of the strategic plan's implementation, which includes increased focus on the business sector, which is characterized by excess financial margins and by the rise of interest and inflation, which increased the financial margins alongside a higher operational efficiency, which stand out positively over time and derive from the mix of the credit portfolio and the business model.

[9] Payment-to-income.
[10] The Research Department's macro-economic outlook, Bank of Israel, July 2024

In contrast, the portfolio quality indicators showed some erosion in the past year, which was reflected by an increase in credit loss expenditure, amid the worsening of macro-economic data and the aforesaid consequences of the War. All of these were expressed in the Bank's operational efficiency ratio, which stood at 35.5% as of the first quarter of 2024, the core return on risk-weighted assets and ROA, which at that date stood at 3.4% and 1.1% (annualized), respectively, which stand out positively relative to the BCA.
The main assumptions regarding the Bank's profitability, on which Midroog's baseline scenario for the years 2024-2025 is based, are as follows: (1) A credit portfolio growth rate of approx. 7%-9% a year; (2) An interest rate environment in the range between 4.0%-4.5%; (3) An inflation rate in the upper limit determined by the Bank of Israel; (4) The credit loss expense rate relative to the credit portfolio will move in the range of approx. between 0.2%-0.4%; and (5) A continued "creeping" of wage expenses, per the Bank's wage agreements, alongside an offsetting effect caused by streamlining processes. In this scenario, Midroog anticipates that during the forecast years, the Bank's profitability ratios will moderate, to some extent, relative to 2023, but will continue to support the ongoing build-up of the capital and the financial profile, with the core yield on risk weighted assets and ROA expected to move in the range between 2.5%-2.9% and 0.8%-0.9%, respectively.

**The capital buffer is reasonable relative to the BCA and demonstrates an improvement trend over the past year**

The Bank is characterized by a capital buffer which is reasonable relative to the BCA that had been building up over the years through the accumulation of profits minus dividend distribution (a policy of 40% of the quarterly net profit), optimization and management of risk weighted assets and the asset mix. As of March 31, 2024, the Bank's tier 1 shareholders' capital, the central absorption buffer for unexpected losses, amounted to approx. 10.6%, an improvement compared to 10.1% as of March 31, 2023.

The Bank's leveraging level is high relative to the BCA and the comparison group's average, and hinders the Bank's risk profile, as reflected by a capital to balance sheet ratio of approx. 6.3%, as of March 31, 2024, compared with an average of approx. 7.2% in the comparison group, but also demonstrates an improvement trend over the past year (approx. 5.7% on March 31, 2023). We are of the opinion that in light of the volatility in the capital market, the total profit of the Bank in particular - and that of the banking system in general - might be affected from adjusting securities available for sale according to fair value and changes the actuary undertaking for employee benefits.

Midroog tested a holistic stress scenario for one year ahead on the Bank's loss absorption buffers relative to its risk profile, while assuming various PD and LGD rates in the main sectors of the operation, losses from the securities portfolio, erosion in the financial margin and the loss of commission income, along with the build-up of the shareholders' capital through current profitability and the non-distribution of a dividend. The Bank's tier 1 capital ratio would amount to approx. 9.7% at the end of the scenario - a level that reflects the good ability of the Bank to absorb unforeseen losses, in our assessment, which at this stage is expected to support its stability during the War.

Midroog's base scenario anticipates that the capital buffer will continue to be accumulated, so that the core capital adequacy ratio will move in the range between 10.2% and 10.5%. This ratio will be affected by the following factors: (1) Accrued profits; (2) Dividend distribution to the extent of up to 40% of the net revenues in the forecast years; and (3) A growth in risk weighted assets similar to the credit portfolio's increase rate.

**A good liquidity profile relative to the BCA and supported by a comfortable resource structure and a substantial liquid asset inventory**

The Bank's resource structure, similarly to the local banking system, mainly relies on a broad retail deposit base, which is characterized by a relatively high stability throughout the economic cycle. The Bank's resource structure contains a substantial proportion of widely-dispersed stable (retail) deposits (approx. 44% households and private banking and approx. 16% small and micro businesses, as of March 31, 2024), which are appropriate for the Bank's risk profile, in Midroog's assessment. The Bank has a reasonable rate of financing sources which are less stable[11] out of the total assets, per our definition, that amounted to approx. 20.1% on that date. Moreover, the Bank is characterized by a relatively high ratio between credit to the public and deposits from the public, which on March 31, 2024, amounted to 92% vs. a comparison group average of approx. 75% on that date. Moreover, the NSFR ratio on March 31, 2024 was at 114%, which is appropriate for the rating and supports the Bank's financing profile.

The Bank's liquidity buffer includes an inventory of liquid assets[12] relative to the total deposit is good relative to the BCA and amounted to approximately 35% on March 31, 2024 and supports the Bank's high liquidity. This inventory mainly includes cash and deposits at banks; and the securities portfolio.

[11] Deposits from banks, deposits from financial institutions, and bonds and debentures to be paid within the next 12 months

[12] Cash and deposits at banks, Israeli government bonds, US government bonds and bonds backed by the US government.

This portfolio constituted approx. 5% of the total assets on that date and is characterised by a risk level (credit) that is relatively low in view of Israel and US government bonds constituting substantial components thereof (approx. 84% and approx. 3%, respectively). The portfolio serves as a tool to absorb excess resources and manage the Bank's various market exposures, but exposes it to an interest rate risk. The liquidity management is also supported by a high regulatory liquidity coverage ratio (LCR) which amounted to approx. 139% on March 31, 2024 - significantly higher than the regulatory bar (100%). This rate also supports the liquidity profile and business flexibility of the Bank. In our assessment, liquidity management will continue to be challenging for both the bank and the system, due to a high interest rate environment, which may add and lead to a change in consumer preference following alternative investment routes for deposits, which yield an excess return on deposits and at a similar level of tradability. However, Midroog anticipates that the Bank's resource structure and good liquidity will remain so within the forecast range.

## Additional considerations

**ESG considerations**

**Environmental considerations:** In our assessment, the banking industry is exposed to environmental risks in a relatively moderate manner at this stage.

**Social considerations:** In our assessment, the banking industry faces moderate social risks. However, we are seeing a development in risks related to information security, client privacy and cyber, although these are partially mitigated by substantial investments in technology alongside the banking system's extensive experience in handling sensitive client data. Fines and reputation damages constitute another social risk. In addition, strict labor laws and strong labor unions in the banking system limit the flexibility of the workforce and increase wage costs. However, banks have reduced employee positions through early retirement programs and implemented cost control, which has allowed them to mitigate these challenges.

**Corporate governance considerations:** In our assessment, corporate governance risks have a substantial impact on the banking industry. These risks are a major credit consideration, where weaknesses in corporate governance may lead to a deterioration in the bank's credit repayment capacity, while strong corporate governance may positively impact the bank's credit repayment capacity. A mitigating factor for corporate governance risks is the regulatory framework under which banks operate, which outlines a system of internal reviews as well as tight controls on the side of the regulator.

## Structural considerations and external support

### A review of the relative projected loss ranking

According to Midroog's methodology, the rating of the Bank's subordinated debts (deferred bonds) is based on the Bank's baseline credit assessment (BCA), which is the anchor for rating the Bank's liabilities and reflects the risk of failure and the Bank's ability to serve its liabilities independently, without the assumption of external support. Midroog adjusts the rating relative to the BCA to the credit risk of the subordinated debt instrument, according to its specific characteristics – taking into consideration the extent of the instrument's structural subordination, the loss absorption mechanisms per the instrument's conditions and the uncertainty regarding their point of activation (at the contractual trigger and/or at the discretion of the Supervisor of Banks). Midroog is removing one rating level (notch) off the Bank's BCA for the rating of the deferred bonds with contractual loss absorption mechanism (CoCo). The removal of the notch embodies the legal-contractual deferral with respect to the rest of the Bank's liabilities (excluding tier 1 instruments and shareholders' capital) and the contractual loss absorption mechanism. Considering the Bank's BCA (aa2.il) and the current level of capital adequacy – tier 1 capital ratio (of approx. 10.6% on March 31, 2024), as well as the one anticipated in our base scenario (10.2%-10.5%) and the liquidity profile, which is appropriate relative to the BCA, the uncertainty regarding the likelihood of reaching the 'nonviability point[13]' is low; therefore, it was not embodied by the reduction of another notch.

### External support

The rating of the deposits and senior debt are granted the benefit of two rating levels (notches) due to the high probability of external support from the state, according to Midroog's JDA model. The assumption of external support probability is based on the following considerations: the banking system's high importance to the local economy and the payment system, and the need to maintain its stability; the high concentration of the banking and financial system; the relatively high connectivity between the banking system and financial institutions; the local financial system serving as a central credit provider to the government; some uncertainty regarding the behavior and trust of the different debtors, in terms of bail-ins close to the point of failure, in the absence of previous experience.

[13] Establishing nonviability event: 1. A notice from the Supervisor of Banks that the write-off/conversion of a security is necessary to avoid the nonviability point. 2. The provision of external support, without which the Bank would reach the nonviability point. It should be noted that the Supervisor of Banks has yet to define the term 'nonviability point'.

Furthermore, the State of Israel had, in the past, proved its willingness to support failed banks, and we do not assume any change in this policy.

## About the bank

Mizrahi Tefahot Bank was among the first banks to be established in Israel (1923) and is one of the five major banking groups in Israel.

In 2005, two banks – United Mizrahi Ltd. and Tefahot Israel Mortgage Bank Ltd. – were merged together into Mizrahi Tefahot Bank Ltd. On September 30, 2020, a tender purchase offer was finalized with regard to the shares of Union Bank. 100% of Union Bank’s issued and outstanding share capital and voting rights was purchased in the offer. In December 2022, Union Bank’s merger with and into the Bank was finalized. With the merger’s finalization, Union Bank ceased to exist as an independent legal entity and all of its assets and liabilities were instilled with the Bank. The Bank group operates in Israel and abroad and includes Yahav Bank, which is held at 50%. The group engages in commercial (business and retail) banking activities, and mortgage activities in Israel, through a nationwide chain of 208 branches (as of late 2023) and business centers. The Bank’s international activities are conducted through two banking units. In addition to its banking activities, the Bank Group is engaged in various activities related to the capital market, including: Consultancy for capital market activities, management of security portfolios for customers, pension advisory service, trust services, distribution of mutual funds, operation of provident funds and distribution of mortgage insurance. The Bank's controlling shareholders are the Ofer and Wertheim families.

**The bonds rated by Midroog*:**

| Series | Security No. | Rating | Outlook | Final Repayment Date |
|---|---|---|---|---|
| MZTF Iss Bond 60 | 2310456 | Aaa.il | Stable | Sep 5 2024 |
| MZTF Iss 45 | 2310217 | Aaa.il | Stable | Sep 28 2024 |
| MZTF Iss CP 2 | 1202167 | P-1.il | - | Dec 25 2024 |
| MZTF Iss Bond 57 | 2310423 | Aaa.il | Stable | Mar 1 2025 |
| MZTF Iss CP 3 | 1207547 | P-1.il | - | Jun 5 2025 |
| MZTF Iss 40 | 2310167 | Aaa.il | Stable | Jun 7 2025 |
| MZTF Iss 49 | 2310282 | Aaa.il | Stable | Jun 23 2026 |
| MZTF Iss Bond 61 | 2310464 | Aaa.il | Stable | Dec 4 2026 |
| MZTF Iss 46 | 2310225 | Aaa.il | Stable | Sep 28 2027 |
| MZTF Iss Bond 62 | 2310498 | Aaa.il | Stable | Oct 21 2028 |
| MZTF Iss 50 | 2310290 | Aa3.il(hyb) | Stable | Dec 23 2029 |
| MZTF Iss 42 | 2310183 | Aaa.il | Stable | Jun 7 2030 |
| MZTF Iss 52 | 2310381 | Aaa.il | Stable | Jul 1 2030 |
| MZTF Iss 53 | 2310399 | Aa3.il(hyb) | Stable | Jun 24 2031 |
| MZTF Iss Bond 63 | 2310548 | Aaa.il | Stable | Apr 12 2031 |
| MZTF Iss Bond 64 | 2310555 | Aaa.il | Stable | Apr 12 2031 |
| MZTF Iss Bond 66 | 1191667 | Aaa.il | Stable | Dec 8 2031 |
| MZTF Iss 65 | 1191675 | Aa3.il(hyb) | Stable | Jun 8 2033 |
| MZTF Iss Bond 67 | 1196807 | Aaa.il | Stable | Jun 12 2033 |
| MZTF Iss Bond 68 | 1202142 | Aaa.il | Stable | Dec 25 2033 |
| MZTF Iss 69 | 1202159 | Aa3.il(hyb) | Stable | Jun 25 2034 |

** Issued by the Bank and by Mizrahi Tefahot Issuing Company Ltd – a subsidiary fully owned by the Bank*

Baseline Credit Assessment (BCA) Matrix

| | | | For Mar 31 2023 | | Midroog's outlook [1] | | |
|---|---|---|---|---|---|---|---|
| **Category** | **Parameter** | **Sub-parameter** | **Measu1re [1]** | **Score** | **Measure** | **Score** | **Additional considerations** |
| Business profile | Business positioning | | - | aa.il | - | aa.il | *Market share positioning in housing loan segment* |
| | Income stability | % retail income | 95% | aaa.il | >80% | aa.il | *Percentage of income from commissions* |
| | Income dispersion | Number of business lines over 15% of total revenues | 2 | baa.il | 2 | baa.il | *Retail sectors* |
| Risk profile | Corporate governance | | - | aa.il | - | aa.il | |
| | Risk management policy | | - | aa.il | - | aa.il | |
| | Credit portfolio concentration | Largest industry to tier 1 shareholders' capital | 140% | aa.il | ~140% | a.il | *Real estate sector* |
| | Credit portfolio concentration | Major borrowers to tier 1 shareholders' capital | 8%* | aa.il | 15%-40% | a.il | |

| | | | | | | |
|---|---|---|---|---|---|---|
| | Market risk appetite | VaR limit on tier 1 shareholders' capital | 9%* | a.il | ~9% | a.il |
| Financial profile | Asset quality | Problem debts to loans to the public | 1.8% | aaa.il | 2.0%-2.2% | aaa.il |
| | | Problem debts to total shareholders' capital and provision for credit losses | 18% | aa.il | ~20% | aa.il |
| | Profitability | Net profit to asset average | 1.1% | aaa.il | 0.8%-0.9% | aa.il |
| | | Profit before taxes and credit loss expenses to risk weighted asset average | 3.4% | aaa.il | 2.5%-2.9% | aaa.il |
| | | Efficiency ratio | 36% | aaa.il | 39%-43% | aaa.il |
| | Capital adequacy | Tier 1 shareholders' capital to risk weighted assets | 10.6% | aa.il | 10.2%-10.5% | aa.il |
| | | Shareholders' capital to total assets | 6.6% | a.il | 6.2%-6.3% | a.il |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | Liquidity & financing | Less stable finance resources to total assets | 20.1% | aa.il | ~20.1% | aa.il | |
| | | Liquid assets to deposits from the public | 35% | aa.il | ~35% | aaa.il | *LCR ratio* |
| **Deriving baseline credit assessment** | | | | | | **aa2.il** | |
| **Actual baseline credit assessment** | | | | | | **aa2.il** | |

*[1] The metrics presented in the table have been adjusted by Midroog, and are not necessarily identical to those presented by the company. Midroog's forecast includes Midroog's assessments regarding the issuer, per Midroog's base scenario, rather than the issuer's assessments.*

**According to the data of December 31 2023*

**Rating of the Bank's debts**

| | Baseline credit assessment (BCA) | Owner and/or affiliated party support | Adjusted BCA | Subordination and loss absorption capacity | State support | Rating |
|---|---|---|---|---|---|---|
| Deposits and bonds | aa2.il | 0 | aa2.il | 0 | +2 | Aaa.il |
| Subordinated bonds with a contractual loss absorption capacity (tier 2 capital) | aa2.il | 0 | aa2.il | -1 | 0 | Aa3.il(hyb) |

## Related reports

Mizrahi Tefahot Bank Ltd – Related reports

Bank Rating – Methodology Report, September 2019

Consequences of the Iron Swords War on the Credit Repayment Capacity of ssuers Rated by Midroog – Special Report, October 2023

Promotion of Competition in the Banking System – Special Report, February 2023

Banking System – Guidelines for Examining Environmental, Social and Corporate Governance Risks in Credit Ratings – Methodology Report, February 2022

Connections and Holdings Table

Midroog Rating Scales and Definitions

The reports are published on Midroog's website: www.midroog.co.il

## General information

| | |
|---|---|
| **Rating report date:** | August 5 2024 |
| **Last date on which rating was updated:** | June 4 2024 |
| **Date on which rating was first published:** | September 10, 2017 |
| **Name of the rating initiator:** | Mizrahi Tefahot Bank Ltd |
| **Name of the party paying for the report:** | Mizrahi Tefahot Bank Ltd |

## Information from the issuer

In its ratings, Midroog relies, inter alia, on information received from authorized parties at the issuer.

**Baseline Credit Assessment (BCA) Scale**

| | |
|---|---|
| aaa.il | Issuers and issues assessed at aaa.il are those that, in Midroog's judgment, have the highest internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government. |
| aa.il | Issuers and issues assessed at aa.il are those that, in Midroog's judgment, have very high internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government. |
| a.il | Issuers and issues assessed at a.il are those that, in Midroog's judgment, have relatively high internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government. |
| baa.il | Issuers and issues assessed at baa.il are those that, in Midroog's judgment, have moderate internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and may have certain speculative characteristics. |
| ba.il | Issuers and issues assessed at ba.il are those that, in Midroog's judgment, have relatively weak internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and have speculative characteristics. |
| b.il | Issuers and issues assessed at b.il are those that, in Midroog's judgment, have very weak internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and have significant speculative characteristics. |
| caa.il | Issuers and issues assessed at caa.il are those that, in Midroog's judgment, have excessively weak internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and have very significant speculative characteristics. |
| ca.il | Issuers and issues assessed at ca.il are those that, in Midroog's judgment, have extremely weak internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and are very near default, with some prospect of recovery of principal and interest. |
| c.il | Issuers and issues assessed at c.il are those that, in Midroog's judgment, have the weakest internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and are usually in default, with little prospects of recovery of principal and interest. |

Note: Midroog appends numeric modifiers 1, 2, and 3 to each rating category from aa.il to caa.il. The modifier ‘1’ indicates that the debenture ranks in the higher end of its rating category, which is denoted by letters. The modifier ‘2’ indicates that it ranks in the middle of its rating category and the modifier ‘3’ indicates that the debenture ranks in the lower end of that category, denoted by letters.

Midroog does not publish the BCA forecast, unlike the publications that have been made so far, in order to separate the BCA from credit ratings.

**Local Long-Term Rating Scale**

| | |
|---|---|
| Aaa.il | Issuers or issues rated Aaa.il are those that, in Midroog's judgment, have the highest creditworthiness relative to other local issuers. |
| Aa.il | Issuers or issues rated Aa.il are those that, in Midroog's judgment, have very high creditworthiness relative to other local issuers. |
| A.il | Issuers or issues rated A.il are those that, in Midroog's judgment, have relatively high creditworthiness relative to other local issuers. |
| Baa.il | Issuers or issues rated Baa.il are those that, in Midroog's judgment, have relatively moderate credit risk relative to other local issuers, and could involve certain speculative characteristics. |
| Ba.il | Issuers or issues rated Ba.il are those that, in Midroog's judgment, have relatively weak creditworthiness relative to other local issuers, and involve speculative characteristics. |
| B.il | Issuers or issues rated B.il are those that, in Midroog's judgment, have relatively very weak creditworthiness relative to other local issuers, and involve significant speculative characteristics. |
| Caa.il | Issuers or issues rated Caa.il are those that, in Midroog's judgment, have excessively weak creditworthiness relative to other local issuers, and involve very significant speculative characteristics. |
| Ca.il | Issuers or issues rated Ca.il are those that, in Midroog's judgment, have extremely weak creditworthiness and very near default, with some prospect of recovery of principal and interest. |
| C.il | Issuers or issues rated C are those that, in Midroog's judgment, have the weakest creditworthiness and are usually in a situation of default, with little prospect of recovery of principal and interest. |

Note: Midroog appends numeric modifiers 1, 2, and 3 to each rating category from aa.il to caa.il. The modifier '1' indicates that the debenture ranks in the higher end of its rating category, which is denoted by letters. The modifier '2' indicates that it ranks in the middle of its rating category and the modifier '3' indicates that the debenture ranks in the lower end of that category, denoted by letters.

**Local Short-Term Rating Scale**

| | |
|---|---|
| P-1.il | Issuers rated Prime-1.il, in Midroog's judgment, have a very good ability to repay short-term obligations relative to other local issuers. |
| P-2.il | Issuers rated Prime-2.il, in Midroog's judgment, have a good ability to repay short-term obligations relative to other local issuers. |
| P-3.il | Issuers rated Prime-3.il, in Midroog's judgment, have a moderate ability to repay short-term obligations relative to other local issuers. |
| NP.il | Issuers rated Not Prime.il do not belong in any of the Prime categories. |

**The Connection between the Long-Term and Short-Term Rating Scales**

The following table shows the long-term ratings consistent with short-term ratings, when such long-term ratings exist[14].

| Long-term rating | Short-term rating |
|---|---|
| Aaa.il<br>Aa1.il<br>Aa2.il<br>Aa3.il<br>A1.il<br>A2.il<br>A3.il | Prime-1.il |
| A3.il<br>Baa1.il<br>Baa2.il | Prime-2.il |
| Baa2.il<br>Baa3.il | Prime-3.il |
| Ba1.il,Ba2.il,Ba3.il<br>B1.il,B2.il,B3.il<br>Caa1.il,Caa2.il,Caa3.il<br>Ca.il<br>C.il | Not Prime |

[14] Structured finance short-term ratings are usually based on the short-term rating of a liquidity provider for the transaction or an assessment of cash flows available to repay the rated obligation.

[ Midroog disclaimer ]