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STANDARD & POOR'S
MAALOT

McGraw Hill Financial

Oil Refineries Ltd.

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December 18, 2013

Rating Update

Rating upgraded to 'ilBBB' due to a marked improvement in the liquidity profile and equity structure

Primary Credit Analyst:

Matan Benjamin, 972-3-7539700 matan_benjamin@standardandpoors.com

Secondary Credit Analyst:

Zvi Boimer, 972-3-7539700 zvi_boimer@standardandpoors.com

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Overview

- In recent months, the Company has taken several measures to substantially improve its liquidity profile, including a new outline of its credit agreements with the banks, a bond issue, and progress on the raising of capital by means of a rights issue that is due to be completed in coming weeks.
- Based on our criteria, we estimate that there has been a significant improvement in the liquidity profile compared with "weak" liquidity that characterized the company at the time of the last rating action. ORL now has sufficient resources to meet its commitments in 2014.
- We estimate that there is less risk that ORL will deviate from the financial covenants in the short term, following a revision of the covenants as part of a new outline of the credit agreements with the banks.
- We have upgraded the rating of Oil Refineries Ltd. (ORL) to 'ilBBB' from 'ilBBB-' and we have also removed the rating from CreditWatch with negative outlook.
- The stable rating outlook reflects our assessment that the Company will be able to create a positive free cash flow by gradually reducing its debt burden, facilitating compliance with a debt to EBITDA ratio that is less than 7.0x, which we consider compatible with the current rating.

Rating Action

- On December 18, 2013, Standard & Poor's Maalot upgraded the rating of Oil Refineries Ltd., a refining and petrochemicals company, to 'ilBBB' from 'ilBBB-', and at the same time removed the rating from CreditWatch with negative outlook list, on which it was placed on October 14, 2013. The rating outlook is stable.

Rationale

The higher rating reflects the Company's improved liquidity profile resulting from several measures taken in recent months. These are expected to increase the Company's sources of finance by USD 500 million over the coming year. The liquidity profile has improved, and according to our criteria liquidity is now defined as "less than adequate", in contrast with "weak" at the time of the last rating action. Accordingly, notwithstanding that there is still room for improvement in the medium term, the liquidity profile does not adversely affect the Company's rating. We estimate that the Company has adequate resources to meet its commitments in 2014. Measures taken by the Company include, inter alia, the following:

- A new outline of credit agreements with the financing banks, in which context short-term, uncommitted credit lines will be replaced by (short-term) committed credit lines until December 31, 2014. Furthermore, the Company obtained the banks' agreement to extend, and even expand, the validity of the existing credit facilities receivables factoring. Based on the outline, the Company has increased its financial resources by USD 250 million.

- Completion of a bond issue in the amount of USD 80 million (with potential for raising a further USD 100 million by January 2014 by means of bond options).

- A rights issue in the amount of USD 120-150 million in coming weeks. The rights issue will be backed by the Israel Corporation (ilA+/Stable), which has announced its intention of participating in the issue with an amount of up to USD 100 million.

Likewise, we estimate that the risk that the Company will deviate from the financial covenants in the near future has been reduced, due to the new outline of the agreements with the financing banks.

In 2013, ORL's operating performance improved as the supply of natural gas began to flow from the Tamar field during the second quarter, and the hydrocracker facility was operated in the first quarter. The improvement was achieved despite an environment of low refining margins and a technical malfunction in one of the service facilities during the second quarter, which affected the Company's production capacity. As part of our basic operating scenario, we anticipate that ORL's operating performance will continue to improve in 2014 as well due to a slight recovery in the refining margins, continuous operation of the Company's plants, including the full, on-going supply of natural gas, and a certain contribution by the recently announced efficiency plan. According to our basic operating scenario, we expect the adjusted debt to EBITDA ratio to be about 8.0x in 2013, and 6.5x in 2014. Leverage, as reflected in the aforementioned financial ratios remains high, but we believe that it is compatible with the current rating.

Liquidity

Following the measures introduced by ORL in recent months, the liquidity profile has improved. According to our criteria, ORL's liquidity is currently defined as "less than adequate", in contrast with "weak" on the date of the last rating action. Despite this improvement, we believe that the liquidity profile is still negatively affected by the high volume of debt repayments in forthcoming years. We estimate that the ratio of financial resources to uses in 2014 will be 1.5x (assuming that the banks recycle the short-term credit lines).

We assume that the principal resources available to the Company as of September 30, 2013, include:

- Cash and cash equivalents of approximately USD 95 million.
- Cash flow from operating activities of approximately USD 250 million in 2014.
- Bond issue of USD 80 million.
- Rights issue of USD 120 million.
- Receipts of USD 30 million from derivative transactions by the end of 2013.
- Expansion of the inventory availability transaction by USD 25 million up by the end of 2013.
- Utilization of (available) committed short-term credit facilities of USD 110 million (valid until December 31, 2014).
- Utilization of available receivables factoring facilities of USD 100 million (valid until December 31, 2014).

Conversely, we assume that the principal uses as of September 30, 2013, include:

- Repayment of approximately USD 474 million of long-term debt by the end of 2014.
- Capital investments of approximately USD 120 million by the end of 2014.
- Dividends – we assume that the company will not distribute dividends in 2014, as agreed with its financers.

Whereas in recent years ORL operated with a limited margin from its financial covenants, and in some cases even deviated from them, we estimate that the risk that it will deviate from the covenants in the near future has been reduced, following a revision of the covenants as part of the new outline of the agreements with the banks.

Outlook

The stable outlook reflects our assessment that ORL will be able to generate positive free cash flow which will support a lower leverage and access to sources of credit as a result of improved operating performance. We consider an adjusted debt to EBITDA ratio of up to 7.0x over time as compatible with the current rating.

Upside scenario

We will consider positive rating action if ORL presents a debt to EBITDA ratio below 6.0x over time, and it continues to maintain its present level of liquidity (at least).

Downside scenario

We will lower the rating if ORL's liquidity profile deteriorates. We could also lower the rating if our revised forecasts indicate that the debt to EBITDA ratio will rise above 7.0x. In our opinion, this scenario is possible if there is an erosion of refining and petrochemical margins, if production is lower than expected, oil prices rise sharply, or due to a dividend distribution policy which is more aggressive than we anticipate in 2015, delaying the process of reducing the debt burden.

Reconciliation

Sector-based distribution: no impact

Equity structure: no impact

Liquidity: no impact

Finance policy: no impact

Management, strategy and corporate governance: no impact

Peer groups: no impact

Related research

- For information about our methodology for examining the liquidity of companies and the effect on rating, see: Methodology – "Assessment of an Issuer's Liquidity", September 2011. The article can be found on the Internet site of Standard & Poor's Maalot at: http://www.maalot.co.il/data/uploads/pdfs/haarahat_nezilut.pdf
- For information about the relationship between global and local rating scales, see: Methodology – "The Relationship Between Global and Local Rating Scales", published February 2013: http://www.maalot.co.il/publications/RS20130207103905.pdf
- For information about the importance of credit rating see article: "Maalot and the Limitations of Credit Rating", published May 2012: http://www.maalot.co.il/publications/ART20120529134904.pdf

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The above articles can be found on the Standard & Poor's Maalot website at www.maalot.com

Ratings list

Oil Refineries Ltd.	Current rating	Previous rating
Issuer's rating	ilBBB/Stable	ilBBB-CW Negative
Series A	ilBBB	ilBBB-/CW Negative
Series B	ilBBB	ilBBB-/CW Negative
Series C	ilBBB	ilBBB-/CW Negative