

Israel Corporation Ltd.

November 22, 2016

Research Update

Rating Lowered To 'iIA' On Erosion Of Consolidated Debt Coverage Ratios; Outlook Stable

Primary Credit Analyst

Matan Benjamin, 972-3-7539731 matan.benjamin@spglobal.com

Secondary Credit Analyst

Tom Dar, 972-3-7539722 tom.dar@spglobal.com

Table of Contents

Summary

Rating Action

Rationale

Outlook

Related Criteria And Research

Please note that this translation was made for the company's use only and under no circumstances obligates Standard & Poor's Maalot. In the case of any discrepancy with the official Hebrew version published on November 22, 2016, the Hebrew version shall apply.

Research Update

Rating Lowered To 'iIA' On Erosion Of Consolidated Debt Coverage Ratios; Outlook Stable

Summary

- Due to an increase in debt and a weakening in subsidiary Israel Chemicals Ltd.'s operating performance, Israel Corporation Ltd.'s debt coverage ratios for 2016 and 2017 deviate from the range we determined to be commensurate with the previous rating.
- Israel Corporation's financial flexibility eroded as a result of an increase in the loan-to-value (LTV) ratio to above 40%.
- On the other hand, the company's liquidity profile improved in recent months as it updated its set of financial covenants and now has sufficient headroom over them.
- We are lowering our rating on Israel Corporation Ltd., operating in the fertilizers and specialty chemicals and energy fields, to 'iIA' from 'iIA+'.
- The stable outlook on Israel Corporation reflects our expectation that its subsidiary, Israel Chemicals Ltd., will maintain its dominant business position in its fields of operation, and our assessment that Israel Corp will show debt coverage ratios commensurate with the current rating, i.e. debt to EBITDA between 4.0x and 5.0x.

Rating Action

On November 22, 2016, Standard & Poor's Maalot lowered its rating on operating holding company Israel Corporation Ltd. to 'iIA' from 'iIA+'. The outlook is stable.

Rationale

The downgrade reflects the increase in debt and the relative weakness in operating performance of subsidiary Israel Chemicals Ltd. ("ICL; BBB-/Stable/iIAA/Stable), and the fact that Israel Corporation's current debt coverage ratios and those we expect for 2016 and 2017 deviate from the level we determined to be commensurate with the previous rating. The downgrade also reflects the erosion in the company's financial flexibility as a result of its LTV ratio rising above 40%.

Following the completion of a strategic spin-off by the company of its holdings in early 2015, we have changed our methodological approach and now assess Israel Corporation's credit profile mainly through the examination of the debt coverage ratios that arise from its consolidated statements, while examining the company's LTV ratio as an indicative metric for assessing its leverage and refinancing capabilities. ICL's results are fully consolidated into Israel Corporation's financial statements, while Oil Refineries Ltd. ("Bazan", iBBB+/Stable) is an affiliated company and its results are listed using the equity method in the affiliated companies income section.

So far this year, potash prices have been \$30-\$40 below our projections, with Israel Chemicals' competitor JSC Belaruskali signing key benchmark contracts with major customers from India and China at \$227 per metric ton and \$219 per metric ton, respectively. This pressure on prices has stemmed, among other things, from weakened supply-demand

equilibrium on the backdrop of further capacity start-ups in 2017-2018. Because the weak supply-demand balance is likely to continue, we believe that prices are unlikely to recover significantly through 2018 from current spot levels. We believe that capacity additions will likely overcompensate currently announced production curtailments and outages of about 5 million metric tons. Furthermore, capacity additions in 2018 and 2019 could apply new pressure on prices. In reaction to challenging market conditions, ICL has decided to implement several measures, including modifying its dividend policy (in 2016 and 2017 up to 50% of the adjusted net profit will be distributed, compared to up to 70% of the reported net profit in previous years), cutting costs, and reducing capital expenditure (capex). While ICL's decision to scale down dividend distribution adversely affects Israel Corporation's liquidity profile, we estimate that the aforementioned measures may contribute to the deleveraging of the group in the medium/ long term. We intend to follow up on these measures and their effect on the group's debt coverage ratios and financial position.

As for Bazan, after very strong operating results in 2015, we expect profitability to diminish in 2016, on the backdrop of weaker market conditions, mostly in the refinement segment, and periodic maintenance in a significant part of the company's production facilities as well as of its subsidiaries Carmel Olefins and Gadiv. In our base case scenario we estimate that Bazan will start distributing dividends again in 2016, with Israel Corporation's share estimated at about \$20 million - \$30 million per year.

Under our base case, we assume:

- Annual revenues at ICL of \$5.4 billion-\$6.0 billion in 2016-2018.
- Gradual improvement in ICL profitability in 2017, due implementation of cost-cutting initiatives
- EBITDA of about \$1.0 billion in 2016 and \$1.2 billion in 2017.
- Net investment of about \$650 million in 2016-2017 at ICL, with no investments at the Israel Corporation level.
- Annual dividend payout of up to 50% of ICL's adjusted net profit in 2016-2017.

Based on these assumptions, we arrive at the following credit measure:

- Debt to adjusted EBITDA of about 4.0x-5.0x in 2016 and 2017, likely to decline in the longer term.

Liquidity

Our assessment of Israel Corporation's liquidity, reflecting the analysis at the holding company level, is adequate according to our criteria, underpinned by material cash balances and dividend receipts from subsidiaries.

We estimate that the recent rise in the LTV ratio, stemming largely from the decline in ICL's value, reduces Israel Corporation's financial flexibility. Israel Corporation's portfolio is currently valued at about \$2.83 billion, and the LTV ratio is about 43%, while historically this ratio was below 40%. According to Israel Corporation's financial covenants, part of its debtors may demand immediate repayment, if ICL's share price drops below \$2.4, while the current share price is about \$3.8. In addition, in accordance with the indentures of bond series 10 and 11, Israel Corporation's equity must remain above \$360 million (approximately 1.02 billion as of June 30 2016) and its equity to balance sheet ratio must exceed 20% (approximately 40% as of June 30, 2016). The company currently has sufficient headroom on all of its covenants.

We estimate that the ratio between the company's liquidity sources and uses will exceed 1.2x in the upcoming year. In our base case scenario we estimate that the company's liquidity sources as of September 30, 2016, are:

- Cash and liquid investments of about \$814 million;

- Dividend receipts from subsidiaries at about \$150 million-\$160 million until year end 2017.

Our assumptions regarding the company's uses as of September 30, 2016, are:

- Principal payment of about \$325 million until year end 2017;
- Interest, general and administrative expenses of about \$150 million until year end 2017.

Outlook

Israel Corporation's stable outlook reflects our expectation that its subsidiary Israel Chemicals will maintain its dominant business position in its fields of operation and continue to distribute about 50% of its net profit as dividends. The outlook also reflects our assessment that Israel Corporation will present debt coverage ratios commensurate with the current rating, i.e. debt to EBITDA between 4.0x and 5.0x, and our assessment that its financial flexibility does not decline further as a result of significant increase in the LTV ratio.

Downside Scenario

Israel Corporation's rating may come under pressure if its debt to EBITDA ratio exceeds the range we determined to be commensurate with the current rating and if its financial flexibility continues to decline. This may result if ICL's operating performance erodes beyond our current assessments, and subsidiaries' value drops.

Upside Scenario

We may consider a positive rating action if ICL's operating results improve, resulting in a decrease in Israel Corporation's debt to EBITDA ratio to below 3.5x over a long period.

Related Criteria And Research

- [National And Regional Scale Credit Ratings](#), September 22, 2014
- [Group Rating Methodology](#), November 19, 2013
- [Criteria For Rating Non-Financial Corporate Issuances On Standard & Poor's Maalot's Local Rating Scale](#), September 22, 2014.
- [S&P Global Ratings' National And Regional Scale Mapping Tables](#), June 1, 2016
- [Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers](#), December 16, 2014
- [S&P Global Ratings Definitions](#), August 18, 2016
- [Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings](#), October 24, 2013
- [Key Credit Factors For The Commodity Chemicals Industry](#), December 31, 2013

Credit Rating Surveillance

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.

All rights reserved © No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Maalot Ltd. or its affiliates (collectively, S&P). S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis.

In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process. S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on S&P Maalot's website, www.maalot.co.il, and S&P Global's website, www.standardandpoors.com and may be distributed through other means, including via S&P publications and third-party redistributors.