

# Delek Group Ltd.

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April 1, 2020

## Research Update

# Ratings Lowered To 'iBBB-', Kept On CreditWatch With Negative Implications On Weak Liquidity Reflected In Material Gap Between Short-Term Sources And Uses

### Primary Credit Analyst:

Sivan Mesilati, 972-3-7539735 [sivan.mesilati@spglobal.com](mailto:sivan.mesilati@spglobal.com)

### Additional Contact:

Tamar Stein, 972-3-7539721 [tamar.stein@spglobal.com](mailto:tamar.stein@spglobal.com)

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## Research Update

# Ratings Lowered To 'iBBB-', Kept On CreditWatch With Negative Implications On Weak Liquidity Reflected In Material Gap Between Short-Term Sources And Uses

### Rating Action Summary

- In the next 12 months, Delek Group (“the Company” or “Delek”) is required to repay debt maturities (principal and interest) and other payments totaling about NIS 2.5 billion, of which about NIS 488 million are due in the next six months. To the best of our knowledge, the Company does not currently have sufficient sources to cover these payments, and its ability to cover them depends on asset sales, debt refinancing or super royalties securitization. Therefore, simultaneously and until these sources are obtained, the Company is pursuing financing transactions such as bridging loans from institutional investors and banks.
- Since our last publication, the Company was required to increase collaterals for several banks due to breach of several financial covenants which provides the bank cause to demand immediate repayment.
- On March 29, 2020, the Company paid about NIS 121 million to Series 13 bondholders in accordance with the bonds' amortization schedule. At the same time, the Company's bondholders united to select a representative for their negotiations with the Company.
- On March 31, 2020, we lowered our rating on Delek Group Ltd. to 'iBBB-' from 'iIA'. The downgrade is in line with the rating update we published on March 12, 2020, when we placed the Company's ratings on CreditWatch with negative implications. We also lowered our rating on the Company's unsecured senior debt to 'iBBB-' due to our recovery expectations of 30%-50%.
- The ratings' placement on CreditWatch with negative implications reflects the uncertainty in current market conditions regarding the completion of financing transactions and asset sales in order to improve liquidity and obtain sufficient sources, and regarding the effects of the coronavirus outbreak on the Company's operating environment. We intend to reexamine the rating in the upcoming weeks, and update it according to developments.

### Rating Action Rationale

Lowering Delek Group's ratings and keeping them on CreditWatch with negative implication reflect our assessment that the Company's liquidity and its ability to meet its short-term obligations have deteriorated, inter alia due to uncertainty in global markets and the sharp drop in oil and gas prices, as noted in our last publication. We estimate that the Company does not currently possess sufficient certain sources to repay its maturities in the upcoming year and even in the next six months (until the end of September 2020). The Company is currently facing principal

and interest payments of NIS 488 million in the next six months. The Company's certain or relatively certain sources include a NIS 216 million cash balance, which includes the NIS 164 million proceeds from the sale of its 20% holding in IDE, and our assessment of a ~NIS 185 million dividend from subsidiary Ithaca. However, the Company is making progress on several actions designed to increase its financing sources, based, among other things, on the sale of its subsidiary Delek Israel, on taking a loan on royalties from Karish and Tanin gas fields and on securitization of super royalties from the Leviathan gas field. On the other hand, challenging market conditions, in particular the situation in the energy market, increase the execution risk of the Company's plans, and therefore its credit risk, in the short term. Therefore, simultaneously and until these sources are obtained, the Company is pursuing financing transactions such as bridging loans from institutional investors and banks. We note that at this point we do not take into account in our scenario any dividend receipts from Delek Drilling partnership in 2020.

On March 29, 2020, the Company paid about NIS 121 million to Series 13 bondholders in accordance with the bonds' amortization schedule. At the same time, the Company's bondholders united to select a representative for their negotiations with the Company.

Citibank, one of the Company's financing banks, recently realized a lien on 15% of Delek Drilling partnership units in exchange for an outstanding loan of NIS 57 million and the sale of 12% of the units to a third party. On March 25, 2020, Delek Group signed an agreement with the third party to purchase 7% of the partnership units. As a result of these actions, Delek Group's share in Delek Drilling decreased to 55% from about 59.1%. This reduced the Company's cash balance and therefore its available sources to repay its short-term obligations.

Given current market conditions, we estimate the Company's financial flexibility to sell assets and its access to the capital market to be limited. But the aforementioned actions indicate that the Company may be able to execute some of its plans within several weeks. We intend to follow any developments in the upcoming weeks and update the rating accordingly.

We note that there is a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see macroeconomic and credit updates here: [www.spglobal.com/ratings](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates accordingly.

## CreditWatch

The ratings' placement on CreditWatch with negative implications reflects the uncertainty in current market conditions regarding the completion of financing transactions and asset sales in order to improve liquidity and obtain sufficient sources, and regarding the effects of the coronavirus outbreak on the Company's operating environment.

We may take a negative rating action if the Company fails to complete the actions aimed at increasing its sources in the immediate term, i.e. in the upcoming weeks, and as a result lacks sufficient sources to cover its obligations

in full in the next six months. In this case we may even downgrade the Company by several notches, depending on the uncertainty regarding the Company's immediate sources and our assessment of the Company's exposure to execution risks of these actions, which are inherently adversely affected by current market conditions.

We may remove the ratings from CreditWatch depending on the completion of the abovementioned actions, including bank financing, receipt of dividends from subsidiaries and asset sales, and the strengthening of the Company's liquidity for the upcoming year. A positive rating action is unlikely in the short term, due to the Company's weak liquidity and high leverage, and in light of current market conditions that materially affect oil and gas demand and prices and the value of subsidiaries' assets.

## Liquidity

Delek Group's liquidity is "weak" according to our criteria. We estimate that the ratio between the Company's sources and uses will be significantly lower than 1.0x in the upcoming year. The weak liquidity assessment is based, inter alia, on our assessment that the Company's certain sources are currently insufficient to cover its uses even in the next six months.

As mentioned above, the Company is currently promoting several actions designed to improve its sources, including the sale of its subsidiary Delek Israel, taking out a loan on royalties from Karish and Tanin gas fields, and securitization of super royalties from the Leviathan gas field. These actions, if they materialize, are expected to generate cash to serve the Company's maturities, as the assets are unencumbered. Given local and global market conditions and current market uncertainty, the Company is exposed to execution risks on these actions, which are fairly complex and therefore were not included in our base case scenario.

In our base case scenario we assume the relatively certain sources at the Company's disposal in the six months beginning April 1, 2020, to be as follows:

- Cash of about NIS 216 million.
- Dividend receipt from Ithaca of NIS 185 million.

Our assumptions regarding the Company's uses for the same period are as follows:

- Bond maturities and interest expenses of about NIS 318 million.
- Bank loan maturities and interest expenses of about NIS 116 million.
- Other payments totaling about NIS 54 million..

## Recovery Analysis

### Key analytical factors

- We are lowering our rating on Delek Group Ltd.'s unsecured bond series (Series 13, 22, 31, 33, 34) to 'iBBB-', identical to the issuer rating. The recovery rating for this series is '4', reflecting our assessment that in a hypothetical default scenario, the recovery expectations are 30%-50% (in the upper end of this range).
- The recovery rating on the unsecured bond series is affected by the devaluation of the Company's portfolio, alongside increased liquidity pressure and the need for faster liquidation of assets.

### Simulated default assumptions

- Year of default: 2022
- At the date of the hypothetical default, the market value of the Company's portfolio and its cash on hand will be equal to its remaining debt, due to a sharp decrease in the market value of Delek Drilling and Cohen Development. We assume an additional 40% reduction due to urgent liquidation.
- 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's creditors will attempt to sell its holdings in subsidiaries, in part or in full..

### Simplified waterfall

- Gross enterprise value: about NIS 4,430 million
- Administrative costs: 5%
- Net enterprise value available for secured debt: about NIS 4,209 million
- Total secured debt (not rated): about NIS 1,272 million
- Net enterprise value available for unsecured debt: about NIS 2,937 million
- Total unsecured debt: about NIS 6,112 million
- Recovery expectation for rated unsecured debt (Series 13, 22, 31, 33, 34): 30%-50%
- Recovery rating for unsecured debt (Series 13, 22, 31, 33, 34) (1 to 6): 4

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

| Recovery rating* | Recovery description               | Nominal recovery expectations |           | Issue rating notches relative to ICR |
|------------------|------------------------------------|-------------------------------|-----------|--------------------------------------|
|                  |                                    | Greater than or equal to      | Less than |                                      |
| 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).

### Modifiers

Liquidity: Weak

Financial policy: Neutral

Management and governance: Neutral

Comparable rating analysis: Neutral

## Related Criteria And Research

- [Use Of CreditWatch And Outlooks](#), September 14, 2009
- [Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings](#), October 1, 2012
- [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](#), July 5, 2019

## Ratings List

### Rating Details (As of 01-April-2020)

#### Delek Group Ltd.

##### Issuer rating(s)

Local Currency LT iIBBB-\Watch Neg

##### Issue rating(s)

##### Senior Unsecured Debt

Series 13,22,31,33,34 iIBBB-\Watch Neg

#### Issuer Rating history

Local Currency LT

01-April-2020 iIBBB-\Watch Neg

12-March-2020 iIA\Watch Neg

26-Dec-2011 iIA/Stable

5-Jan-2011 iIA/Negative

26-May-2009 iIA/Stable

30-Nov-2008 iIAA\Watch Neg

26-Mar-2007 iIAA/Stable

29-June-2005 iIAA

1-Sep-2001 iIAA-

#### Other Details

Time of the event 12:38 01/04/2020

Time when the analyst first learned of the event 12:38 01/04/2020

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.

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