



Delek Leviathan Overriding Royalty Ltd – Bond Rating

Tel Aviv, November 5, 2020. Delek Group (TASE: DLEKG, US ADR: DGRLY) (“the Company”) announces that further to what is stated in the Company’s Immediate Reports dated October 8, 2020 (ref. no. 2020-01-109698), October 19, 2020 (ref. no. 2020-01-113586), October 25, 2020 (ref. no. 2020-01-115590) and October 28, 2020 (ref. no. 2020-01-117066) concerning a bond offering to qualified investors secured by overriding royalties from the Leviathan Project, on November 4, 2020 Fitch Ratings published a B+ international rating for the bonds of Delek Leviathan Overriding Royalty Ltd (“Delek Royalty”), a 100% indirectly wholly-owned subsidiary of the Company. The bonds were offered to foreign and Israeli qualified investors at a par value of USD 180 million and secured by a lien on the overriding royalties of the share of Delek Drilling Limited Partnership in the Leviathan Project, which were transferred to Delek Royalty from the Company and from Delek Energy Systems Ltd.

Attached as an Appendix to this Report is the full rating published by Fitch Rating.

This is a convenience translation of the original HEBREW immediate report issued to the Tel Aviv Stock Exchange by the Company on November 5, 2020.

About The Delek Group

Delek Group is an independent E&P company with activities in the UK North Sea and the East Mediterranean. Delek Group has significant holdings in the Leviathan and Tamar natural gas reservoirs in the East Mediterranean (Israel's territorial water), with reserves and resources of more than 30 TCF and annual production capacity of more than 20 BCM. These reservoirs are a major natural gas supplier to the growing markets of Israel, Egypt and Jordan and Delek continues to lead the region’s development into a major natural gas export hub. Through its wholly owned subsidiary Ithaca, Delek Group holds high-quality oil and natural gas assets in the UK North Sea totaling approximately 260 million barrels of oil equivalent (boe) and producing about 25 million boe per year. Delek Group is one of Israel’s largest and most prominent companies with a consistent track record of growth. Its shares are traded on the Tel Aviv Stock Exchange (DLEKG:IT) And its ADRs are traded on the US OTC market (DGRLY:US).

For more information on Delek Group please visit www.delek-group.com

Contact

Investors

Limor Gruber

Head of Investor Relations

Delek Group Ltd.

Tel: +972 9 8638443

Limorg@delek-group.com



RATING ACTION COMMENTARY

Fitch Assigns Delek Overriding Royalty Leviathan Ltd's Bond 'B+' Rating; Stable Outlook

Wed 04 Nov, 2020 - 11:05 AM ET

Fitch Ratings - London - 04 Nov 2020: Fitch Ratings has assigned Delek Overriding Royalty Leviathan Ltd's (the issuer) USD180 million bond a 'B+' rating.

RATING RATIONALE

The issuer's credit profile is driven by the rating of the Leviathan gas field, a large offshore gas field in Israel that pays royalties to the issuer. The rating considers the issuer's exposure to refinancing risk, given the high initial leverage as well as the uncertainty on the timing of the royalty rate step-up, which is linked to the Leviathan gas field production.

The rating factors in the seniority of royalty payments in the Leviathan gas field's cash flow waterfall as well as the stable cash flow generation supported by the high-quality reserves, the use of commercially proven technology and the strong operating setup with Noble Energy Mediterranean Ltd providing day-to-day operating services.

KEY RATING DRIVERS

Lower-rated Counterparties, Diversified Offtake Base: Revenue Risk - Midrange

The issuer benefits from the payment of overriding royalties (ORRI), which rank senior to operating costs and debt service on the bond issued by Leviathan Bond Ltd. However, the increase in the royalty rate from 1.5% to 6.5% at the well head (1.38% to 5.98% expected effective rate at the entry to the grid) will be linked to the timing of the full recovery of the Leviathan gas field investment (return on investment; ROI) and this limits the visibility of project cash flow generation over the medium term.

Under the Fitch Base Case, the ROI date is in 2025, while under the Fitch Rating Case, which assumes lower revenues in line with the 1P production forecast, it is in 2027, highlighting that the ORRI payment depends on the timing of revenue generation of the gas field.

The Leviathan gas field benefits from a diversified offtake structure with long-term contracts with offtakers in Jordan and Egypt as well as a large pool of companies in Israel. The export volumes make up the majority of Leviathan's gas sales and imply a reliance on the offtakers in Jordan and Egypt to perform on their payment obligations.

The Leviathan gas field's 15-year gas sales and purchase agreement (GSPA) with the Jordanian NEPCO is for an annual contracted quantity of 3.1-3.6 billion cubic metres (BCM). NEPCO is the national electricity company of the Hashemite Kingdom of Jordan (BB-/Negative) and is wholly owned by the Jordanian government. NEPCO is the sole carrier of electric power in the country.

We view Leviathan's gas as strategically important to Jordan as the country does not have any domestic sources of energy other than renewables and is otherwise reliant on the import of relatively expensive LNG. Leviathan's piped natural gas is therefore important to the country's economic development, which is reflected in the government guarantee of NEPCO's obligations to the Leviathan sponsors.

The Leviathan gas field also has a 15-year GSPA in place with Blue Ocean for the export of up to 4.7BCM per year to Egypt. Blue Ocean is the local marketing company that acts as the intermediary between Leviathan and the ultimate offtaker, the Egyptian Natural Gas Holding Company (EGAS, NR). The GSPA expressly allows for the export of Leviathan gas as LNG in addition to domestic use. This provides a strong incentive for Egypt to make full use of the contractual volumes even as it develops its domestic gas fields in the Eastern Mediterranean.

Furthermore, East GAS together with Delek Drilling and Noble Energy acquired a 39% stake in the Eastern Mediterranean Gas Pipeline (EMG), which also gives it the exclusive right to transport gas through the EMG from Israel to Egypt. This demonstrates Egypt's intention to maintain a long-term relationship with Leviathan.

We view the Israeli GSPAs as systemic in nature as the gas supply in Israel is limited to Tamar and Leviathan currently and Karish/Tannin from 2021. Gas demand from the Israeli economy is forecast to grow significantly in the medium term with the gasification of the transport system and replacement of coal-fired power plants.

The Leviathan gas field's volume risk is limited through the long-term nature of most offtake contracts and the take-or-pay requirements under the GSPAs. The contracts also allow for additional sales in excess of contractual volumes if Leviathan has capacity to meet nominations.

The gas sales prices are based on various pricing formulas including linkages to the electricity production tariff determined by the Public Utility Authority-Electricity for most GSPAs in Israel and the Brent barrel price for the NEPCO and Blue Ocean GSPAs. This exposes the project to price risk. However, this is limited by the provision of floor prices set in the individual contract.

Experienced Operator: Operating Risk - Midrange

The royalties rank super senior as they are paid before any operating expenditure. As a result, royalties are not directly exposed to cost volatility. Nevertheless, the issuer's bond holders are fully exposed to the operating performance of the Leviathan gas field.

The operation of gas & oil facilities is at the higher end of complexity within the infrastructure space, but the project benefits from the presence of Noble Energy as an experienced operator of gas fields in the Eastern Mediterranean region with demonstrated performance on Tamar and the Yam Thetys/Mari-B fields.

There is also a good alignment of interest with Delek Drilling through Noble Energy's participation as a partner in the Leviathan lease. Furthermore, the joint operating agreement clearly outlines the responsibilities of the parties.

The Leviathan gas field uses commercially proven technology and a relatively high level of equipment redundancy. The gas field further benefits from the lessons learned on Tamar which reduces outage risk.

Sufficient Resources, High Quality Reservoir: Supply Risk - Stronger

The technical advisor views the Leviathan gas field as a high-quality gas reservoir with a relatively strong drive mechanism. This should result in the reservoir pressure remaining high even as gas volumes reduce, as well as reducing the need for well drilling.

The reservoir is expected to produce 322 BCM in the 1P scenario, and 376 BCM in the 2P scenario (as of June 2020). In the Fitch Rating Case (1P) the reservoir is therefore expected to produce until 2064 without any further discoveries. Additional existing gas volumes currently classified as contingent (1C and 2C) will be added to the 1P and 2P reserves once additional wells are approved for drilling and the volumes become commercial, but we have not given any credit to these volumes under the Fitch Rating Case.

New Assets and Complex Venture: Infrastructure Development and Renewal - Midrange

ORRI rank senior to the Leviathan gas field's capital expenditure.

Like most other oil & gas fields, the Leviathan gas field's operations will have to sustain production and to address the operational issues that can be expected to arise in complex ventures. The operator's experience makes it more likely that the field's operational and development requirements will be appropriately managed and anticipated.

Refinancing Risk - Debt Structure: Midrange

The debt structure at the issuer's level has several stronger features such as its senior secured nature, the absence of exposure to variable interest rates and a comprehensive covenant package. An interest reserve account (IRA), funded from the bond issuance proceeds, is intended to cover the shortfall between the cash generated and debt service in the early periods before the ROI date is reached. We expect it will be almost entirely used by the time of the refinancing and will not be replenished.

There is no additional debt service reserve account to support debt service after the IRA has been drawn, which we view as a weaker feature. Moreover, the debt's bullet maturity in 2023 exposes the project to refinancing risk. However, the long operating life of the Leviathan gas field mitigates the refinancing risk.

Financial Profile

The lower royalty rate in the early years of the issuer results in high leverage, at 20.0x under the Rating Case at time of refinancing. However, the stable cash flow generation of the Leviathan gas field, demonstrated by project life cover ratio of 1.24x at time of refinancing, mitigates the refinancing risk.

PEER GROUP

There are no close peers in Fitch's portfolio. However, we rate Leviathan Bond Ltd's notes at 'BB'. The royalty claims rank senior to the debt service of Leviathan Bond Ltd, but are exposed to the uncertainty around the payout date. Combined with refinancing risk, this puts the rating of the Delek Overriding Royalty Leviathan bond two notches below Leviathan Bond at 'B+'.

RATING SENSITIVITIES

Delek Overriding Royalty Leviathan is credit-linked to the Leviathan Bond transaction.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Upgrade of Leviathan Bond transaction, which we deem unlikely as the Leviathan gas field is exposed to lower-rated counterparties

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Downgrade of Leviathan Bond transaction
- Failure to refinance the 2023 bullet well in advance of maturity

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The

complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>].

TRANSACTION SUMMARY

Delek Drilling holds a 45.34% working interest in the Leviathan gas field and pays overriding royalties to its parent companies, Delek Energy Systems Ltd and Delek Group.

Delek Group and Delek Energy Systems have assigned and transferred the royalty rights to the issuer. The notes issued are secured by a first priority fixed pledge over the royalty rights.

The Leviathan gas field is owned by Delek Drilling LP (45.34%), Noble Energy (39.66%) and Ratio Oil (15%). The gas field was discovered in 2010 and reached first gas in 2019 on time and below budget. Phase 1A consists of 1,200MMscfd production capacity. The gas reservoir is located offshore Israel in the Eastern Mediterranean Sea, approximately 120km west of Haifa. The gas extracted from the wells is gathered at the field in a subsea manifold and delivered to an offshore fixed platform via 115km gathering flowlines. Gas to the domestic and export markets is transported from the platform via a pipeline to the Israel Natural Gas Lines onshore grid. Other gas exports may occur via additional pipelines connected to the fixed platform.

The structure of the transaction protects the issuer from creditors of entities within the Delek group in the event of insolvency proceedings. This is confirmed by a legal opinion Fitch received on the ring-fencing of the issuer from other Delek Group entities.

FINANCIAL ANALYSIS

At the Leviathan gas field level, we formulate the assumptions that we detail here under the Fitch Base Case and Fitch Rating Case:

Fitch Base Case: We assume a 2P production profile in the Fitch Base Case and our base case Brent price forecasts starting at USD41/bbl in 2021 and then gradually increasing to

USD53/bbl after 2023. For gas we assume a price of USD4.7/mcf for 2020 for any uncontracted volumes. In the long term we assume USD5.0/mcf for uncontracted volumes in line with Fitch's forecast for TTF/NBP hub prices. Interest rates for the refinancing debt are increased by 50-200 bp based on the debt terms, compared with the current expected interest rates.

Fitch Rating Case: In the Fitch Rating Case, we assume the 1P production profile and our stressed Brent price forecasts starting at USD37 /bbl in 2021 and then gradually increasing to USD48/bbl after 2023. For gas we assume a price of USD4.3/mcf for 2020 for any uncontracted volumes. In the long term we assume USD4.5/mcf for uncontracted volumes in line with Fitch's forecast for TTF/NBP hub prices. Interest rates for the refinancing debt are assumed in line with the Fitch Base Case.

DATE OF RELEVANT COMMITTEE

13 October 2020

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Linked to Leviathan bond Ltd

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit

www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Delek Overriding Royalty Leviathan Ltd.		
● Delek Overriding Royalty Leviathan Ltd./Debt/1 LT	LT	
● ● USD 180 mln 7.49% bond/note 31- Dec-2023 IL0011691354	LT	B+ Rating Outlook Stable New Rating B+ (EXP) Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Antoine Pavageau

Senior Analyst

Primary Rating Analyst

+44 20 3530 1729

Fitch Ratings Ltd

30 North Colonnade, Canary Wharf London E14 5GN

Christiane Kuti

Director

Secondary Rating Analyst

+44 20 3530 1396

Danilo Quattromani

Managing Director

Committee Chairperson

+39 02 879087 275

MEDIA CONTACTS

Athos Larkou

London

+44 20 3530 1549

athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com**APPLICABLE CRITERIA**[Infrastructure and Project Finance Rating Criteria \(pub. 24 Mar 2020\) \(including rating assumption sensitivity\)](#)**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Third-party Model ([24 March 2020](#))**ADDITIONAL DISCLOSURES**[Dodd-Frank Rating Information Disclosure Form](#)[Solicitation Status](#)[Endorsement Policy](#)**ENDORSEMENT STATUS**

Delek Overriding Royalty Leviathan Ltd. -

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