Maalot

S&P Global Ratings

Oil Refineries Ltd.

March 31, 2020

Research Update

Issuer & Rated Issuance Ratings Lowered To ‘ilA-‘; Ample Liquidity And Good Performance In 2019 Will Mitigate But Not Fully Prevent Effects Of Coronavirus Crisis And Drop In Refining Margins; Outlook Negative

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Rating Action Summary

- The Coronavirus pandemic is expected to lead to a material drop in consumption of oil products (e.g. petrol and jet fuel) due to the decrease in land and air traffic, and the oil price war between Russia and Saudi Arabia further increases volatility in oil and refining markets. According to our sensitivity analysis, Oil Refineries Ltd.’s (“Bazan” or “the Company”) financial metrics could be materially affected if this situation continues into 2021.
- On the other hand, demand for Bazan’s petrochemical products has increased, among other things due to increasing demand for plastic products and reliance on local producers, and margins in this sector are rising globally. In addition, the Company holds a large cash balance and has lately decreased its debt and extended its average duration, and will be able to mitigate difficult conditions by reducing dividends and investments.
- We are lowering the issuer rating on refining and petrochemical company Oil Refineries Ltd. and the issue ratings on its rated bond series to ‘ilA-‘ from ‘ilA’.
- The negative outlook reflects our assessment that despite the Company’s cash balance and its local business position, if the decrease in demand and margins in the refining sector continues into 2021, it may adversely affect the Company’s financial metrics and even result in another downgrade.

Rating Action Rationale

Oil and refining markets have recently become extremely volatile, mainly due to the oil price war between Russia and Saudi Arabia. At the same time, demand for some of the Company’s refining products has decreased due to the decrease in transportation and aviation volume. On the other hand, demand for plastic products has increased since people consume more single-use products and Israeli industries rely more heavily on raw materials produced locally.

The downgrade reflects the fact that in our base case scenario we expect an adjusted debt to EBITDA ratio that may exceed 3.5x, depending on various market conditions. However, according to our sensitivity analysis, unless refining margins improve by year end 2020, the Company’s financial metrics may well be commensurate with a lower rating, i.e. an adjusted debt to EBITDA ratio exceeding 5x. Nevertheless, even in our sensitivity scenario we expect the Company to maintain “adequate” liquidity in 2020, due to its large cash balance and its ability to reduce dividend distributions and investments. We expect the Company will take the necessary actions to preserve its financial robustness in this time of crisis.

Outlook

The downgrade and negative outlook reflect the adverse effects of the Coronavirus crisis on the oil and gas sector, and the material drop in demand for some refining products. We expect the Company to present an adjusted debt to EBITDA ratio exceeding 3.5x in a moderate scenario, and an adjusted debt to EBITDA ratio exceeding 5x if refining margins remain particularly low throughout 2020.

Downside Scenario

We may take a negative rating action if the Company's adjusted debt to EBITDA ratio consistently exceeds 5x. This could result if demand for the Company's products continues to decrease or lead to a decrease in operating income, or if refining margins remain low into 2021.

Upside Scenario

We may change the outlook to stable if we estimate that the Company's adjusted debt to EBITDA ratio will not consistently exceed 5x. This could happen if markets and demand return, at least partially, to their pre-crisis condition, or if the Company takes ameliorating actions such as decreasing dividend distributions and investments. If we estimate that the Company's adjusted debt to EBITDA ratio will decrease below 3.5x, we may raise the rating back to 'ilA'.

Company Description

Bazan operates in the refining and petrochemical markets, mainly through a single manufacturing facility in the Haifa Bay. It uses a combined manufacturing process such that some of the refining products are used in petrochemical production and some petrochemical products are used in the refinery. Refining activity generates about 55% of the Company's EBITDA and petrochemical activity generates the remainder.

Base-Case Scenario

Our base-case scenario is underpinned by the following key assumptions:

- Crude oil (Brent) price of $40 per barrel in 2020 and $50 per barrel in 2021, as per S&P Global assumptions.
- ~$3-$6 margin over the price per barrel in 2020-2021, depending on the scenario.
- Contribution of over $500 per ton from the petrochemical segment in 2020-2021.
- Utilization rate of refining and petrochemical facilities similar to the Company's historical figures.
- Maintenance of the Company's business position as the largest refining and petrochemical corporation in Israel.
- Investments and dividends totaling about $200 million in 2020 and about $220 million in 2021, taking into account planned investments and the Company's policy to distribute 75% of net income. We nevertheless note that the Company is very flexible on these two factors.
- Continued decrease in debt, although the Company's policy is very flexible on this as well.

We forecast debt coverage ratios to be as follows:

- Depending on various market conditions, adjusted debt to EBITDA that could exceed 3.5x.
- In stress scenario, adjusted debt to EBITDA exceeding 5x.

Liquidity

The Company's liquidity is "adequate", according to our criteria. We expect the ratio between the Company's sources and uses to be about 1.6x in the 12 months beginning January 1, 2020, in a scenario where refining margins are in line with the Company's historic average. In our stress scenario we also expect the Company's liquidity to remain "adequate" in the same period. In our liquidity scenario we include the $84 million issuance completed early this year.

In our base-case scenario we estimate the Company's main sources in the 12 months starting January 1, 2020, to be as follows:

- Cash and liquid investments of about $510 million;
- Cash flow from operations of about $120 million;
- Debt issuance of about $84 million.

Our assumptions regarding the uses in the same period are as follows:

- Debt maturities of about $330 million (including the repayment of the receivable's securitization, although we believe it will be extended);
- Negative working capital of about $40 million;
- Investments and dividends of about $200 million.

Financial Covenants

The Company has several financial covenants, including minimum equity, minimum EBITDA, minimum cash and cash equivalents and a specific debt to EBITDA ratio, in accordance with specific definitions in the Company's financing agreement. The Company is also required to maintain a cash balance of $75 million at all times. We understand the Company meets its financial covenants.

Recovery Analysis

Key analytical factors

- We are assigning our 'ilA-' rating, identical to the issuer rating, to Bazan's bond series. The recovery rating for these series is '4', reflecting our assessment that in the hypothetical default scenario, the recovery rate would be at the higher end of the 30%-50% range.

Simulated default assumptions

- Year of hypothetical default: 2023
- A sharp decrease in oil prices, a drop in demand and a shutdown of some of the production facilities, alongside the need to refinance debt, will greatly decrease revenues and lead to a default.
- The company will continue operating as a going concern, an assessment supported by its importance as the supplier of about 60% of the demand for liquid fuels in the Israeli economy.
- In the hypothetical deterioration path, the Company will use most of its cash on hand.

Simplified waterfall at emergence

- Gross discrete asset value as going concern: about $414 million
- Administrative costs: 5%
- Net value available to secured creditors: about $393 million
- Secured senior debt: about $244 million
- Net value available to unsecured creditors: about $149 million
- Unsecured debt: about $360 million
- Unsecured debt recovery expectation: 30%-50%
- Unsecured debt recovery rating (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

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

Modifiers

Diversification/Portfolio effect: Neutral

Capital structure: Neutral

Liquidity: Neutral

Financial policy: Neutral

Management and governance: Neutral

Comparable rating analysis: Negative

Related Criteria And Research

- 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
- Key Credit Factors For The Oil Refining And Marketing Industry, March 27, 2014
- 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, July 5, 2019

Ratings List

Rating Details (As of 31-March-2020)	
Oil Refineries Ltd.	
Issuer rating(s)	
Local Currency LT	ilA-\Negative
Issue rating(s)	
Senior Unsecured Debt	
Series A, D, E, F, G, I	ilA-
Serie J	ilA-
Issuer Rating history	
Local Currency LT	
31-March-2020	ilA-\Negative
07-April-2019	ilA\Stable
03-April-2018	ilA-\Positive
09-April-2017	ilA-\Stable
31-May-2016	ilBBB+\Positive
14-May-2015	ilBBB+\Stable
29-Dec-2014	ilBBB\Positive
18-Dec-2013	ilBBB\Stable
14-Oct-2013	ilBBB-\Watch Neg
02-Dec-2012	ilBBB+\Negative
06-May-2012	ilBBB+\Stable
30-Nov-2011	ilA-\Watch Neg
25-March-2010	ilA-\Stable
07-July-2009	ilA\Negative
23-April-2009	ilA\Watch Neg
11-Dec-2008	ilA\Negative
11-Nov-2007	ilAA\Stable
01-March-2003	ilAA
21-Sept-1992	ilAAA

Other Details

Time of the event	31/03/2020 10:29
Time when the analyst first learned of the event	31/03/2020 10:29
Rating requested by	Issuer

Credit Rating Surveillance

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