

Delek Group Ltd.

Credit Review | July 2019

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

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Delek Group Ltd.

Series Rating	A2.il	Credit Review with Negative implications
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Midroog places Delek Group Ltd's (hereinafter: "Delek Group" or the "Company") debentures (Series M, R, S, V, AE and AG) rating. under review with negative implications. The rating was placed under review following the announcement of the Company on May 30, 2019 with regard to the signing of a binding agreement by the subsidiary Ithaca Energy Limited (hereinafter: "Ithaca"), subject to the completion of various suspending conditions and required approvals, with Chevron North Sea Holdings Limited (hereinafter: "Chevron") for the acquisition of the rights held by Chevron in ten oil and gas properties in the North Sea area at an effective cost estimated by the Company to be approximately USD 1.65 billion¹.

As part of the transaction, Ithaca (B1 rating by Moody's) is expected to acquire the share capital of Chevron North Sea Limited (hereinafter: "CNSL" or the "Acquired Company"), which holds ten North Sea oil and gas producing properties with proven reserves (2P) of a volume of approximately 131 million barrels of oil equivalent (MBOE) and with contingent resources (2C) of approximately 45 million barrels of oil equivalent (the share of the Acquired Company), as of December 31, 2018 (hereinafter: the "Chevron Transaction"). In accordance with the data of the Company, the production rate of the acquired properties was in excess of approximately 60 thousand barrels of oil in the first quarter of 2019 (the share of the Acquired Company). In five of the ten acquired properties, which constitute approximately 67% of the 2P reserves attributed to the acquired properties, the Acquired Company serves as the operator. The acquired properties in the transaction include 85% of the rights in the Captain Reservoir held by CNSL, which includes 2P oil and condensate reserves of approximately 53 million barrels of oil equivalent, constituting approximately 40% of the total 2P reserves acquired as part of the transaction. The closing of the transaction is subject to, among other things, compliance with the suspending conditions set forth in the acquisition agreement which includes obtaining the approval of the UK Oil and Gas Authority.

The total consideration determined in the transaction for the acquisition of 100% of the share capital of CNSL is approximately USD 2.0 billion, wherein on the closing date of the transaction, the amount of cash accumulated in the Acquired Company with respect to the acquired properties will be deducted from the consideration of the transaction from the effective date of the transaction (January 01, 2019) until the closure date thereof; on the date of the report of the transaction the Company estimated the aforesaid cash amount to be approximately USD 350 million. In accordance with the estimate of the Company, a large part of the transaction is expected to be financed by a reserve based the credit facility (RBL), which will be taken by Ithaca, as well as a bridging loan / debenture to be raised by Ithaca. As part of the financing of the transaction, Ithaca is expected to refinance its current financial liabilities (which are expected to total on the closing date of the transaction in the range of USD 0.5 - 0.55 billion). Midroog estimates that the volume of resources which the Delek Group will be required to inject into Ithaca, in the form of shareholders' equity in the transaction, is in the range of USD 400 - 500 million, which may decrease or increase dependent on the amount of cash which will have accumulated in the account of the Acquired Company by the closing date of the transaction and whether the Company and / or Ithaca will add additional partners to this investment. It should be noted that concurrent therewith, a guarantee provided by the Company in favor of Ithaca in the amount of USD 300 million is expected to be canceled.

In our opinion, the Chevron Transaction is in line with the business strategy of the Delek Group and is intended to position Ithaca as an oil and gas company of a significant size with operational and production capabilities. The acquired properties are expected to significantly increase Ithaca's 2P reserves, which currently amount to

¹ The report of the Company dated May 30, 2019 - <https://mayafiles.tase.co.il/rpdf/1223001-1233000/P1232409-00.pdf>

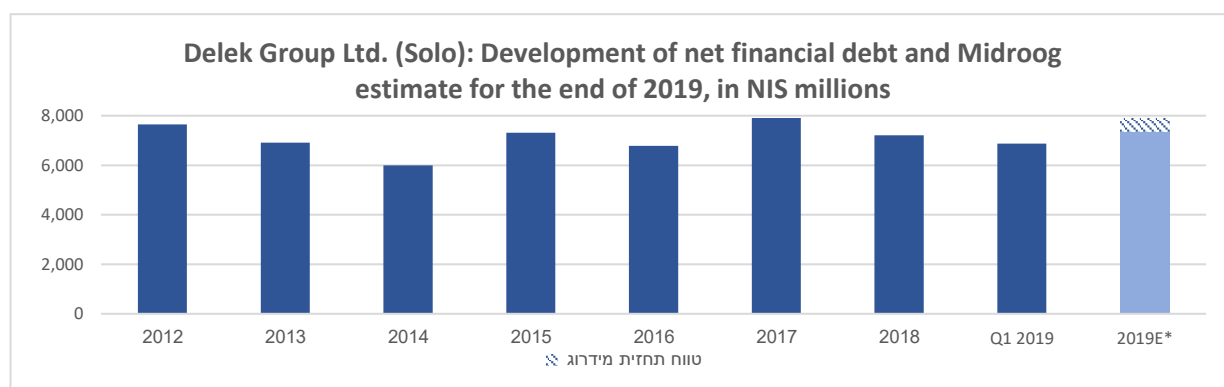
approximately 90 MBOE, and to increase the distribution of oil and gas properties in Ithaca. In addition, CNSL is a veteran and experienced operator of oil properties in the North Sea region, which employs approximately 450 workers and holds an infrastructure system which includes rigs and pipes. Nonetheless, Midroog estimates that the Chevron Transaction increases the level of the business risk of the Delek Group due to the high exposure of the transaction to oil prices, taking into account the significant size of the transaction and the volume of shareholders' equity expected to be invested in the transaction by the Company, and given the cash flow characteristics of the acquired properties. In accordance with the resources report as of December 31, 2018 prepared by NSAI regarding the acquired properties² (hereinafter: the "NSAI Report") and the preliminary review of Midroog, the acquired properties are expected to generate relatively high cash flows in the coming years, also taking into account Ithaca's stated policy of hedging oil prices in the short and medium term (which was carried out by the Company and Ithaca wherein, as of the date of this report, the Company stated that approximately 32 million barrels of oil had already been hedged at an average price of USD 65 per barrel, an action which reduces the volatility of Ithaca's current cash flow in relation to oil prices). The expected production volume at the 2P probability level of the reservoirs acquired as part of the Chevron Transaction in accordance with the NSAI report is expected to be approximately 22 MBOE, approximately 19 MBOE and approximately 17 MBOE in 2019, 2020 and 2021 respectively, compared to an average annual production of approximately 8 MBOE expected in the current Ithaca reservoirs in these years. In addition, the Company estimates that the profits derived from the Acquired Company will enable Ithaca to exploit in the coming years the accumulated losses reported by Ithaca in the amount of approximately USD 2.2 billion. Furthermore, in accordance with the Company, the expenses of the Acquired Company are expected to be made more efficient upon its transfer to Ithaca. However, in accordance with the NSAI report, the cash flow from the transaction properties is negatively impacted by the relatively rapid exhaustion of key properties over the medium term, as well as significant long - term disposal and sealing costs. It should be noted that in our opinion, the Company and Ithaca are planning to continue developing the reservoirs in the acquired properties in order to extend their life cycles, an action which may over time reduce the sealing costs. Due to the cash flow structure of the properties, Midroog estimates that in the initial years, Ithaca will be required to divert most of the available cash flow from the properties in favor of servicing of the senior debt and the debentures which Ithaca will issue. At the same time, the financing terms of the transaction create a continuing exposure to the value of the reservoir's resources, dependent, inter alia, on the price of oil, and given the sealing costs and the relatively rapid erosion of the net property value of the main property in the transaction, the Capitan Reservoir. It should be noted that despite the fact that the significant disposal and sealing costs are expected mainly in the long term, which in the Company's estimation is expected to be partly offset by the expected tax benefit in respect thereof, Ithaca may, in accordance with the accepted mechanisms in the industry, be required to provide bank guarantees against the disposal and sealing expenses, and even pay their share already in the medium term, dependent on the expected oil price environment. It should be noted that Ithaca has an RBL framework for providing the guarantees.

As we have noted in the past, Midroog expects that the policy of the Company to focus on the energy sector in Israel and abroad, and as part thereof, the realization of non - core holdings, will lead to a reduction in the financial debt of the Company. As we estimate at this stage, the Chevron Transaction is expected to increase the net financial debt of the Company in the range of NIS 0.5 to NIS 1 billion, dependent on the final structure of the transaction, assuming that the Company completes the sale of its holdings in Phoenix in the short term (but not necessarily prior to completion of the transaction) for an amount of approximately NIS 1.6 billion, of which approximately NIS 1.3 billion is expected to be received at the time of closing. Over time, the scope of the financial debt also depends on the amount of the dividends which the Company will distribute to the shareholders, as well as the scope of the additional realizations which the Company will make, including the realization of the holdings

² The NSAI report was reported by the Delek Group on June 16, 2019

in Tamar. In our opinion, there is uncertainty with respect to the timing and the extent of future cash flows from future realizations.

Placing the rating under review indicates our assessment of the possibility of a negative impact of the transaction on the rating of the Company or the rating outlook in the short term, and if this transaction is carried out, Midroog will examine this impact. The acquisition constitutes an additional step in transforming the Company into an international energy player in the field of exploration and production (E&P). In this context, we will also review the need to adapt the methodology to the type of activity of the Company, which is currently classified as a holding company focusing on energy.



* The estimated net financial debt at the end of 2019 in accordance with the Midroog scenario, assuming the completion of the Chevron Transaction, and assuming the completion of the Phoenix sale, and prior to the addition of partners in the Chevron Transaction.

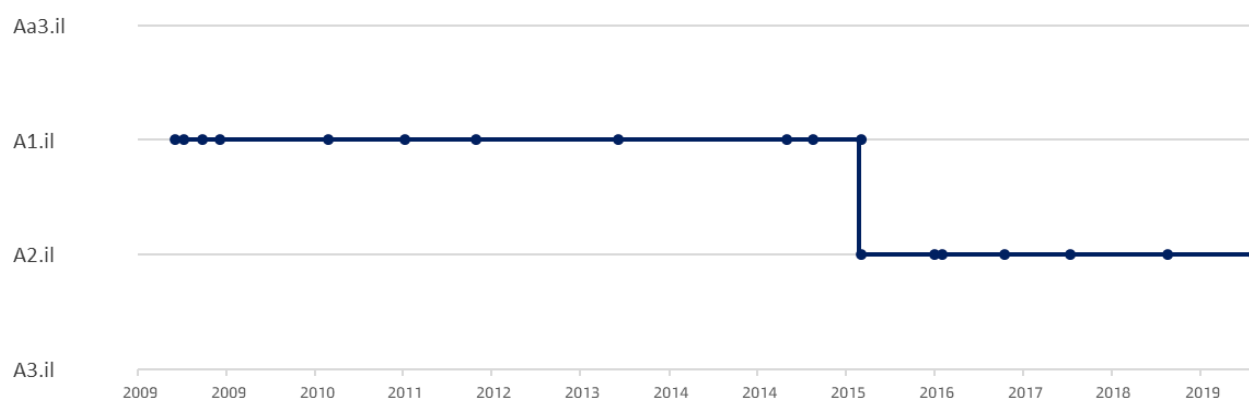
Outstanding debentures which are rated by Midroog:

Debenture Series/ Loan	Security ID	Rating	Rating Outlook	Final Maturity Date
M	1105543	A2.il	Credit Review with negative implications	29.9.2021
R	1115823	A2.il	Credit Review with negative implications	31.10.2022
S	1121326	A2.il	Credit Review with negative implications	10.11.2022
V	1106046	A2.il	Credit Review with negative implications	31.12.2021
AE	1134790	A2.il	Credit Review with negative implications	20.02.2025
AG	1138882	A2.il	Credit Review with negative implications	10.01.2022
AH	1143361	A2.il	Credit Review with negative implications	31.12.2028

Company's Profile

The Delek Group is a holding company which holds the control of a variety of companies operating mainly in the energy sector. The Company holds Delek Energy (100%), which operates in the field of oil and gas exploration, through its holdings in Delek Drilling (54.11%). The Company also has direct holdings in Delek Drilling (4.99%). The main assets of Delek Drilling are rights in the Leviathan reservoir (45.34%), rights in the Tamar project (22%), and a 22.6% holding in Tamar Petroleum. In addition, the Company holds Ithaca (100%, a foreign private company), Delek Israel (100%, private company), Delek Automotive (22.5%) and Phoenix Holdings (30.14%). The Group also holds 20% of the share capital of IDE Technologies Ltd., which operates in the field of construction and operation of desalination plants in Israel and the world. The main shareholder is Mr. Yitzhak Tshuva, who holds 60.77% of the share capital of the Company and 62.09% of the voting rights. The CEO of the Company is Mr. Asi Bartfeld and the Chairman of the Board is Mr. Gabi Last.

Rating History



Related Reports

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[Delek Drilling Limited Partnership](#)

[Tamar Petroleum Ltd.](#)

[Rating of Holding Companies - Methodological Report, November 2017](#)

[Table of Affinities and holdings](#)

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General Information

Date of rating report:	July 11, 2019
Date of last revision of the rating:	October 10, 2018
Date of first publication of the rating:	May 26, 2009
Rating commissioned by:	Delek Group Ltd.
Rating paid for by:	Delek Group Ltd.

Information from the Issuer

Midroog relies in its ratings inter alia on information received from competent personnel at the issuer.

Long-Term Rating Scale

Aaa.il	Issuers or issues rated Aaa.il are those that, in Midroog judgment, have highest creditworthiness relative to other local issuers.
Aa.il	Issuers or issues rated Aa.il are those that, in Midroog judgment, have very strong creditworthiness relative to other local issuers.
A.il	Issuers or issues rated A.il are those that, in Midroog judgment, have relatively high creditworthiness relative to other local issuers.
Baa.il	Issuers or issues rated Baa.il are those that, in Midroog 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 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 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 judgment, have extremely 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 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 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 obligation 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 obligation ranks in the lower end of that category, denoted by letters.

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