

# Maalot

**S&P Global** Ratings

## **Bazan Ltd.**

April 3, 2018

### Rating Report

**Confirmation of iIA- rating and revision of the outlook from stable to positive due to improvement of the financial ratios; confirmation of iIA- rating for the rated debentures due to application of debt recovery methodology**

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## **Contents**

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Summary

Rating

Key Rating Considerations

Rating Forecast

Rating Adjustments

Debt Recovery Analysis

Methodology and Related Articles

## Rating Report

### Confirmation of iIA- rating and revision of the outlook from stable to positive due to improvement of the financial ratios; confirmation of iIA- rating for the rated debenture series following application of debt recovery methodology

#### Summary

- 2017 was better than the forecasts for Bazan due to increased utilization of the facilities and high refining and petrochemical margins, inter alia, due to the impact of Hurricane Harvey in the USA, despite shutdown for periodical turnarounds in some of Bazan Group's facilities. 2018-2019 are expected to be more challenging, but in our estimation, by balancing its different needs, including debt repayment and distribution of dividends, Bazan will comply with the coverage ratios that we consider as corresponding with an iIA rating.
- We estimate that there is a strong possibility (1 in 3) that in the coming years Bazan will succeed in presenting a debt to adjusted EBITDA ratio of up to 3.5x without requiring significantly favorable market conditions or a significant cut in investments.
- We hereby confirm the iIA- rating of Bazan Ltd.
- The positive outlook reflects our assessment that Bazan will be able to consistently show an adjusted debt to EBITDA ratio of up to 3.5x by balancing between debt repayment, investment and distribution of dividends also under fluctuating refining market conditions, while maintaining its business positioning and market share.
- We hereby confirm the iIA- rating of Bazan's debenture series following application of debt recovery rating methodology.

#### Rating

On April 3, 2018, S&P Maalot confirmed the iIA- rating of Bazan Ltd, which operates in the refining and petrochemical sectors, and revised the Company's rating outlook from stable to positive. S&P Maalot also confirmed the iIA- rating of Bazan's debenture series.

#### Key Rating Considerations

Bazan's performance in 2017 was better than forecast due to increased utilization of the facilities and high refining and petrochemical margins and despite shutdown for periodical turnarounds in some of Bazan's Group facilities. The improvement in margins was also derived from the impact of Hurricane Harvey, which shut down refining facilities in the south of USA, resulting in an increase in refining margins worldwide. We believe this situation will not continue in 2018 and 2019. 2018 results are also expected to include a one-time payment of USD 75 million for development levy, which has already been made. In 2018, Bazan is also expected to perform periodic maintenance in some of its facilities, which will reduce their availability (88% compared to 93% later). Accordingly, we estimate that if Bazan presented a debt to adjusted EBITDA ratio of 3.0x in 2017, this ratio is likely to be closer to 3.5x or more in 2018. However, balancing between investments, debt repayment and distribution of dividends compared to our forecast may certainly lead to Bazan presenting a debt to adjusted EBITDA ratio lower than 3.5x. This, together with recognition of Bazan's significant liquidity (at the end of 2017 its cash and cash equivalents were USD 400 million), supports our assessment that the Company is likely to continue presenting financial ratios that support a higher rating.

Bazan is exposed to environmental regulatory risks. A significant change in costs required to comply with all regulatory requirements may impair Bazan's financial ratios and lead to deterioration of its revenue if, for instance, it is forced to reduce operations for such compliance. However, under our basic scenario we do not expect any exceptional fines or detrimental changes in Bazan's operations in the coming years. If our basic scenario does not occur, a negative impact on rating is possible.

**Our basic scenario is based on the following key assumptions:**

- Refining margin of USD 6.3 – USD 6.4 per barrel in 2018-2019.
- Oil price of USD 60 per barrel in 2018 and thereafter, USD 55 per barrel.
- Polymer contribution of USD 535 per ton in 2018 and USD 519 per ton in 2019.
- Refining facility availability of 88% in 2018 and 94% in 2019.
- No significant change in demand despite the economic growth of the market against the background of possible moderation in demand for fuels.
- Investments of USD 135 million in 2018 and USD 120 million in 2019. However, we should note that Bazan has investment flexibility and the minimum investment, in our estimation, is USD 65 million.
- Distribution of dividends of USD 100 -130 million in 2018 and USD 60 million in 2019. Bazan has a policy of distributing dividends of at least 75% of the net profit in the previous year, subject to conditions in financing agreements and its internal constraints and decisions. We believe that Bazan may increase or decrease the dividends and investments as it wishes in order to balance all considerations.
- Refinancing of most of Bazan's debt. We estimate that as from 2019, Bazan will take measures to reduce the debt principal by USD 60 million per year.

**Under our basic scenario, the forecast debt coverage ratios will be as follows:**

- Average adjusted debt to EBITDA ratio of 3.5x in the coming years. As noted, in 2018 this ratio may be higher, but Bazan has the financial flexibility required (by balancing between investments, debt refinancing and distribution of dividends) to lower this ratio, bringing about a drop in the average ratio to below 3.5x also without any change in the market conditions.
- Debt to adjusted FFO (funds from operations) ratio is about 20%. Again, this ratio may be slightly lower in 2018, but Bazan has the option to improve it.

**Liquidity**

According to our criteria, Bazan's liquidity is "adequate". We estimate that the ratio between Bazan's resources and uses will be 1.2x in the next 12 months. This estimate is based on the amount of cash and positive FFO, payment of maturities, capital investments and distribution of dividends.

**In our basic scenario, we assume that the resources available to Bazan as of January 1, 2018 are:**

- Cash and marketable financial assets of USD 400 million.
- Operating cash flow of USD 260 million.
- Debt issue of USD 116 million, which was already implemented.

**Our assumptions regarding Bazan's uses as of January 2018 are:**

- Repayment of working capital facilities of USD 235 million.
- Repayment of long term debt principal of USD 224 million.
- Minimum investment of USD 65 million.
- Distribution of dividends of USD 120 million.

Note that in view of Bazan's intention to refinance the full amount of the credit paid up this year, its dividend policy and its access to credit markets and the banking sector, we expect it to issue a greater volume of debt than raised until now this year, and to renew its working capital facilities. In such a situation, its investments will increase to USD 130 million.

## Rating Forecast

The positive rating outlook reflects our estimate that Bazan will be able to consistently present a debt to adjusted EBITDA ratio of up to 3.5x through the balancing between debt repayment, investments and distribution of dividends, even in fluctuating refining market conditions and maintaining the stability of its business and market share.

### Negative Scenario

We may consider a negative rating action if the Company consistently presents a debt to adjusted EBITDA of higher than 4.5x, if the resource to uses ratio is lower than 1.2x or in case of concern of a breach of a financial covenant. Such action may stem from an aggressive financial policy, e.g. high investments, distribution of high dividends or market changes, such as decreased refining margins or stiffening of regulatory requirements.

### Positive Scenario

We may increase the Company's rating by one notch if it succeeds in presenting a debt to adjusted EBITDA of lower than 3.5x throughout the business cycle and maintaining adequate liquidity. Bazan can balance its different needs and adjust itself to fluctuating market conditions, and we believe there is a reasonable possibility (at least 1 in 3) that it will present such results.

## Rating Adjustments

Sectoral diversification: Unaffected

Capital structure: Unaffected

Liquidity: Unaffected

Financial policies: Unaffected

Administration, strategy and corporate governance: Unaffected

Comparison with benchmark groups: Unaffected

## Debt Recovery Analysis

### Key Considerations

- We are setting an iIA- rating for Bazan's debenture series, the same as the issuer rating. The debt recovery rating for these series is 4 and reflects our estimation that given a hypothetical default scenario, the debt recovery rate will be 30%-50% (in the lower part of the range).

### Key Assumptions for a Hypothetical Default Scenario

- Year of occurrence of a hypothetical default scenario: 2021
- A sharp increase in oil prices, a steep decline in refining margins, and an unplanned and prolonged shutdown of some of the production facilities in parallel with the need for debt refinancing will lead to an acute impairment of revenue, and to default.
- Bazan will continue to operate as a going concern, an assessment supported by the importance of the Company as the supplier of 60% of the market demand for liquid fuel.
- During the hypothetical deterioration of the Company's position, it will use 85% of its credit facilities.

### Basic waterfall payments at the time of the default

- Going concern value (gross) based on value of assets: USD 630 million
- Estimated of secured debt recovery: 30%-50% (in the lower part of the range)
- Secured debt recovery rating (1 to 6). 4

### Impact of estimated debt recovery on the debt rating the issuer rating compared to

Estimated debt recovery %	Description	Debt recovery score	Series rating above/below the issuer rating
100%	Full return forecast	+1	+3 notches
90%-100%	Extremely high debt recovery	1	+2 notches
70%-90%	High debt recovery	2	+1 notch
50%-70%	Significant debt recovery	3	0 notches
30%-50%	Average debt recovery	4	0 notches
10%-30%	Modest debt recovery	5	-1 notch
0%-10%	Negligible debt recovery	6	-2 notches

Debt recovery ratings are limited in certain countries to take into account low debt recovery prospects in those countries. Recovery ratings of unsecured debt issues are also usually limited (for further information see Step 6, paragraphs 90-98 of Methodology: Recovery Rating Criteria for Speculative-Grade Corporate Issuers, December 7, 2016).

### Methodology and Related Articles

- Methodology: Use of CreditWatch and Outlooks, September 14, 2009
- Methodology: Management and Governance Credit Factors for Corporate Entities and Insurers, November 13, 2012
- Methodology - General: Timeliness of Payments, Grace Periods, Guarantees, and Use of 'D' and 'SD' Ratings, October 24, 2013
- Methodology: Corporate Methodology, November 19, 2013.
- Methodology: Corporate Rating - Financial Ratios and Adjustments, November 19, 2013.
- Methodology: General Corporate Rating Methodology, November 19, 2013.
- Methodology: Country Risk Assessment Methodology, November 19, 2013.
- Methodology: Industry Risk, November 19, 2013.
- Rating Scales and Definitions: National and Regional Scale Credit Ratings, September 22, 2014.
- Methodology: Key Credit Factors for the Commodity Chemical Industry, December 31, 2013.
- Methodology: Key Credit Factors for the Oil Refining and Marketing Industry, March 27, 2014.
- Methodology: Methodology for Applying Recovery Ratings to National Scale Issue Ratings, September 22, 2014.
- Methodology and Assumptions: Liquidity Descriptors for Global Corporate Issuers, December 16, 2014.
- Methodology Recovery Rating Criteria for Speculative-Grade Corporate Issuers, December 7, 2016.
- Rating Scales and Definitions: S&P Global Ratings' National and Regional Scale Mapping Tables, August 14, 2017.
- S&P Global Ratings Definitions, June 26, 2017.
- Opinion and Interpretation: Connection between Global Rating Scale and Israeli Rating Scale, January 25, 2016.

## General Information (as at April 3, 2018)

### Bazan Ltd.

#### Issuer Rating

Long term ilA-\Positive

#### Issue Rating

##### Unsecured senior debt

Series A, D, E, F, G, I ilA-

March 2004 Series, index linked, maturity in 2019 ilA-

November 2004 Series, maturity by 2019 ilA-

#### Issuer Rating History

Long term

April 3, 2018 ilA-\Positive

April 9, 2017 ilA-\Stable

May 31, 2016 ilBBB+\Positive

May 14, 2015 ilBBB+\Stable

December 29, 2014 ilBBB\Positive

December 18, 2013 ilBBB\Stable

October 14, 2013 ilBBB-\Watch Neg

December 2, 2012 ilBBB+\Negative

May 6, 2012 ilBBB+\Stable

November 30, 2011 ilA-\Watch Neg

March 25, 2010 ilA-\Stable

July 7, 2009 ilA\Negative

April 23, 2009 ilA\Watch Neg

December 11, 2008 ilA\Negative

November 11, 2007 ilAA\Stable

March 1, 2003 ilAA

September 21, 1992 ilAAA

#### Additional details

Time of occurrence of event April 3, 2018 1:39 PM

Time event first became known April 3, 2018 1:39 PM

Rating ordered by Rated Company

We regularly monitor developments that may affect the credit rating of issuers or specific debenture series that we rate. The purpose of the monitoring is to ensure that the rating is constantly updated and to identify the parameters that may lead to a rating change.

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