Maalot

S&P Global Ratings

Delek Group Ltd.

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Delek Group Ltd.

Corporate Credit Rating Affirmed	ilA/Stable

Rationale

Business Risk	Financial Risk
• A medium/high quality investment portfolio supported, in our opinion, by a strong competitive position in the Israeli natural gas market. • Significant exposure to the relatively high-risk energy sector. • Limited geographic diversification, focusing on the Israeli market. • Relatively high concentration of the portfolio.	• 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. • No dividend distribution policy, and actual dividend distribution which we believe does not support capital structure strengthening.

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 will maintain an LTV (loan to value) ratio that would not materially exceed 50% in the next 12 months even if it makes material investments. Our assessment is based on the Company's financial policy to maintain a leverage level commensurate with the rating, through sales that would offset investments, among other things.

Our analysis does not include possible moves related to the implementation of the Anti-Concentration Law at this point, as their implementation and timing is highly uncertain. When the group's moves are clearer, we shall examine their effect on the Company's rating.

Downside Scenario
We may consider a rating downgrade if the Company’s LTV ratio consistently exceeds 50%. A higher leverage level could stem, among other things, from a decline in portfolio value or from an aggressive investment or dividend policy. We may also consider a rating downgrade if the operating performance of the Company’s major holdings significantly deteriorates, possibly leading to a downward revaluation of the portfolio, or if their credit risk increases to a level that forces the group to inject significant funds to support these holdings. 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 rating upgrade if the Company completes several planned asset divestments and thus sustainably deleverages to an LTV ratio below 30%, as part of a more conservative financial policy, while maintaining adequate liquidity.

Base-Case Scenario

Our base case scenario does not include significant investment such as completing the tender offer on Delek Energy shares. Neither does it include the effect of selling the remaining holding in the Tamar reservoir and in The Phoenix, due to uncertainty regarding the timing of the sale and the amount of proceeds. We estimate that dividend distributions could exceed our base-case assumptions, depending on any sales performed. However, we believe the Company will maintain a leverage level commensurate with the rating in light of its financial policy, taking into account its ability to sell assets and its investment plans.

Principal Assumptions

- At least NIS 600 million annually in dividend receipts, management fees and natural gas royalties in 2018 and 2019.
- About NIS 30 million in general and administrative expenditures.
- Interest expenses of NIS 300 million – NIS 400 million per year.
- Dividend distribution of NIS 100 million in October 2018 according to the Company's announcement, and NIS 400 million – NIS 500 million in 2019.

Key Metrics

	2017A*	2018E	2019E
Total coverage ratio**	3.4x	3.0x	1.2x
Net debt/portfolio value (LTV)	<50%	<50%	<50%

A – Actual, E – Estimate.

* As of last follow-up – September 2017.

** 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. Most of its operations are in the following sectors: gas and oil, gas stations and road convenience stores, financial services and insurance, water desalination, power plants and automotive. Following natural gas discoveries off the Israeli shore and in the Mediterranean Sea, in which the Company was involved, and the acquisition of Ithaca Energy Ltd. which operates in the North Sea, it 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

High competitive position in the natural gas market, highly concentrated portfolio

Delek Group's business risk profile is underpinned, in our opinion, by the group's strong competitive position in the Israeli natural gas market (Tamar gas field, 22% held by the Company, is currently Israel's sole natural gas provider). The correlation between the group's assets' operating performance is relatively low, 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 reflected by the fact that the

Company's subsidiary Delek Energy Systems Ltd. currently constitutes around 42% of the portfolio value, and the three largest companies in the portfolio constitute around 67% of its value. Although about 67% 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 medium term, due to its strategy of focusing on the energy sector, and divestment from non-core assets, and as a result of the coming into effect of the Anti-Concentration Law. Steps taken by the Company include its efforts to sell The Phoenix Holdings Ltd. due to the Anti-Concentration Law, inter alia by selling The Phoenix shares in stages through swap transactions; the sale of Gadot Biochemical Industries Ltd. to the Fortissimo fund; the sale of the Company's holdings in Faroe Petroleum; and the sale of its power plant holdings. The Company also intends to sell its holdings in the water infrastructure company IDE. In addition, according to the conditions of the natural gas regulatory framework approved by the Israeli government, the group must divest its holdings in the Tamar field by December 2021 in order to preserve its holdings in the Leviathan field and to develop it. We estimate that focusing on the energy sector will increase the Company's business risk as it will increase its business concentration and due to the sector's relatively high volatility. On the other hand, we estimate that proceeds from asset realization will be partly used to reduce debt in the medium term, thus possibly reducing financial risk.

Delek Group Ltd. - Portfolio

Holding	Industry	Stake (%)	Listed/Private	Value for LTV (NIS mil.)	% of Portfolio Value
Delek Energy	Energy	88.2%	Listed	7,896	47%
Phoenix	Insurance	30.1%	Listed	1,728	10%
Delek Israel	Energy	100.0%	Private	1,077	6%
Delek Drilling	Energy	7.8%	Listed	1,009	6%
Delek Automotive	Auto	22.5%	Listed	424	3%
Ithaca	Energy	100.0%	Private	2,150	13%
Cohen pituach	Energy	51.8%	Listed	281	2%
Vendor loans	N.R	N.R	Private	785	5%
Other - including IDE+ Royalties	N.R	N.R	Private	1,462	9%
Total				**16,812**	100%

N.R - Not relevant

Financial Risk

Intermediate leverage, financial flexibility

The Company's financial risk profile is underpinned by:

- Leverage (at the holding company level) in line with peers
- Ownership of tradable assets, mostly unencumbered, which provide the group with financial flexibility to use refinancing or asset sale to pay its maturities

On the other hand, 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.
- Lack of declared dividend distribution policy, and large dividend distributions which sometimes come at the expense of strengthening capital structure.
- "Adequate" liquidity profile, according to our criteria, at the holding company level in the upcoming year. However, the maturity burden is relatively high in the medium term, and leads to dependence on refinancing or liquidations.

The value of Delek Group's portfolio decreased In the 12 months since the last surveillance report was published. This decrease was mainly due to asset sales, but also from a 7% decrease in the market value of Delek Energy. On the other hand, the Company's cash balance increased following the sales and dividend receipts, so that, despite a temporary increase in Delek Group's LTV ratio to about 48% as of October 10, 2018, we estimate that the entire group's leverage ratio is about 44%. Given our current estimate of business parameters (portfolio risk), we believe that the current rating is commensurate with an LTV ratio of up to about 50%.

In addition, the Company presented good coverage ratios (the ratio between dividend receipts and management fees to general and administrative expenses, interest expenses and dividends paid), as a result of sufficient dividend receipts vis-à-vis the large interest expense. We estimate that coverage ratios in 2018 and 2019 will be significantly lower than in 2017 (as a result of material dividends received from Delek Energy in 2017 which is expected to be lower in 2018 and 2019) but will remain above 1.0x.

Liquidity: Adequate

According to our criteria, Delek Group’s liquidity at the holding company level is “adequate”. We estimate that the Company’s sources to uses ratio in the next 12 months will exceed 1.2x. This assessment is based on the large amount of cash on hand and other liquid assets, on estimated cash inflow, such as dividends from subsidiaries, and on loan repayment. Our scenario does not include receipts from future asset sales that have not yet been completed, e.g. The Phoenix and the remainder of the Tamar field holding. We estimate that if these sales are carried out, there may be additional dividend distributions. The Company also has committed credit facilities of about NIS 1 billion expiring in 2019. According to our criteria, committed credit facilities maturing in less than a year are not included in our liquidity assessment, but we estimate that the existence of these facilities contributes to the group’s financial flexibility, as does its holding of high-quality tradable assets.

Following are the company's main sources and uses for the 12-month period starting September 30, 2018:

Principal Liquidity Sources	Principal Liquidity Uses
• About NIS 970 million in cash and tradable financial assets; • About NIS 600 million – NIS 700 million in dividend receipts from operating companies; • About NIS 40 million in gas royalties; • Repayment of about NIS 200 million of seller financing.	• Interest expenses of about NIS 300 million – NIS 400 million; • Long-term debt and other maturities of about NIS 700 million; • General and administrative expenses of about NIS 30 million; • Dividend distribution of about NIS 400 million – NIS 500 million, of which NIS 100 million have already been announced (we estimate that any additional asset sales would be accompanied by additional dividend distribution).

Delek Group Ltd. – Debt Maturities

(NIS million)	Q3-Q4/2018	2019	2020	2021	2022	2023 and thereafter
Maturities	857	1,137	1,008	945	1,796	2,726

Covenant Analysis

As of June 30, 2018, the group meets all its financial covenants with sufficient headroom, and we expect them to be complied with in the medium term. The Company's covenants vis-à-vis banks and bond holders include, among other things, a requirement to maintain equity above NIS 2.4 billion and equity/balance sheet above 20%.

Modifiers

Liquidity: Neutral

Financial policy: Neutral

Management/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, 32, 33, 34). The recovery rating for this series is '3', reflecting our assessment that in the case of default, the recovery rate would be in the 50%-70% range.

Simulated default assumptions

- Year of default: 2022

- 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 assets and the potential to sell holdings in the three major subsidiaries without losing its 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 Energy, The Phoenix, and Delek Drilling shares. We assume an additional 30% reduction due to urgent liquidation.

Simplified waterfall at emergence

- Gross enterprise value: about NIS 5,440 million
- Administrative costs: 5%
- Net Enterprise value available for secured debt: about NIS 5,170 million
- Total secured debt (not rated): about NIS 750 million
- Net Enterprise value available for unsecured debt: about NIS 4,420 million
- Total unsecured debt: about NIS 7,560 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, 32, 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 (for further detail, see Step 6, paragraphs 90-98 of Recovery Rating Criteria For Speculative-Grade Corporate Issuers, December 7, 2016).

Reconciliation

In order to create a basis for comparison with other rated companies, we adjust the data reported in the Company's financial statements that we use to calculate coverage ratios. The main adjustments we made to Delek Group's consolidated data are deducting surplus cash, as we define it, from reported financial debt and including financial guarantees given to third parties in respect of engagements by subsidiaries.

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
- Group Rating Methodology, November 19, 2013
- Corporate Methodology: Ratios And Adjustments, November 19, 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
- S&P Global Ratings Definitions, April 19, 2018

Rating Details (As of 10-Oct-2018)

Delek Group Ltd.	
Issuer rating(s)	
Local Currency LT	ilA/Stable
Issue rating(s)	
Senior Unsecured Debt	
Series 13,22,31,32,33	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	15:33 10/10/2018
Time when the analyst first learned of the event	15:33 10/10/2018
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.