

"No-one takes risks, no-one takes responsibility"

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Hezi Chermoni, of Tadiran Communications fame, speaks his mind about the Israeli business scene.

Hezi Chermoni has had a bellyful. The legendary CEO of Tadiran Communications, who led one of the most impressive buyout moves ever seen in Israel and retired with tens of millions of dollars he had accumulated from salaries and, mainly, from selling his shares in the company, is angry at the management culture and style of corporate governance that have taken root in Israel, at the capital market that he says is captive to officialdom, at the feebleness of company directors, the laziness of the investment institutions, and at what is happening here in general.

"The capital market in Israel is dominated by former Ministry of Finance officials," he says. "They're all honest people, all talented. They're not thieves, only as time goes by it starts to look to them as though that is how the world runs: some respectable mister sits in some respectable company, I don't know, Phoenix or somewhere else, receives risk-free bonds from the Ministry of Finance and charges half a percent or a percent on them. He received a license to make money, he thinks it's all thanks to his talent, and he's paid a salary in the millions. And who approves it? The directors who come to meetings for the small talk and to massage one another's egos.

"Few of the people who manage the major investment institutions in Israel have ever

seen the whites of the eyes of a business or lost their own money - most of them come from the public sector, and they are the one's managing the public's money. If they had ever had that experience, we wouldn't have got into the situation of financing real estate investments in Romania, that sent billions of our pension money down the tubes.

"And what's shocking," Chermoni continues, "is that it's now repeating itself. Jewish real estate developers from the US have discovered the bond market here and are raising billions of shekels. Great, who from? The suckers in Israel are once more putting the money down. They're issuing bonds backed by no collateral, at interest rates of 4% and 5%. I pinch myself and can't believe it. They're raising debt as though it were equity without collateral and returning to the US with the money. Whoever provided the money will at best make a few percentage points a year, and all the risk is on him, while the developers have tens of percent upside. It makes no sense, and everyone knows it, but they continue rushing to the cliff edge."

"Look," says Chermoni, volunteering an example from his real estate activity in the UK (of which more later), "Today, we operate in the UK, on a very large scale. You see that you have to come with 35-40% equity, and that without that there's no deal. You don't raise it at 4-5% as they do here with bonds; it costs me at least 8-9% for mezzanine funding. So why should I, as an investor from among the public in Tel Aviv, give them loans at interest rates of 4% and 5%?"

Why does no-one cry that the emperor has no clothes?

"The institutions don't bang on the table. There's no activism. They only make decisions when there's a debt settlement. They're honest and smart, but lazy. Why make an effort if you can get by without it, and I'm not talking about the boards of directors, where they're all pals?"

Chermoni knows what he's talking about. When he was CEO of Tadiran Communications, after that company was taken over by [Elbit Systems Ltd.](#) (Nasdaq: [ESLT](#); TASE: [ESLT](#)), he headed the opposition to an insider transaction whereby Tadiran Communications was to have bought Elisra from the controlling shareholders in Koor at an inflated price. He thus became probably the first CEO in the history of Israel's capital market to have prevented an insider deal, protecting the interests of the minority shareholders in the company.

Chermoni did everything he could to stop the deal. He dramatically resigned from the Tadiran Communications board, and held talks with investment institutions, in which he pointed out that the acquisition of Elisra constituted oppression of the minority shareholders in the company. Setting up an independent committee didn't help Koor, nor did its attempts to persuade the investment institutions and the reassuring messages it broadcast via the business press. When threats started to be made of lawsuits against the directors if the Elisra deal was completed, it was decided to shelve it.

"For the most part, the institutions were not up in arms, but I rallied the board, we

opposed it, and we torpedoed it," Chermoni recalls. "The management fought to the bitter end against a conflict of interests between the controlling shareholders and the company; there's no precedent for it. If Israel's business culture were like that of Tadiran Communications, my children would have a better future here, but Tadiran Communications was an exceptional case that unfortunately did not set a norm."

Corruption, selfishness, and the system

As Chermoni speaks, it is clear that he does so from the heart. "I regard myself as a Zionist and a concerned citizen," he says. "My parents came to this country from Lithuania through Zionist youth movements. My father worked in a supermarket, and I went to study engineering, because 'the boy needs to learn a profession'. The general mood then was that it was important that in Israel it would be better for the children, but today there's no chance that anyone of the parent generation will give their children more than they received from their own parents. There's a lost generation here of wonderful young people who serve in the army, who fight, people who care, who deserve more, and it's not happening. Our leaders are incapable of giving it to them."

Why is that?

"Corruption, selfishness, and a system that does not allow people to get ahead, except perhaps in high tech. A shock has to happen here, and I believe that it will, but a small push is lacking. So anyone who can should set out their convictions, not in an unctuous way, but they should take a look in the mirror and bring it about that the mass anger puts new politicians into the system."

Business, Chermoni claims, has played a central role in the creation of this frustrating situation. "Genuinely competitive business people, who risk their money and base themselves on production, are lacking here. The large corporations don't work in a competitive atmosphere, and that happens because of the walls of regulation, import duties, and cartels. This leads to a situation in which the cost of living here rises and life becomes difficult. An Israeli citizen is squeezed on one side by the cost of living that arises from an uncompetitive business environment, and on the other side is worn down by regulation and bureaucracy. He's trapped. I want my children's generation to have a better life, as my father wanted for me.

"Look at the companies on the Tel Aviv 25 list, most of them with monopoly status, in food, insurance, telecommunications, banking. How many genuine entrepreneurs do you see there? In the end, a person is measured by the degree of risk they take. Where is there any risk here? Have you seen a bank that loses money? At worst, it sometimes makes a slightly lower profit. No-one takes risks, no-one takes responsibility, and no-one is held accountable. The same names go around all the time in the big companies. They were bureaucrats, they remain bureaucrats, and they leave with thirty, forty or fifty million shekels in salary they have accumulated without risking any of their own money.

"Take Nir Gilad, for example. There are no words to describe what that man symbolizes.

What on earth did he receive such a salary for? What good did he do the shareholders in Israel Corporation? Perhaps he was good for the controlling shareholder. If corporate governance at Israel Corporation was as it should be, perhaps they would have shown him the door three years ago."

"Some things happened by fluke"

During his time at Tadiran Communications, Chermoni, 63, was described as a talented CEO and as someone who got things done, with the ability to put together a good, goal-oriented team, and he achieved impressive results. He led Tadiran Communications, a maker of tactical communications systems for military and security purposes, to the status of a glittering star in the defense exports sky. During his time, the company became a world leader for its technological capabilities, and acquired tremendous experience in developing communications systems for the IDF, which it leveraged to win customers from all over the world.

Besides his opposition to the acquisition of Elisra, Chermoni led some other breakthrough moves in the previous decade. It started in 2000, with the flotation of Tadiran Communications on the stock exchange. The successful flotation took place just a few months after Chermoni led a group of managers at the company, alongside private equity firm FIMI (in one of its earliest and most successful investments) and US investment firm Shamrock, in a leveraged buyout of Tadiran Communications from Koor.

"In my view, some of the things happened by fluke," Chermoni admits. "That is to say, thanks to my somewhat Israeli hutzpah. It started when one day I looked at the company, and saw that about \$100 million cash was sitting there, a really good company. And I also had a sense of the cash flow as manager I had a feel for everything and I say to myself, this is a good business, and feel that, in their minds, the current shareholders give it a value that I think is far less than it should be.

"Now, to carry out a management buyout you need someone to finance you, and this is perhaps the most piquant part of the story. Nehemiah Shiff, the CFO, and I went to Bank Hapoalim. I told them, listen, I need an \$80 million loan. They were convinced that there were tycoons behind me and that I was just the messenger. A month went by, and they told me that the investment committee had approved the loan, on condition that it was a matter of grade A shareholders, so I found Shamrock and FIMI, and we formed a team that both we and Bank Hapoalim were happy with. We were a few managers who put together a million dollars and held 15% of the shares." Chermoni and his wife Zophy even mortgaged their home in Savyon in order to obtain the loan for the buyout. "Since then," he says, "she has been a full and active partner in every assessment of business risk. We didn't receive options, and we didn't sleep at night, but in the end, when you use your own money, it raises the chances that you will make the right decisions for the good of the company. You don't see many people today who risk their own money.

"Altogether," Chermoni recalls, "the buyout group brought \$21 million equity to the deal. Eight years later, Tadiran Communications was delisted in a tender offer to purchase

filed by Elbit Systems for the shares held by the public at a valuation of over \$600 million, so there were a few percentage points profit along the way."

"I've lost faith in stocks"

Today, after unsuccessfully bidding for control of communications equipment company Telrad, Chermoni has abandoned his dream of returning to the industry, and has redirected the capital he accumulated to real estate. In recent years, he has run the business of the family company ZC Ronogil Investments in the British real estate market. The family owns a portfolio of eight commercial assets worth some 70 million pounds, in London, Liverpool and Newcastle, among other places, some of them bought together with developer Jacob Engel.

How did you get into investment in income producing real estate?

"I think that in the collapse of 2008, I lost faith in stocks. The truth is that I have never understood why anyone would buy a share if he'll only see his money back again in fifteen years. Apart from that, look at a stock over fifteen years, its a flick-flack up and down, not a real business.

"In bonds, on the other hand, I found in that period pure mathematics of risk versus opportunity, and I reinvented myself. I started to specialize in highly complex bonds. We bought CDO bonds and others at 20-30 cents on the dollar, and sold at profits in the hundreds of percent when prices came into line. A bond is something very easy to calculate. You calculate the yield, you can work out how much it will be worth in another few years, it's something businesslike. And if you compare bonds to something physical, they're basically commercial real estate. In principle, if the land doesn't rise in value and you only look at the returns, commercial real estate is a bond."

Chermoni leads the family income producing real estate business together with his three sons Ronen (41), Noam (39), and Gilad (29). Their first overseas buying target was actually India, there too alongside Jacob Engel, but Chermoni and his sons did not get much joy out of that country. "We started in India in 2007-8, only with equity, and in a cautious way," Chermoni relates, "It ended two-three years later with an orderly retreat. We came there at the worst time, and essentially wasted time, but we acquired a great deal of experience. After that we bought a few properties here in Israel, and then switched to the UK three years ago."

Why the UK?

"A few reasons: an independent currency, English law is very clear, the English language, and the fact that ownership rights are well established and protected. There's protection there for property owners, and a ten year lease agreement is an agreement that can be enforced if the tenant leaves."

Contrary to what happens in Israel?

""Here it takes a year to two years to obtain a transfer of ownership in the land registry; there it takes two weeks. In Israel, a contract is an option for the tenant; if it doesn't suit him it's not good for him in Holon, he wants to be in Ashdod he leaves. And between the two of us, what will you do to him? Nothing. The market here is less sophisticated and fluid. There, you can be Israeli or Japanese, the infrastructure is orderly, waiting for you, taxation is clear and easy without twists and turns. You see a system that is very, very focused and efficient, and the result is that investors come there from all over the world. In Israel, it's a bureaucratic nightmare like nowhere else, betterment tax you can't calculate, uncertainty that doesn't suit investors."

There are risks there too. Should I remind you of Delek Real Estate?

"Because they were leveraged. They took 90% finance, and then, when something small happens, you fall. But if you don't go wild, and put aside cash for a rainy day, the falls will be softer. Everyone and the level of risk they want to take. Risk level is at the heart of business, and it brings us back to what we were talking about before: some enterprises operate without a sense of risk on the part of the decision makers, and where there's no sense of risk, the whole mechanism is warped. When the money is in your veins, then you are very focused. What we do every day is to assess profit versus risk. That's the name of the game. Everyone knows how to calculate the profit; not so many can assess the risk."

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