Maalot
S&P Global Ratings

Delek Group Ltd.

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Delek Group Ltd.

Affirmed Corporate Credit Rating	ilA/Stable

Overview

Key Strengths	Key Risks
• A medium quality investment portfolio supported by a strong competitive position in the Israeli natural gas market. • Good financial flexibility due to a tradable asset portfolio. • Adequate liquidity at the holding company level in the upcoming year. However, the maturity burden is relatively heavy in the medium term.	• Significant exposure to the relatively high-risk energy sector. • Limited geographic diversification, focusing on the Israeli market and on North Sea assets. • High leverage, with LTV ratio expected to remain around 50% in the short- to medium-term. • Lack of dividend distribution policy, and actual dividend distribution which we believe does not support capital structure strengthening.

We expect material changes in the Company's portfolio in the short term. In order to comply with the Israeli anti-concentration law, the Company is endeavoring to completely divest from The Phoenix Holdings, thus increasing its dependence on the energy segment, which will also increase due to the expected closing of a transaction through which subsidiary Ithaca will acquire ten oil assets in the North Sea from Chevron Corp.

The Company's leverage is high, but expected to decrease in the medium term. The Company's LTV ratio (loan to value) is relatively high, about 55%, and is adversely affected both by the recent decrease in market value of the Company's tradable assets and by the size of its debt (including ~$300 million guarantee in respect of fully owned subsidiary Ithaca's debt). We expect this ratio to decrease to 45%-50% following the completion of The Phoenix sale and the Ithaca-Chevron deal, since we estimate that the latter will increase Ithaca's asset value and decrease the Company's debt by about NIS 1 billion (~$300 million) with the removal of its guarantee for Ithaca's debt.

The Company has no declared dividend distribution policy, and in 2019-2020 we expect it to distribute dividends similar to the annual average (~NIS 400 million). **This assumption is in line with the group's commitment to deleverage by decreasing debt (on an extended solo basis) to about NIS 6 billion by year end 2020, including guarantees, bank loans and bonds.** We note that if the group fails to meet its commitment to deleverage, this would adversely affect the rating.

Outlook: Stable

The stable outlook reflects our assessment that Delek Group Ltd. continues to focus its activity on the upstream energy sector – natural gas and oil exploration, production and marketing. It also reflects our assessment that the Company deleverage, maintaining an LTV (loan to value) ratio below 50% in the next 12 months. Our assessment is based on our expectation that the Group will divest from The Phoenix Holdings, the advanced negotiations to include a new partner in Ithaca will bear fruit and the Ithaca-Chevron deal will be completed, and on the Group's commitment to reduce its debt.

We note that after the Group implement the anti-concentration law, we will henceforth examine the Company's rating according to our criteria for rating companies in the oil and gas exploration and production industry.

Downside Scenario

We may consider a negative rating action if the Company's LTV ratio consistently exceeds 50%. A higher leverage level could stem from a decline in portfolio value or from an aggressive investment or dividend policy. We may also consider a negative rating action if the operating performance of the Company's major holdings significantly deteriorates, possibly leading to a downward revaluation of the portfolio, or if these holdings' credit risk increases to a level that forces the group to inject significant funds to support them. An adverse change in our assessment of the Company's liquidity profile could also lead to a negative rating action.

Upside Scenario

We may consider a positive rating action if the Company materially reduces its debt and thus deleverage to an LTV ratio consistently below 30%, as part of a more conservative financial policy, while maintaining adequate liquidity.

Base Case Scenario

Key Assumption

- About NIS 660 million annually in dividend receipts, management fees and natural gas royalties in 2019 and 2020.
- About NIS 30 million in general and administrative expenditures.
- Interest expenses of NIS 300 million – NIS 350 million per year.
- Sale of The Phoenix Holdings for about NIS 1,300 million.
- Completion of the Ithaca-Chevron deal subject to an investment of about NIS 600 million – NIS 1,100 million by Delek Group and to strategic partners' capital investments of about NIS 1,000 million.
- Dividend distribution of about NIS 400 million per year in 2019 and 2020.
- No investments and acquisitions in the medium term except for the Ithaca-Chevron deal.
- No debt issuances in the upcoming year.

Key Metrics

Financial Metric	09/2019A	2019E	2020E
Total coverage ratio*	1.2x	1.7x-2.0x	1.2x-1.5x
Net debt/portfolio value (LTV)	55%	<50%	<50%

A – Actual. E – Estimate.

* Total coverage ratio = (dividend receipts + management fees + interest income) / (interest expenses + general and administrative expenses + dividends paid)

Company Description

Delek Group is a holding company with various assets in Israel and abroad, which operates, among other things, in the gas and oil industry, in the Israeli gas stations and convenience stores industry, in financial services and insurance, in water desalination, in power plants and in automotive. Following natural gas discoveries off the Israeli shore and in the Mediterranean Sea, in which the Company was involved, and the Company's efforts to complete the Ithaca-Chevron deal, the Company has been focusing its operations in the energy field – exploration, production and sale of oil and natural gas (upstream energy) and gas stations (downstream energy). The major shareholder in Delek Group is Mr. Yitzhak Tshuva, who holds about 61% of its shares. The remaining shares are held by the public, including institutional investors.

Business Risk

Delek Group's business risk profile is underpinned, in our opinion, by the group's strong competitive position in the Israeli natural gas market, due to its holdings in the Tamar (15.4%) and Leviathan (27.1%) gas fields.

The correlation between the group's assets' operating performance is currently moderate, and most of the group's holdings benefit from a strong competitive position in their respective areas of activity. On the other hand, the group's business risk is adversely affected by relatively high concentration of its investment portfolio and by de-facto low liquidity of major holdings. The investment portfolio's concentration is due to the fact that the Company's subsidiary Delek Drilling LP. currently constitutes about 39.5% of the portfolio value. The three largest companies in the portfolio constitute around 67% of its value. Although about 54% of the Company's holdings are registered for trading on the stock exchange, we estimate that the actual liquidity of held shares is moderate, among other things because the group holds controlling interests and is therefore, in our opinion, less willing to sell shares in order to adjust its leverage. This is especially true regarding the group's energy holdings.

We expect significant changes in the Company's portfolio in the short term, as a result of the coming into effect of the Anti-Concentration Law, and due to the Company's strategy of focusing on the energy sector, and divestment from non-core assets. We expect a deal to sale about 32% of The Phoenix Holdings to corporations controlled by Centerbridge Partners LP and Gallatin Point Capital LLC to be completed by year end 2019, as required by the Anti-Concentration Law. We therefore included proceeds from this sale in our 2019-2020 base case scenario. We expect these proceeds to be used, inter alia, to complete the Ithaca-Chevron deal.

According to the group's declared strategy, it endeavors to expand Ithaca's assets (Ithaca Energy Inc., B+ prelim/Stable), and intends to use it to complete the acquisition of Chevron North Sea Limited assets (ten oil and gas producing assets in the North Sea in the U.K.) for about $2 billion. For this purpose, Ithaca has issued about $500 million in bond, and engaged with a consortium of international banks that will extend a $1.65 billion RBL (reserved based lending) credit facility. The group is currently negotiating bringing in an equity partner to Ithaca, which is expected to reduce its investment in the completion of the deal to an estimated ~$250 million. We expect the deal to be completed in the short- to medium term.

The group has about NIS 2 billion in unencumbered assets which it can divest from in the short- to medium term, including super royalties from Karish, Tanin and Leviathan fields. According to the terms of the natural gas framework approved by the Israeli government, the group must divest from the Tamar field by December 2021 if it wants to hold on to its Leviathan field rights. We expect the group's business risk to increase following the higher concentration on the energy segment and due to the relatively high volatility of this industry. However, we estimate that the proceeds from divestment will be partly used to reduce the medium-term debt burden, as the group committed to us.

Delek Group Ltd. – Porftolio (Mil NIS)

Holding	Industry	Stake (%)	Listed/Private	Value for LTV	% of Portfolio Value
Phoenix	Insurance	32.5%	Listed	1,815	11%
Delek Israel	Energy	100.0%	Private	1,154	7%
Delek Drilling	Energy	59.1%	Listed	6,438	39%
Delek Automotive	Auto	22.5%	Listed	312	2%
Ithaca	Energy	100.0%	Private	2,657	16%
Cohen pituach	Energy	51.8%	Listed	288	2%
Vendor loans	N.R	N.R	Private	1,464	9%
Other - including IDE+ Royalties	N.R	N.R	Private	2,219	14%
Total				**16,347**	100%

N.R. – Not relevant

Financial Risk

The Company's financial risk profile is underpinned, in our opinion, by ownership of tradable assets, mostly unencumbered, which provide the group with financial flexibility to use refinancing or asset sale to repay its maturities. On the other hand, the group's current LTV ratio is high, about 55%, and is adversely affected both by the decrease in market value of the Company's tradable assets and by the size of its debt (including ~$300 million guarantee in respect of Ithaca's debt). We expect this ratio to decrease to 45%-50% following the completion of the The Phoenix sale and the Ithaca-Chevron deal, since we estimate that the latter will increase Ithaca's asset value and decrease the Company's debt by about NIS 1 billion (~$300 million) with the removal of its guarantee for Ithaca's debt.

The group has no declared dividend policy, and we estimate that it will distribute annual dividends of about NIS 400 million in 2019 and 2020 and avoid adopting an aggressive distribution level at the expense of strengthening its capital structure. This assumption is in line with the group's commitment to reduce its debt (at the extended solo level) to about NIS 6 billion, including guarantees, bank loans and bonds. We note that if the group fails to meet its commitments, this would adversely affect the rating.

The Company's financial risk profile is restricted by limited independent cash flow sources of investee companies, which rely on dividend receipts from subsidiaries/affiliates and on asset sales to meet their obligations. However, the company's total coverage ratios (management fees and dividend receipts to administrative expenses, interest expenses and dividends paid) are good thanks to sufficient dividend receipts compared with high interest expenses. We expect this ratio to be about 1.7x-2.0x in 2019, compared with about 1.2x in 2018, as a result of material dividend receipts expected from Delek Drilling. In 2021 the group expects material proceeds from its divestment in the Tamar field, in accordance with the Israeli government's natural gas framework.

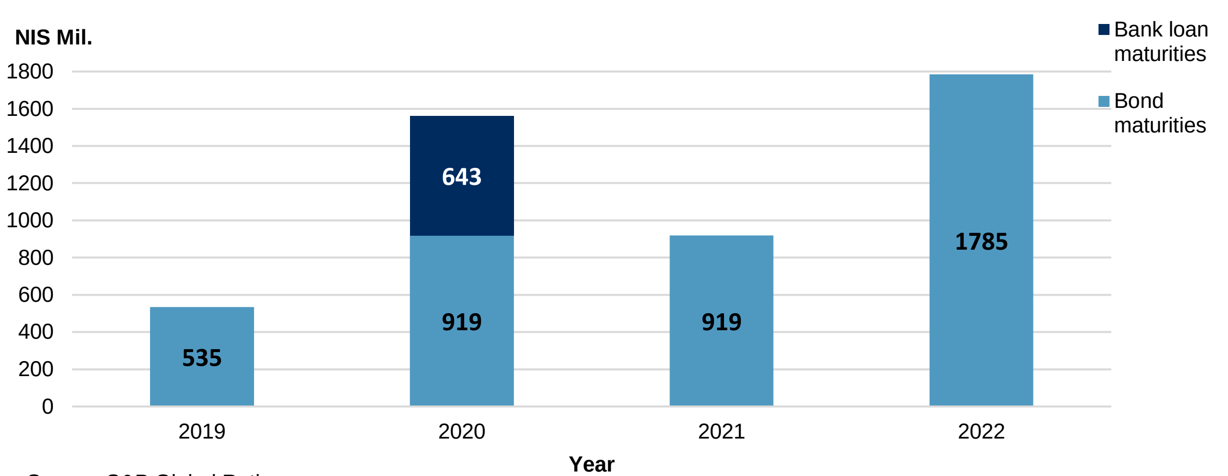
Liquidity: Adequate

We estimate Delek Group's liquidity, at the holding company level, to be "adequate". We estimate that the Company's sources to uses ratio in the next 12 months will be about 1.2x. This assessment is based on the amount of cash on hand and other liquid assets, on unused committed credit facilities and on our estimated cash inflow, such as dividends from subsidiaries and affiliates and loan repayment. Our scenario also includes the proceeds from the Phoenix sale on the one hand and investment in the Ithaca-Chevron deal on the other hand.

Following are the Company's major sources and uses for the 12-month period starting October 1, 2019:

Principal Liquidity Sources	Principal Liquidity Uses
• About NIS 540 million in cash and tradable financial assets; • About NIS 600 million – NIS 700 million in expected dividend receipts from operating companies; • About NIS 180 million in gas royalties; • About NIS 400 million in unused committed credit facilities (for over a year); • About NIS 1,300 million in proceeds from the Phoenix sale.	• Interest expenses of about NIS 300 million – NIS 400 million; • Long-term debt and other maturities of about NIS 1,000 million; • General and administrative expenses of about NIS 25 million; • Investment in the Ithaca-Chevron deal of about NIS 600 million – NIS 1,000 million.

Debt Maturities



Source: S&P Global Ratings.

Covenant Analysis

Expectations

We expect the Company to maintain adequate headroom (over 15%) on all its financial covenants.

Requirements

The Company's covenants vis-à-vis banks and bond holders include, among other things, a requirement to maintain equity above NIS 2.6 billion and equity/balance sheet above 20%.

Modifiers

Liquidity: Neutral

Financial policy: Neutral

Management, strategy and corporate governance: Neutral

Comparable ratings analysis: Neutral

Recovery Analysis

Key analytical factors

- We are affirming our 'ilA' rating, identical to the issuer rating, on Delek Group Ltd.'s unsecured bond series (Series 13, 22, 31, 33, 34). The recovery rating for this series is '3'.
- Our assessed recovery expectations are constrained to be 50%-70% range despite the simplified waterfall assumptions, due to our assessment that during the period leading to the hypothetical default, the Company will replace unsecured debt with secured or senior debt.

Simulated default assumptions

- Year of default: 2023
- A material decrease in the holdings' market value, due, among other things, to a deep recession in various global markets increasing competitive pressures and causing a general price drop including in the energy market.
- The Company will be liquidated, an assessment based on the fact that it has no activity of its own and that its entire value at the time of default will be based on the shares it holds.
- The Company will refinance its debt during the period leading to the hypothetical default.
- The Company's creditors will attempt to sell its holdings in subsidiaries, in part or in full, an assessment supported by the low synergy between the basic assets and the potential to sell holdings in the three major subsidiaries without losing controlling share.
- We estimate that at the date of the hypothetical default, the portfolio market value and the Company's cash on hand will be equal to its remaining debt, due to a sharp decrease (about 50%) in the market value of Delek Drilling, Cohen Development and The Phoenix shares. We assume an additional 30% reduction due to urgent liquidation.

Simplified waterfall

- Gross enterprise value: about NIS 5,610 million
- Administrative costs: 5%

- Net enterprise value available for secured debt: about NIS 5,330 million
- Total secured debt (not rated): about NIS 1,053 million
- Net enterprise value available for unsecured debt: about NIS 4,277 million
- Total unsecured debt: about NIS 6,962 million
- Recovery expectation for rated unsecured debt (Series 13, 22, 31, 32, 33, 34): 50%-70%
- Recovery rating for unsecured debt (Series 13, 22, 31, 33, 34) (1 to 6): 3

All debt amounts include six months' prepetition interest.

Mapping Recovery Percentages To Recovery Ratings - Group A Jurisdiction

For issuers with a speculative-grade issuer credit rating

		Nominal recovery expectations		
Recovery rating*	**Recovery description**	**Greater than or equal to**	**Less than**	**Issue rating notches relative to ICR**
1+	Highest expectation, full recovery	100%	N/A	+3 notches
1	Very high recovery	90%	100%	+2 notches
2	Substantial recovery	70%	90%	+1 notch
3	Meaningful recovery	50%	70%	0 notches
4	Average recovery	30%	50%	0 notches
5	Modest recovery	10%	30%	-1 notch
6	Negligible recovery	0%	10%	-2 notch

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

Related Criteria And Research

- Use Of CreditWatch And Outlooks, September 14, 2009
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, November 13, 2012
- Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of ‘D’ And ‘SD’ Ratings, October 24, 2013
- Corporate Methodology, November 19, 2013
- Country Risk Assessment Methodology And Assumptions, November 19, 2013
- Methodology: Industry Risk, November 19, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, December 16, 2014
- Methodology: Investment Holding Companies, December 1, 2015
- Recovery Rating Criteria For Speculative-Grade Corporate Issuers, December 7, 2016
- Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Group Rating Methodology, July 1, 2019
- S&P Global Ratings Definitions, October 31, 2018

Ratings List

Rating Details (As of 25-Sept-2019)	
Delek Group Ltd.	
Issuer rating(s)	
Local Currency LT	ilA/Stable
Issue rating(s)	
<u>Senior Unsecured Debt</u>	
Series 13,22,31,33,34	ilA
Issuer Rating history	
Local Currency LT	
26-Dec-2011	ilA/Stable
5-Jan-2011	ilA/Negative
26-May-2009	ilA/Stable
30-Nov-2008	ilAA/Watch Neg
26-Mar-2007	ilAA/Stable
29-June-2005	ilAA
1-Sep-2001	ilAA-
Other Details	
Time of the event	14:23 25/09/2019
Time when the analyst first learned of the event	14:23 25/09/2019
Rating requested by	Issuer

Credit Rating Surveillance

S&P Maalot is the commercial name of S&P Global Ratings Maalot Ltd. S&P Maalot conducts surveillance activities on developments which may affect the creditworthiness of issuers and specific bond series which it rates, on an ongoing basis. The purpose of such surveillance is to identify parameters which may lead to a change in the rating.