Convenience translation from Hebrew

The binding version is the Hebrew version only as published by Standard & Poor's-Maalot

Oil Refineries Ltd.

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1st of January 2015

Rating Update

Confirmation of ilBBB rating and update of the rating forecast to positive as the result of an additional improvement in the coverage ratio

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Summary

- The operational performance and available manufacturing capability of the Oil Refineries Ltd. (Bazan) improved since the 2014 year, following the positive contribution of the Hydrocracker facility, the reduction in the cost of energy as the result of the flow of natural gas from the "Tamar" field, a significant improvement in market conditions in the refining and polymer sector and implement efficiency steps.
- In view of the growth in the ability to generate cash, there is an improvement in the coverage ratio. The debt to EBITDA ratio adjusted for the period of 12 months that ended on the 30th of September 2014 stood at about x 6.0 as compared to x 8.6 as of the end of the 2013 year.
- The high level of fluctuation that characterized the petrochemical and refining industry and the continued weakness in the European market conditions continue to serve as risk factors.
- We confirm the rating of ilBBB of Oil Refineries Ltd. (Bazan) that operates in the field of refining and petrochemicals and we update the rating from stable to positive.
- The positive forecast rating reflects our assessment that Bazan's leverage ratio will decrease in the short term up to the level that suits a higher rating, while continuing to maintain a conservative policy regarding the management of liquidity.

Rating Action

On the 1st of January, 2015 Standard & Poor's Maalot , confirmed the rating of ilBBB for Oil Refineries Ltd., that operates in the field of refining and petrochemicals. At the same time S&P Maalot raised the Company's rating from stable to positive.

Primary Considerations in the Rating

Changing the rating forecast to positive reflects the improvement that occurred recently in the operational results of Bazan and our expectations that Bazan will be able to generate free available cash flow over time that will support a gradual process of reducing leverage. Bazan's operational results improved during 2014 as the result of a positive contribution from the Hydrocracker facility. From the drop in the cost of energy due to the flow of natural gas from the "Tamar" field, a significant improvement in the market conditions in the refining and polymer field and the implementation of steps toward higher efficiency.

Since the activation of the Hydrocracker facility in the first quarter of the 2013 year, and the flow of natural gas from the "Tamar" field, Bazan shows on average a refining margin that is about 4 dollars higher as compared to the benchmark margin in the refining industry (the Ural Refining Margin serves as the benchmark). Despite this, in the third quarter of the 2014 year, the margin between the refining margin from Bazan and the benchmark was lower, and this as the result of a breakdown that took place in the Hydrocracker facility and as the result of a drop that occurred in the price of crude oil that has yet to be reflected in the margin in a complete manner. The profitability of the polymer division improved significantly in 2014 due to a sharp drop in the price of the primary raw product, naphtha while the prices of final products (polypropylene and polyethylene) dropped at a slower rate as well as the result of the attaining of synergy in the flow of raw products from Bazan. Additionally, the Company's profitability was positively affected from the implementation of the efficiency program that included, among others, the reduction of fixed costs and the execution of improvements in the manufacturing process.

In the first nine months of 2014 the Company enjoyed a significant cash flow from ongoing activity at a scale of 660 million dollars, among others due to the expansion of the discount framework from customers and due to the drop in the price of oil that contributed to the reduction of the investment in working capital. The aforementioned cash flow enabled Bazan to reduce the scope of the use of the short term credit framework (as of the third quarter, at the level of crude oil for 95 dollars a barrel the scope of their utilization stood at about only 77 million dollars out of an overall framework of 485 million dollars) and to reduce the net scope of the debt. As of the publication of the report the price of crude oil dropped to about 58 dollars per barrel a drop that allows for a further reduction in operating capital. We note that if there should be a sharp rise in the price of crude oil the Company will be required to expand the scope of its investment in operating capital by taking advantage of the available frameworks at its disposal.

Under our basic operational scenario we estimate that the benchmark margin in the coming years will remain relatively low (1-2 dollars per barrel), under the influence of weak macroeconomic factors in Europe and the creation of production surplus in industry. While we are aware of the rise that occurred in the benchmark margin beginning in the third quarter, (the average in the fourth quarter stood at about 3.8 dollars per barrel), we estimate that the present margin ratio is not sustainable, and the margin is expected to return to a lower level. Under the basic operational scenario we expect Bazan will continue to present a refining margin higher by about 3.5-4.5 dollars per barrel from the benchmark margin, and that there will be no significant change in its operating capital needs. In our estimation, the results of the polymer division will remain relatively stable in light of supportive market conditions and the continued implementation of efficiency measures. In the 2015 year the Company is expected to execute periodic maintenance works within which framework part of the refining facilities will be shut down for a period of about 45 days. Accordingly, in our basic scenario we expect that the ratio use of manufacturing capacity will decrease to about 85% as compared to about 90% in a regular year. On the basis of these assumptions, we expect the adjusted EBITDA of the Company to stand at about 350-370 million dollars in the year 2014 and the year 2015 as compared to about 296 million dollars in the 2013 year. Additionally, we estimate that the adjusted debt EBITDA ratio will stand at about x5.0 – x6.0 in the years 2014 and 2015.

Our Basic Scenario is based on the Following Central Assumptions:

- A rate use of manufacturing capacity of about 90% in the 2014 year and about 85% in the 2015 year, due to the periodic infrastructure works in the refinery facilities.
- A refining margin of about 5 – 5.5 dollars per barrel;
- Capital investments totaling about 60 million dollars in the 2014 year and about 90 million dollars in the 2015 year due to maintenance works.

- Non distribution of dividends in the 2015 year according to the Company's agreements with the financing bodies.
- **Pursuant to our base scenario, the debt coverage ratios are expected to be as follows:**
- Adjusted EBITDA debt of about x5.0 – x6.0 in the years 2014 and 2015.
- FFO (funds from operations) for the adjusted debt of about 10% - 12% in the 2014 year and 11% - 13% in the 2015 year.

Liquidity

We estimate that Bazan's liquidity level as "Less than Suitable", according to our methodology. We estimate that the ratio between the resources available to Bazan and is needs at about x 1.0 in the 2015 year (based on the assumption that the banks will recycle the short term credit and the clearance framework from customer). We are of the opinion that there has been improvement in the liquidity profile of the Company in view of the actions taken beginning from the end of the 2013 year, and among them – the raising of capital through the issue of rights and the issue of bonds – and in view of the limited scope of use of the short term frameworks. Despite the aforementioned improvement, we believe that the liquidity profile is still negatively affected from the large scope of debt repayment in the coming years and from the inherent high fluctuations in the operational performance.

We assume that the primary sources that are available to the Company as of the 30th of September 2014 include:

- Cash and cash equivalents totaling about 284 million dollars, of which, in our estimate, 100 million dollars are required for the ongoing operations;
- FFO of a scope of about 290 million dollars up to the end of the 2015 year;
- Issuing of bonds – 30 million dollars (realization of options);

Conversely we assume that the primary needs as of the 30th of September 2014 include:

- Repayment of short term debt of a scope of about 385 million dollars by the end of 2015;
- Capital investments at a scope of about 100 million dollars by the end of 2015;
- Non distribution of dividends in the 2014 and 2015 years pursuant to the consent of the appointees.

While in recent years Bazan acted with a smaller margin than in its stipulations and even deviated from them on occasion, we estimate that the risk decreased for a deviation from the financial yardsticks in the short term due to an update from the value of the stipulations executed at the end of the 2013 year as well as due to an improvement in results.

Rating Forecast

The positive rating forecast reflects our assessment that Bazan's rate of short term leverage will be reduced to a level that suits a higher rating level, while continuing to maintain conservative policy in the management of liquidity. In our estimate, in the 2015 year, the Company will continue to generate positive free cash flow that will support the gradual reduction of the debt level and the meeting of the debt to EBITDA ratio that is lower than x6.0 which suits a higher rating. We see an adjusted debt EBITDA ratio of up to X7.0 over time, as suiting the ilBBB rating.

The Positive Scenario

We will consider raising the rating if Bazan shows a debt to EBITDA ratio lower than x6.0 over time, while maintaining the current liquidity level (at least).

The Negative Scenario

We will consider a negative rating in the event that our updated forecasts point to the debt to EBITDA ratio being higher than X6.0. In our opinion this scenario could come into being if there will be erosion in the margins for refining and petrochemicals, lower than expected production due to a technical failure, or a sharp rise in oil prices. Furthermore, we could take the step of a negative rating, including the reduction of the rating if there will be a deterioration in Bazan's liquidity profile.

Adjustments to the Rating

Sectoral spread: without effect

Capital Structure: without effect

Liquidity: without effect

Financial policy: without effect

Management, Strategy and Corporate Governance: without effect

Comparison to the control group: without effect

Related Research

- For information regarding our methodology for examining the liquidity in companies and the affect on the rating see: "Assessing the Liquidity Level for an Issuer", September 2011. http://www.maalot.co.il/data/uploads/pdfs/haarahat_nezilut.pdf
- For information regarding the relationship between the global rating scale and the local rating scale see: "Relationship between the global rating scale and the local rating scale", February 2013. http://www.maalot.co.il/publications/RS20130207103905.pdf
- For information regarding the significance of the credit rating see "Advantages and Limitations of a Credit Rating", May 2012. http://www.maalot.co.il/publications/ART20120529134904.pdf

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List of Ratings

	Current Rating	Previous Rating
Oil Refineries Ltd.		
Issuer Rating	ilBBB Positive	ilBBB Stable
Series A	ilBBB	ilBBB
Series B	ilBBB	ilBBB
Series D	ilBBB	ilBBB