Maalot
S&P Global Ratings

Delek Group Ltd.

May 5, 2020

Research Update

Ratings Lowered To 'ilCCC' On Increased Risk Of Default; Outlook Negative

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Research Update

Ratings Lowered To 'ilCCC' On Increased Risk Of Default; Outlook Negative

Rating Action Summary

- In the month since our last rating action (see rating report dated April 1, 2020), Delek Group Ltd. ("the Company") was required to increase collaterals for Bank Leumi under the terms of their agreement, in order to prevent immediate repayment of a NIS 100 million loan. On April 30, due to the bank's intention to realize a lien on 5.7% of the Company's partnership units in Delek Drilling against the outstanding loan, the Company asked for and received an ex-parte temporary injunction. According to the Company's reports, a hearing on the subject is due on May 10.
- On April 16, the Company's shareholders filed a request to register a class action against the Company, claiming non-disclosure to the investor public of material information regarding collaterals and liens and regarding the rights provided to lenders by loan agreements, in particular regarding their realization, including their immediate realization.
- According to the Company's reports, on April 19 it sold its holding (51.76%) in Cohen Development Gas & Oil Ltd. to several buyers, for a cash amount of NIS 207 million. In addition, on April 26 the Company received a NIS 9 million dividend from Cohen Development.
- On April 28, the trustees of the Company's bonds sent the Company a letter declaring that they would convene meetings to reach resolutions regarding immediate repayment of the bonds and initiating legal procedures unless the Company resolves to issue NIS 400 million in equity according to their conditions.
- On May 3, the Company published its 2019 financial statements. These reports include a "going concern" warning placed by the Company's auditors, due to a material decline in the value of the Company's assets and its owners' equity; non-compliance with financial covenants after the balance sheet date in relation with financial obligations, and demands for immediate repayment of some obligations and the Company's pleas to the court thereof; material concerns of future non-compliance with equity thresholds set forth in the bonds' indentures; and deficits in the Company's working capital and in the cash needs of the Company and its headquarter companies.
- We believe recent developments show an increased risk that the Company will experience default or be required to perform a debt restructuring, due to the deterioration in its relationship with debt holders as reflected in court proceedings, threats of lien realization and threats of immediate repayment. All this in addition to concerns regarding further decline in the value of the Company's assets.

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- On May 5, 2020, we lowered our rating on Delek Group Ltd. and on its rated bond series to 'ilCCC' from 'ilBBB-'. The downgrade is in line with the rating update we published on April 1, 2020, when we lowered the Company's ratings and kept them on CreditWatch with negative implications.
- The negative outlook reflects the materially higher risk that the Company may experience a default or perform a debt restructuring in the upcoming months. Given the persistence of negative business, financial or economic circumstances, the Company may not be able to meet its financial obligations.

Rating Action Rationale

The negative outlook reflects our assessment of a further material increase in the risk that the Company may experience a default or perform a debt restructuring, and of the Company's dependence on positive business and financial developments in order to meet its obligations. In the month that has passed since our last rating action, several events occurred which we believe show a deterioration in the relationship between the Company and its debtholders. The Company intends to sell assets urgently, in our opinion even at prices lower than their book value. We believe the asset sales would increase the Company's sources in the short term, but decrease its financial flexibility to repay its obligations in the long term.

We believe the Company's ability to repay its obligations depends on its ability to take sufficient actions to increase its sources (e.g. assets sales, dividend receipts, debt refinancing or securitization of Karish and Leviathan super royalties). However, challenging market conditions, in particular the situation in the energy market, and the short time at the Company's disposal, increase the execution risk of the Company's plans, and therefore its credit risk, in the short term.

Our assessment is further supported by recent developments and pressure applied on the Company by various financing entities since the date of our last rating action, e.g. Bank Leumi's request that the Company increase its collaterals under the terms of their agreement in order to prevent immediate repayment of a NIS 100 million loan. Following the bank's intention to realize a lien on 5.7% of the Company's partnership units in Delek Drilling, the Company asked for and received an ex-parte temporary injunction. According to the Company's reports, a hearing on the subject is due on May 10.

In addition, a bondholders meeting took place on April 26, resulting in a letter sent to the Company by the bonds' trustees demanding the immediate equity issuance of at least NIS 400 million. According to the letter, if this demand is not met, meetings will be held to demand immediate repayment. The Company has been negotiating with representatives of its bondholders in order to resolve disagreements regarding the timing of the issuance, required liens and changes in financial covenants.

In addition, several requests have been filed by the Company's shareholders to register class actions against the Company.

In light of the challenges faced by the Company, we more strongly assess that it may face higher than expected repayment requirements in the short term, if any of its debtholders attempt to secure payments to them even at the potential price of entering into a debt restructuring deal.

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On May 3, the Company published its 2019 financial statements. These reports include a “going concern” warning placed by the Company’s auditors, due to a material decline in the value of the Company’s assets and its owners’ equity; non-compliance with financial covenants after the balance sheet date in relation with financial obligations, and demands for immediate repayment of some obligations and the Company’s pleas to the court thereof; material concerns of future non-compliance with equity thresholds set forth in the bonds’ indentures barring material positive changes such as a material increase in oil and gas prices; downgrades on the Company’s bonds occurring after the balance sheet date and the Company’s position regarding them; and deficits in the Company’s working capital and in the cash needs of the Company and its headquarter companies.

This further supports our assessment of an increased risk of a default or debt restructuring in the upcoming period.

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 the outbreak have pushed the global economy into recession (see macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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Outlook

The negative outlook reflects our assessment that the risk that the Company experience default or execute a debt restructuring in the upcoming months has materially increased. The Company’s liquidity stress is reflected in its high dependence on dividends from subsidiary Ithaca, on quick liquidation of assets, on reaching agreements with various financing entities, or on other business actions dependent on the capital market. We therefore believe the Company is materially exposed to execution risks of these moves, which are inherently dependent on parties other than the Company’s management, and are affected by current market conditions.

Downside Scenario

We may lower the rating to ‘ilCC’ if the Company negotiates with its creditors regarding postponement of payments. We will lower the rating to ‘D’ if the Company fails to meet its debt maturities in accordance with the current amortization schedule, in full and in time, including if debt owners demand immediate repayment. Under the current circumstances, we may define an agreement with the Company’s creditors as a default, in accordance with our criteria.

Upside Scenario

We may take a positive rating action depending on the completion of procedures by the Company for a comprehensive agreement with debt holders, including securing bank financing, receipt of dividends from subsidiaries, asset sales, and the strengthening of the Company’s liquidity.

Liquidity

We consider Delek Group’s liquidity as “weak” according to our criteria. We currently 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, selling royalties from Karish and Tanin gas fields or taking out a loan on them, and securitization of super royalties from the Leviathan gas field. Given the Company's situation (in light of the "going concern" warning in its 2019 financial statements) and given local and global market conditions and uncertainty, the Company is exposed to execution risks on these actions, which are fairly complex and therefore are not included in our base case scenario at this stage.

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

- Cash of about NIS 411 million.
- Dividend receipt from Ithaca of NIS 175 million.

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

- Bond and bank loan maturities of about NIS 1,500 million.
- Interest expenses of about NIS 300 million.

Modifiers

Liquidity: Weak

Financial policy: Neutral

Management and governance: Negative

Comparable rating analysis: Negative

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

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- Group Rating Methodology, July 1, 2019
- S&P Global Ratings Definitions, July 5, 2019

Ratings List

Rating Details (As of 05-May-2020)	
Delek Group Ltd.	
Issuer rating(s)	
Local Currency LT	ilCCC\Negative
Issue rating(s)	
Senior Unsecured Debt	
Series 13,22,31,33,34	ilCCC
Issuer Rating history	
Local Currency LT	
05-May-2020	ilCCC\Negative
01-April-2020	ilBBB-\Watch Neg
12-March-2020	ilA\Watch Neg
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	11:38 05/05/2020
Time when the analyst first learned of the event	11:38 05/05/2020
Rating requested by	Issuer

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