Maalot
S&P Global Ratings

Delek Group Ltd.

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Research Update

Company Upgraded To 'ilB' On Actions Taken To Decrease Debt And Increase Sources; Outlook Developing

Primary Credit Analyst:

Sivan Mesilati, 972-3-7539735 sivan.mesilati@spglobal.com

Additional Contact:

Tamar Stein, 972-3-7539721 tamar.stein@spglobal.com

Table of Contents

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Rating Action Overview

- Since the last rating action, Delek Group Ltd. (“Delek” or “the Company”) sold 70% of Delek Fuel Company Ltd. (“Delek Israel”)’s issued and outstanding share capital for NIS 525 million, repaid most of its bank debt using most of the cash proceeds from this sale, issued about $180 million in bonds secured by overriding royalties from the Leviathan project, repaid about $100 million of the BNP loan using dividends received from subsidiary Ithaca (CCC+/Stable) and raised about NIS 140 million in equity.
- This is supplemented by additional actions taken by the Company in 2020, including extensive divestment of assets [Karish-Tanin royalties, Cohen Development (51.76%), IDE (20%), Mehadrin (18.55%) and Delek Royalties], dividend receipts from subsidiaries Delek Drilling, Ithaca and Delek Israel, and about NIS 310 million in equity issuances.
- We believe the actions taken by the Company in 2020, and in recent months in particular, have improved its sources and decreased its financial debt to about NIS 5.4 billion (from about 9.3 billion in the beginning of 2020). However, according to our criteria, there is still a material gap between the Company’s highly certain sources and its uses in the upcoming year. Still, we see a potential for liquidating several additional assets, including core assets, and for refinancing assets and equity issuance, which may improve the Company’s liquidity position in the upcoming 12 months.
- On January 31, 2021, we raised our rating on Delek Group Ltd. and on its bond series to ‘ilB’ from ‘ilCCC’. The outlook is developing.
- The developing outlook reflects our assessment that both a positive rating action and a negative rating action are possible in the upcoming year, depending on the Company’s action to obtain sources to meet its financial obligations. We believe the Company’s liquidity position reflects high dependency on liquidation of assets, including core assets, on dividend receipts from subsidiaries Ithaca, Delek Drilling and Delek Israel, and on other business actions dependent on the capital market. We believe the Company is materially exposed to execution risk on these moves, which are inherently affected by current market conditions. On the other hand, successful asset liquidation,

including an equity action against core assets such as Ithaca, may improve the Company's liquidity position in the upcoming 12 months.

Rating Action Rationale

The upgrade reflects our assessment that the actions taken by the Company's management in recent months have improved its sources for covering its uses in upcoming months. However, the Company continues to depend on the successful implementation of material actions to improve its liquidity in order to meet its financial obligations in the upcoming year and in the following year, in the face of challenging market conditions. This is due to the fact that the principal payments on the Company's long bond series, 31 & 33, will start in 2022. Therefore, according to our criteria, there is still a material gap between the Company's highly certain sources and its uses in the upcoming year, as well as high dependency on financing and/or selling several assets, Ithaca shares in particular.

According to the Company's management, in the upcoming months it intends to liquidate several additional assets (e.g. land in Acre), implement an equity action against core assets such as Ithaca, and obtain financing against Delek Drilling units alongside equity issuance, actions which may improve the Company's liquidity position in the upcoming year. However, we believe the challenging market conditions due to the Coronavirus crisis, and the situation in the energy market, increase the execution risk of the Company's planned actions.

Since the last rating update, in September 2020, the Company completed several material moves that led to a material decrease in its bank debt. In October 2020, the Company sold 60% of the issued and outstanding share capital of Delek Israel to Lahav L.R. Real Estate Ltd. and to BGM Ltd. for NIS 450 million. In accordance with the agreement, the buyers deposited NIS 75 million in a trust account for an additional 10% of Delek Israel's share capital. The buyers were also given an option to acquire 5% more of the shares by June 30, 2021. Upon the completion of the transaction, a total of NIS 450 million were paid in cash, of which about NIS 343 million were used to repay all of the Company's bank debt. The remaining proceeds from the sale were used to repay bond maturities on their due date. Following the repayment of the Company's bank debt, 40% of Delek Drilling units were released from encumbrance by the banks, and encumbered to bond holders, according to the standstill agreement with the latter. The Company holds the remaining 15% of Delek Drilling's participation units.

On October 28, 2020, the Company issued $180 million (about NIS 608 million) in bonds secured by overriding royalties on the Leviathan project. About NIS 500 million (after deducting issuance expenses and an interest reserve fund) were transferred to the Company's bond trustees to repay due maturities.

In early November 2020, the Company repaid about $100 million to BNP using dividend receipts from subsidiary Ithaca. The outstanding BNP loan is currently about $7 million, and after it is fully repaid, Ithaca shares should be unencumbered.

On December 16, 2020, the Company issued about NIS 140 million in equity, in accordance with the standstill agreement with bond holders. About NIS 100 million of these NIS 140 million were issued through the realization of Series 8, 9 and 11 options.

On the other hand, on November 26, 2020, Delek published its Q3 2020 financial statements. Similarly to the financial statements for Q1 and Q2, these reports include a "going concern" warning placed by the Company's auditors, who believes that as the completion of the Company's plan is not under its sole control and depends, among other things, on the occurrence of a large number of simultaneous events in a relatively short time frame and/or at large amount, there is uncertainty regarding their actual realization and regarding the Company's compliance with covenants set forth in the agreements with its bondholders.

We note that, as vaccine rollouts in Israel and several countries continue, we believe there remains a high degree of uncertainty about the evolution of the coronavirus pandemic and its economic effects. Widespread immunization, which certain countries might achieve by midyear, will help pave the way for a return to more normal levels of social and economic activity. We are using this assumption regarding the pace of the vaccine rollout in assessing the economic and credit implications associated with the pandemic (see our research on S&P Maalot website and on S&P Global Ratings website). As the situation evolves, we will update our assumptions and estimates accordingly.

Outlook

The developing outlook reflects our assessment that both a positive rating action and a negative rating action are possible in the upcoming year, depending on the Company's action to obtain sources to meet its financial obligations. We believe the Company's liquidity position reflects high dependency on liquidation of assets, including core assets, on dividend receipts from subsidiaries Ithaca, Delek Drilling and Delek Israel, and on other business actions dependent on the capital market. We believe the Company is materially exposed to execution risk on these moves, which are inherently affected by current market conditions. On the other hand, successful asset liquidation, including an equity action against core assets such as Ithaca, may improve the Company's liquidity position in the upcoming 12 months.

Downside Scenario

We may lower the rating by one or more notches if we learn that the risk has increased that the Company will not be able to meet its obligations in full and on time in the next 12 months, including due to escalation of debt by bond holders.

Upside Scenario

We may raise the rating if we estimate that the Company will complete sufficient moves to improve its liquidity position on time, mainly divestment of Ithaca shares through issuance and/or including a strategic partner and/or refinancing. This should be done simultaneously with the divestment of non-core assets, refinancing and equity issuance.

Company Description

Delek Group is an oil and gas company operating in energy fields - natural gas and oil exploration, production and marketing (upstream energy) and gas stations (downstream energy) through subsidiaries Ithaca Energy Limited ("Ithaca", CCC+/Stable), Delek Drilling Limited Partnership ("Delek Drilling") and Delek Fuel Company Ltd. ("Delek"). The major controlling shareholder in Delek Group is Mr. Itzhak Tshuva, who holds about 49.4% of its shares. The remaining shares are held by the public (47.2%) and by Delek Financial Investments (2012) Limited Partnership (3.4%).

Liquidity

We analyze the Company's liquidity on a stand-alone basis, as it serves its financial obligations using its cash on hand, asset liquidation and dividends from subsidiaries Ithaca, Delek Drilling and Delek Israel. We view Delek Group's liquidity as "weak" since we estimate, according to our criteria, that at this point there is a material gap between the Company's highly certain sources and its uses in the upcoming year.

As mentioned above, the Company is currently undertaking several moves to improve its sources, including the sale of land in Acre (a binding letter of intent for NIS 200 million has been signed, and about NIS 10 million were transmitted to the Company as an advance payment), financing against Delek Drilling participation shares, equity issuance and listing Ithaca shares for trading (including by way of an exchange purchase offer). Given the Company's condition (in light of the "going concern" warning in its Q3 2020 financial statements) and given conditions and uncertainty in Israeli and global markets, it is exposed to execution risks of these moves, which are relatively complex, and therefore all of these actions were not included in our base case scenario at this point. Also, in accordance with our criteria, our liquidity scenario did not include possible cash flows from Ithaca, Delek Drilling and Delek Israel, as these haven't been announced yet. Other assets held by the Company which were not taken into account are overriding royalties from Leviathan, the remaining holding in Delek Israel, a ~NIS 250 seller's loan from The Phoenix and a real estate asset in Herzliya.

In our base case scenario we assume the main sources at the Company's disposal in the 12 months starting on January 1, 2021, to be:

- About NIS 270 million in cash.
- About NIS 75 million from the sale of 10% of Delek Israel shares.
- About NIS 65 million in dividend receipts from Delek Drilling.
- About NIS 132 million in other revenues.

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

- Bond principal and loan maturities of about NIS 1,039 million.
- Interest and tax expenses of about NIS 368 million.
- Other payments totaling about NIS 66 million.

We note that, according to the agreement with bond holders, if, at the end of the stated period (from the date of approval until May 31, 2021), S&P Maalot's rating on the bonds is lower than 'ilBBB-', and if, at the time of the publication of the Company's Q2 2021 financial statements, the Company fails to meet the financial covenants agreed upon by the parties, the trustee and the bond holders will have the right to accelerate the bonds and liquidate the collaterals. If this right is exercised, the entire financial debt and interest and tax expenses will be accelerated, and the gap between the Company's sources and uses will increase.

Recovery Analysis

Key analytical factors

- We are raising our rating on Delek Group's secured bond series (Series 13, 22, 31, 33, 34) to 'ilB', identical to the issuer rating. The recovery rating for this series is '3', reflecting our assessment that in the case of a hypothetical default, the recovery rate would be 50%-70% (at the lower part of this range).
- The recovery rating of the secured bond series is affected by the devaluation of the asset portfolio as well as by the increased liquidity pressure and the need for faster liquidation of assets.

Simulated default assumptions

- Simulated year of default: 2022
- The market value of the investment portfolio together with the Company's cash at hand will decrease on the date of the hypothetical default to the level of its remaining debt, due to a sharp

decrease in the market value of Delek Drilling's shares. We also assume an additional 40% reduction at liquidation.

- The Company will be liquidated, an assessment based on the fact that there is no activity at the holding company level and its entire value at the time of default will be based on the shares it holds in Delek Drilling and Ithaca.
- Creditors will attempt to liquidate the collaterals and holdings in subsidiaries or part of them.

Simplified waterfall

- Gross asset value at liquidation: about NIS 3,360 million
- Administrative costs: 5%
- Asset value available for senior secured debt: about NIS 3,190 million
- Total secured debt (not rated): about NIS 133 million
- Asset value available for secured debt (rated): about NIS 3,055 million
- Total secured debt (rated): about NIS 5,460 million
- Rated secured debt (Series 13, 22, 31, 33, 34) recovery expectations: 50%-70%
- Rated secured debt (Series 13, 22, 31, 33, 34) recovery rating: (1 to 6): 3

All debt amounts include six months' prepetition interest.

Mapping Recovery Percentages To Recovery Ratings

Recovery expectations (%)	Description	Recovery rating	Notching above/below issuer rating
100%	Full recovery	1+	+3 notches
90%-100%	Very high recovery	1	+2 notches
70%-90%	Substantial recovery	2	+1 notch
50%-70%	Meaningful recovery	3	0 notches
30%-50%	Average recovery	4	0 notches
10%-30%	Modest recovery	5	-1 notch
0%-10%	Negligible recovery	6	-2 notches

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 (see Step 6, paragraphs 90-98 of Recovery Rating Criteria For Speculative-Grade Corporate Issuers, December 7, 2016, for further detail).

Modifiers

Diversification/portfolio effect: Neutral

Capital structure: Neutral

Liquidity: Negative impact

Financial Policy: Negative impact

Management and governance: Neutral

Comparable ratings analysis: Neutral

Related Criteria And Research

- Principles Of Credit Ratings, February 16, 2011
- 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: Industry Risk, November 19, 2013
- Country Risk Assessment Methodology And Assumptions, November 19, 2013
- Corporate Methodology, November 19, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, December 16, 2014
- 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, January 5, 2021

Ratings List

Delek Group Ltd.	Rating	Date when the rating was first published	Last date when the rating was updated
Issuer rating(s)			
Long term	ilB/Developing	01/09/2001	30/09/2020
Issue rating(s)			
Senior Unsecured Debt			
Series 13	ilB	26/03/2007	30/09/2020
Series 22	ilB	26/06/2007	30/09/2020
Series 31	ilB	24/12/2014	30/09/2020
Series 33	ilB	21/09/2016	30/09/2020
Series 34	ilB	30/01/2018	30/09/2020
Issuer Credit Rating history			
Long term			
January 31, 2021	ilB/Developing		
September 30, 2020	ilCCC/Developing		
May 05 ,2020	ilCCC/Negative		
April 01, 2020	ilBBB-/Watch Neg		
May 12 ,2020	ilA/Watch Neg		
December 26, 2011	ilA/Stable		
January 06, 2011	ilA/Negative		
May 26 ,2009	ilA/Stable		
November 30, 2008	ilAA/Watch Neg		
May 26 ,2007	ilAA/Stable		
June 30, 2005	ilAA		
September 01, 2001	ilAA-		
Additional details			
Time of the event	31/01/2021 13:21		
Time when the event was learned of	31/01/2021 13:21		
Rating requested by	Issuer		