

Delek Group Ltd.

Monitoring Report | March 2020

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 original language.

Contacts:

Kobi Rachmani

Senior Analyst, Lead Rating Analyst

kobir@midroog.co.il

Liat Kadish, CPA

Senior Team Leader, Secondary Rating Analyst

Liatk@midroog.co.il

Sigal Issachar, VP

Head of Corporate Finance

i.sigal@midroog.co.il

Delek Group Ltd.

Series Rating	Ca.il	Credit Review Uncertain
---------------	-------	-------------------------

Midroog downgrades from A2.il to Ca.il the rating of bonds (Series M, R, S, V, EE, GG and HH) issued by Delek Group Ltd. ("Delek Group" or the "Company"), and changes the direction of the review from review for downgrade to review with direction uncertain. The rating downgrade reflects Midroog's assessment of a high probability of default.¹ Hence, the rating of the bonds was determined according to Midroog's Methodology for Rating Defaulted issues and Issuers and Impaired Debt, and based on our estimate of the bond recovery rate given default and the level of uncertainty of this estimate.

Outstanding bonds rated by Midroog:

Bond Series	ISIN	Rating	Outlook	Maturity
M	1105543	Ca.il	Credit review uncertain	29/09/2021
R	1115823	Ca.il	Credit review uncertain	31/10/2022
S	1121326	Ca.il	Credit review uncertain	10/11/2022
V	1106046	Ca.il	Credit review uncertain	31/12/2021
EE	1134790	Ca.il	Credit review uncertain	20/02/2025
GG	1138882	Ca.il	Credit review uncertain	10/01/2022
HH	1143361	Ca.il	Credit review uncertain	31/12/2028

Summary of Rating Rationale

The Company's rating reflects Midroog's assessment of a high probability of default of the bonds issued by the Company, given our estimate of a substantial deterioration in the level of liquidity and financial flexibility of the Company due to the severe global economic and financial crisis caused in recent weeks by the coronavirus pandemic. This extreme pandemic event, which has slowed economic activity in China and the entire world, has also reduced demand for energy products. Concurrently, disagreements among the OPEC+ members over parallel cuts in oil production have led to a sharp drop in the price of a barrel of oil. Meanwhile, the share price of the Company's core holding, Delek Drilling Limited Partnership ("Delek Drilling," A1.il/negative), has declined by a steep 60% since the beginning of the year, with 35% of the decline occurring, amid strong fluctuations, between the beginning of March and the 22nd of the month. Midroog estimates that, simultaneously, there has also been a sharp drop in the value of Ithaca Energy Limited ("Ithaca", B1 rating by Moody's), a private wholly owned subsidiary of the Company, due to its exposure to oil prices, in line with similar companies traded abroad. These events have sparked great uncertainty over the Company's ability to refinance its obligations, to close transactions for the disposal of assets and to take advantage of the financial flexibility it enjoyed on the eve of this crisis.

¹ According to Midroog's definitions of default.

Our assessment of a high probability of default is based on the following considerations:

- According to the Company's reports to the TASE from March 16, 2020 and March 23, 2020, the Company presently is in breach of the collateral ratio and financial covenants undertaken toward several of its financing banks, due to the plunge in the market value of the shares of Delek Drilling, which are the main collateral securing the bank loans taken by the Company. It should be noted that the Company reported to the TASE on March 23, 2020 that together with the headquarters companies it is holding discussions with the different banks on changes in the financial covenants and other events provided for in the agreements with them, so as to prevent the acceleration of some or all of the loans or the foreclosure of collaterals due to temporary noncompliance with the collateral ratio required under the loan agreements, while the banks are keeping their rights, as set out in the Company's said report. Midroog finds it difficult to assess what the response of each of the banks will be to the loss of collateral and failure to comply with financial covenants, considering also that this involves unusual circumstances stemming from an extreme global crisis. Furthermore, the market value of Delek Drilling may not necessarily reflect the economic value of this holding. Nevertheless, the loss of collateral poses a real and immediate threat to the Company's liquidity.
- In the framework of the Chevron transaction, the Company, through the subsidiary (100%) DKL Energy Limited ("**DKL**"), took a loan from Bank BNP Paribas ("**BNP**") for a sum of \$200 million, secured by a charge on all the shares of Ithaca, to finance the acquisition of means of control. Margin call events were defined in relation to this loan, whereby in the event of a 20% drop in the value of a pool of comparable companies (as defined in the loan agreement) or in the FTSE100 Index, the Company would be required to deposit cash in the value of the drop. The Company reports that there has been a breach in the terms of this loan, which, according to the bank, establishes grounds for the acceleration of the debt.
- On the eve of the coronavirus crisis and following the Chevron transaction, we estimated the Company's loan-to-value ratio ("**LTV**") in the range of 60%-65%, whereas, now, the LTV is estimated by us at more than 90%, also as a function of the value of Ithaca, with expectations of LTV volatility in the near term in view of the fluctuations in the Delek Drilling share price. Midroog's assumption regarding the LTV relies on its working assumption of a significant decline in the value of Ithaca, which is not traded. Midroog tested the LTV for a decrease within a range of 50%-70% relative to the amount of the investment (including loans) in Ithaca, based on a comparison with comparable companies traded abroad. The financial debt net of cash and cash equivalents of the Company and the headquarters companies (expanded solo²) immediately

² Expanded solo includes Delek Group, Delek Petroleum, Delek Financial Investments 2012 Limited Partnership, Delek Power Stations Limited Partnership, Delek Infrastructures, Delek Hungary, Delek Energy, DKL Investments and DKL Energy.

before the date of this report amounted to NIS 8.2 billion. Midroog considers this level of leverage to be unsustainable and that the Company's ability to act to reduce its obligations without impairing liquidity is low.

- The Company's liquidity reserves, amounting to NIS 1.0 billion at the beginning of 2020, have significantly eroded since then, after the company reduced its credit facilities with banks, mainly in light of the erosion in collaterals, and also made payments on its bonds according to the amortization schedule. The Company is working intensively to dispose of its unencumbered assets, reporting thus far the sale of its remaining stake (20%) in IDE shares for NIS 160 million. Additional assets that are candidates for sale include mainly Delek Israel Fuel Company Ltd. ("Delek Stations", 100% stake), the overriding royalty interest in the Leviathan reservoir and several real estate properties. Nevertheless, in view of the extreme circumstances prevailing in the markets, Midroog has concerns about the Company's ability to meet the principal and interest payment due at the end of March 2020 (NIS 120 million in principal and interest), while noting the Company's statement to Midroog that it intends to meet the next payment of principal and interest out of the means available to it.
- Midroog estimates that the Company's ability to take advantage of its financial flexibility in the form of unencumbered assets has significantly eroded. In Midroog's assessment, the Company's financial flexibility was already reduced on the eve of the current serious crisis, mainly due to the Chevron transaction, in the framework of which the Company injected into Ithaca from its own resources NIS 1.7 billion (\$480 million – excluding the BNP loans for \$200 million for completing the acquisition of Ithaca), which it derived, inter alia, from the sale of a string of assets, chief among them The Phoenix, IDE and the shares of Delek Automotive. Additionally, the Company used bank credit facilities, against which it mainly encumbered the shares of Delek Drilling. According to Midroog's estimates, the value of the Company's unencumbered assets as of today is in the range of NIS 2.5-3.0 billion, comprising mainly Delek Stations, the Leviathan royalty interest and the Karish-Tanin royalty interest. We consider that there is some uncertainty regarding the Company's ability to dispose of these assets quickly in the short term, while noting that the Company is working intensively in this direction and rating as fairly reasonable the likelihood that one of the transactions will be carried out by the end of the year. Completion of the sale of one of the above assets within the coming months would improve the liquidity position.

In view of our assessment of a high probability of default, the bonds have been rated according to Midroog's Methodology for Rating Defaulted issues and Issuers and Impaired Debt, with the rating determined based on our estimate of the bond recovery rate given default. Midroog estimates the bond recovery rate at 35%-65% according to the baseline scenario set out below, and within the upper end of said range, at around 65%. The rating was determined using the recovery rate table appearing in the

rating methodology, according to the baseline scenario as set out below and taking into account the uncertainty attendant on this scenario:

- Midroog evaluated the Company under a scenario of liquidation of the Company's assets, in the absence of another known scenario at this point in time.
- The two main assets of Delek Group (accounting for approximately 60% of the portfolio of holdings) are a 59.1% stake in the share capital of Delek Drilling and a 100% stake in the share capital of Ithaca. Under the baseline scenario, the stake in Delek Drilling was factored in at the current market value. Midroog also examined the value of Ithaca versus a comparison group of international traded companies operating in the exploration and production (E&P) sector. These companies suffered in the past month sharp drops in their market value, at rates of over 50%. Midroog tested several scenarios, among them a decrease in the value of Ithaca within a range of 50%-70% relative to the value of the investment made by the Company in Ithaca.
- The value of the Company's nontraded assets (Delek Stations, Leviathan royalty interest, Karish-Tanin royalty interest and other assets) was estimated at NIS 2.0-2.5 billion under a quick-sale assumption.
- In view of the decrease in the value of The Phoenix, we did not assume a value for the seller's loan and the deposits provided to the banks in the framework of the swap transactions.
- Midroog's baseline scenario for the recovery rate further assumes that the debt recovery process will extend over a year, with the costs of the arrangement estimated by us at NIS 300-400 million (at a rate of 5% from the amount of the Company's obligations), and that late-payment interest also will accrue to the debt holders as provided in the bond indentures, from the date of first default. It should be noted that Midroog's estimate of the costs involved in the debt arrangement is subject to uncertainty.
- The baseline scenario takes into account that the bondholders stand pari passu among themselves, but that the Company has bank obligations that are secured by charges, as well as banks obligations of subsidiaries holding assets of the Company, and also tax obligations, apart from the costs of management of the arrangement and certain current expenses.

Midroog likewise tested a scenario of increase in the market value of Delek Drilling and in the value of Ithaca, which could materialize in the event of a recovery from the economic crisis within the short term. Under these alternatives, the debt recovery rate may reach a higher range than our present assessment, depending on the extent of the recovery in the value of these holdings. This scenario was not taken at this stage as Midroog's baseline scenario in view of high uncertainty.

At this stage, Midroog has assumed that the debt arrangement scheme will be identical for all the series, hence an identical recovery rate was assumed for all the series. The rating of the bonds remains under credit review with direction uncertain, in view of the likelihood of further developments that could

impact negatively or positively on the recovery rate estimate, in view of the volatility of the Delek Drilling share and in our assessment of the value of Ithaca, and given the uncertainty surrounding the debt arrangement processes.

It should be emphasized that the Midroog's estimate of the recovery rate in the baseline scenario relies to a great extent on sensitivity tests performed by it on the market value of the Delek Drilling share and on the value of Ithaca, at a time of deep crisis in oil prices that may last a long time. Therefore, the above recovery rate estimate is subject to considerable uncertainty, resulting in a relatively broad range of possible values for the recovery rate. Moreover, Midroog's baseline scenario for determining the recovery rate relies on several additional assumptions, as set out above, which are subject to high uncertainty, considering the current economic environment and the inherent complexity of debt arrangements.

Rating Outlook

The Company's rating remains under review, with a change in the direction of the review from negative to uncertain. The prevailing circumstances in the domestic and global financial markets open up Midroog's baseline scenario for the recovery rate to uncertainty, possibly leading to a change in our assessments for the short and medium term.

Factors that could lead to a rating upgrade:

- Positive change in Midroog's assumptions in the baseline scenario for the recovery rate, putting the recovery rate above 65% at a relatively high level of certainty.
- Significant improvement in the Company's liquidity.
- Our estimate of a substantial and sustained improvement in the Company's level of leverage.

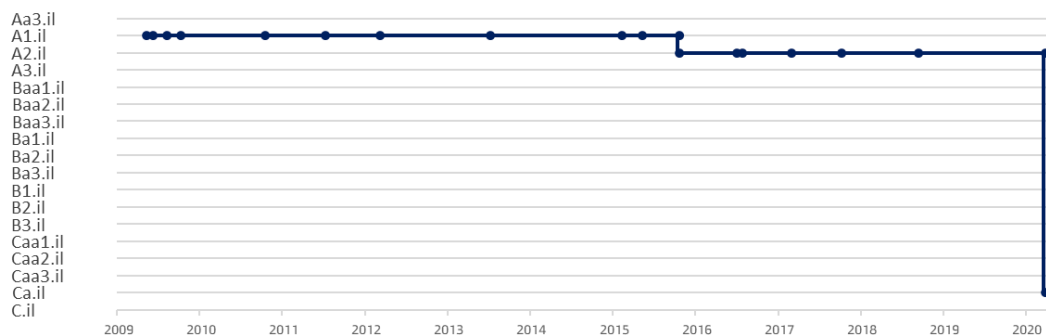
Factors that could lead to a rating downgrade:

- Our estimate of a recovery rate below 35%.

Company Profile

Delek Group is a holding company controlling a range of companies that operate primarily in the energy sector. The Company has a controlling stake (59.17%) in Delek Drilling LP, which operates in the field of oil and gas exploration and drilling, indirectly through Delek Energy (100%) as well as directly. The main assets of Delek Drilling are rights in the Leviathan reservoir (45.34%) and in the Tamar and Dalit drilling sites (22%), as well as a 22.6% stake in Tamar Petroleum. In addition, the Company holds (100%) Ithaca Energy Limited, a private company incorporated in the Channel Islands. The Company has several other holdings, the main one being Delek Israel Fuel Company Ltd. (100%, private company). The principal shareholder is Mr. Yitzhak Tshuva, who holds 61.7% of the Company's share capital and 64.87% of the voting rights. The Company's CEO is Mr. Idan Wallace and the chairman of the board is Mr. Gabi Last.

Rating History



Related Reports

[Delek Group Ltd., Related Reports](#)

[Delek Drilling Limited Partnership, Related Reports](#)

[Tamar Petroleum, Related Reports](#)

[Methodology for Rating Defaulted Issues and Issuers and Impaired debt, September 2017](#)

[Table of Affinities and Holdings](#)

[Midroog Rating Scales and Definitions](#)

The reports are published on the Midroog website at www.midroog.co.il

General Information

Date of rating report:	March 23, 2020
Date of last revision of the rating:	July 11, 2019
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.

Copyright © All rights reserved to Midroog Ltd. (hereinafter: "Midroog").

This document, including this paragraph, is copyrighted by Midroog, and is protected by copyright and by intellectual property law. This document may not be copied, or otherwise scanned, amended repackaged, further transmitted, transferred, disseminated, redistributed, duplicated, displayed, translated, resold, or stored for subsequent use for any such purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person, without advance written consent from Midroog.

Caveat regarding the limitations of a rating and the risks of relying on a rating, and caveats and reservations in respect to the activity of Midroog Ltd. and the information appearing on its website

Ratings and/or publications issued by Midroog are or contain Midroog's subjective opinions about the relative future credit risk of entities, credit obligations, debts and/or debt-like financial instruments, that apply on the date of their publication, and as long as Midroog has not changed the rating or withdrawn it. Midroog's publications may contain assessments based on quantitative models of credit risks, as well as related opinions. Ratings and publications by Midroog do not constitute a statement about the accuracy of the facts at the time of the publication or in general. Midroog makes use of rating scales to issue its opinions, according to definitions detailed in the scale itself. The choice of a symbol to reflect Midroog's opinion with respect to credit risk reflects solely a relative assessment of that risk. Midroog's ratings are issued on a national scale and, as such, are opinions of the relative creditworthiness of issuers and financial obligations within Israel. National scale ratings are not designed to be compared between countries; rather, they address relative credit risk within a given country.

Midroog defines credit risk as the risk that an entity may fail to meet its contractual financial obligations on schedule and the estimated financial loss in the event of default. Midroog's ratings do not address any other risk, such as risks relating to liquidity, market value, change in interest rates, and fluctuation in prices or any other element that influences the capital market.

The ratings and/or publications issued by Midroog do not constitute a recommendation to buy, hold, and/or sell bonds and/or other financial instruments and/or make any other investment and/or forgo any of these actions.

Nor do the ratings and/or publications issued by Midroog constitute investment advice or financial advice, nor do they address the appropriateness of any given investment for any specific investor. Midroog issues ratings on the assumption that anybody making use of the information therein and of the ratings will exercise due caution and make his own assessment (himself and/or through authorized professionals) of the merit of any investment in a financial asset that he is thinking of buying, holding or selling. Every investor should obtain professional advice in respect to his investments, to the applicable law, and/or to any other professional issue.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MIDROOG IN ANY FORM OR MANNER WHATSOEVER.

Midroog's credit ratings and publications are not intended for use by retail investors and it would be reckless and inappropriate for retail investors to use Midroog's credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

All the information contained in Midroog ratings and/or publications, and on which it relied (hereinafter: "the Information") was delivered to Midroog by sources (including the rated entity) that it considers credible. Midroog is not responsible for the accuracy of the Information and presents it as provided by the sources. Midroog exercises reasonable means, to the best of its understanding, so that the Information is of sufficient quality and that it originates from sources Midroog considers to be credible, including information received from independent third parties, if and when appropriate. However, Midroog does not carry out audits and cannot therefore verify or validate the Information.

The provisions of any Midroog publication other than one expressly stated as a methodology do not constitute part of any Midroog methodology. Midroog may change its position regarding the content of such publications at any time.

Subject to applicable law, Midroog, its directors, its officers, its employees and/or anybody on its behalf involved in the rating shall not be held responsible under law, for any damage and/or loss, financial or other, direct, indirect, special, consequential, associated or related, incurred in any way or in connection with the Information or a rating or a rating process, including not issuing a rating, including if they were advised in advance of the possibility of damage or a loss as said above, including but not confined to (a) any loss of profit in present or future, including the loss of other investment opportunities; (b) any loss or damage caused consequential to holding, acquisition and/or selling of a financial instrument, whether it is a subject of a rating issued by Midroog or not; (c) any loss or damage caused consequential to the relevant financial asset, that was caused, *inter alia* and not exclusively, as a result of or in respect to negligence (except for fraud, a malicious action or any other action for which the law does not permit exemption from responsibility) by directors, officers, employees and/or anybody acting on Midroog's behalf, whether by action or omission.

Midroog maintains policies and procedures in respect to the independence of the rating and the rating processes.

A rating issued by Midroog may change as a result of changes in the information on which it was based and/or as a result of new information and/or for any other reason. Updates and/or changes in ratings are presented on Midroog's website at <http://www.midroog.co.il>.