Standard & Poor's

Maalot

S&P Global

Bazan Ltd.

May 31, 2016

Rating Report

Confirmation of ilBBB+ rating and revision of the outlook to positive due to expectation of further compliance with the cover ratios corresponding with a higher rating

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Content

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Summary:

- The operating results of Bazan Ltd. ("Bazan") continued to being strong also in 2015, following the positive trend that began in 2014. The operating results were positively affected by the significant improvement in market conditions in the refining and polymer sectors, the application of streamlining measures and utilization of market opportunities for optimal purchase of raw materials.
- We forecast moderation of Bazan's profit margins in 2016 due to the decline in market conditions particularly in the refining sector and periodic maintenance of a large part of the production facilities of the Company and of its subsidiaries, Carmel Olefins and Gadiv.
- Due to the improved operating results, there has been an improvement in the debt cover rations in 2015. The adjusted debt to EBITDA ratio at the end of 2015 was 2.8x compared with 4.3x at the end of 2014. We expect that the adjusted debt to EBITDA ratio will be 4.0x - 4.5x in 2016, due to the foregoing forecast of profit margin moderation.
- We hereby confirm the ilBBB+ rating of Bazan Ltd. ("Bazan") that operates in the refining and petrochemical sector and at the same time, we are revising the outlook from stable to positive.
- Revising the rating outlook to positive reflects our assessment that Bazan is able to maintain an adjusted debt to EBITDA ratio of up to 4.5x throughout the entire course of business, by maintaining a conservative financial policy for balanced management of liquidity and balanced dividend distribution policy.

Rating

On May 31, 2016 Standard & Poor's Maalot confirmed the ilBBB+ rating of Bazan Ltd., which operates in the refining and petrochemical sectors. Concurrently, S&P Maalot revised the Company's rating outlook from stable to positive.

Key Rating Considerations

Revising the rating outlook to positive reflects our assessment that Bazan is able to maintain an adjusted debt to EBITDA ratio of up to 4.5x throughout the entire course of business, by maintaining a conservative financial policy for balanced management of liquidity and balanced dividend distribution policy.

The operating results of Bazan continued to be strong also in 2015, following the positive trend that began in 2014. The operating results were positively affected by the improvement in market conditions in the refining and polymer sectors, continuing application of the streamlining measures and utilization of market opportunities for optimal purchase of raw materials. The Company's net average refining margin in 2015 was USD 9.2 per barrel compared with USD 6.4 per barrel in 2014. The Company's adjusted EBITDA was USD 680 million in 2015 compared with USD 430 million in 2014. The decline in crude oil prices from USD 100 per barrel in 2014 to USD 50 per barrel in 2015 contributed to Bazan's financial flexibility and allowed it to reduce its investment in working capital and decrease the scope of short term credit utilization (at the end of 2015 it utilized USD 83 million of overall committed facilities of USD 485 million). Due to the foregoing factors, the debt to adjusted EBITDA ratio at the end of 2015 was 2.8x compared with 4.3x at the end of 2014. Since the fourth quarter of 2015, a moderating trend has been recorded in the market conditions primarily in the refining sector. The Company's average net refining margin in the first quarter of 2016 was USD 6.8 per barrel. In addition, in 2016 the Company and its subsidiaries Carmel Olefins and Gadiv are expected to carry out periodic maintenance on their production facilities, which includes among other things, shutdown of each of the units undergoing maintenance for an expected 35 to 50 days.

Under our basic operational scenario, we estimate that the Company's representative refining margin will be USD 6.0 - 7.0 per barrel in the short and mid term. We estimate that the performances of the polymer division will remain relatively stable due to supportive market conditions and continued application of the streamlining measures. Due to the periodic maintenance, we estimate that utilization of the production capacity of the refining facilities will be 85% in 2016. Based on S&P's updated forecasts from January 2016, we estimate that the average price of crude oil in 2016 will be USD 40 per barrel and USD 45 per barrel in 2017. We estimate that the Company will be required to increase its investment in working capital in 2016 as part of its preparations for the maintenance work. Furthermore, in view of public pressure with regard to Haifa Bay air pollution and Bazan's alleged part in generating such pollution, we estimate that the Company is likely to encounter heavy regulatory pressures for further investment to decrease emissions from its plants. As at the end of the first quarter of 2016 the Company has not complied with the conditions set out in its agreement with the financiers for distributing dividends. Nonetheless, it is possible that later in 2016 the Company will meet the required conditions and therefore, according to our basic scenario, we have included distribution of a dividend of 75% of the net profit in accordance with its official policy. Based on these assumptions, and assuming an expected loss of profits due to the periodic maintenance, we forecast that the Company's adjusted EBITDA will be USD 370 - 410 million in 2016.

Our basic scenario is based on the following key assumptions:

- Utilization of refining facilities' production capacity in 2016 will be 85%;
- Refining margin of USD 6 - 7 per barrel;
- Capital investments in 2016 of USD 200 - 220 million, mainly due to the periodic maintenance of facilities during this year;
- Investment in working capital of USD 100 million in 2016 in preparation for the maintenance work;
- Distribution of 75% of the net profit.

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

- Debt to adjusted EBITDA of 4.0x - 4.5x;
- FFO (funds from operations) to adjusted debt of 15% - 20%.

Liquidity

We estimate that Bazan's liquidity will be "less than appropriate". We estimate that the ratio between Bazan's available resources and its needs in 2016 will be 1.0x (facilities for short term credit and factoring of trade receivables are signed until the end of the year and therefore they are included in the 'uses' for the purpose of this calculation).

We assume that the Company's financial flexibility has improved due to the fact that the Company has extended its debt duration in recent years, the low utilization of the short term commited facilities and its substantial available supplier credit (which are directly linked to the low oil price).

Notwithstanding the aforesaid improvement, we assume that the liquidity profile is still adversely affected by high debt repayments in the coming years and the high inherent volatility in its operational performance.

In our basic scenario we assume that the resources available to the Company at January 1, 2016 are:

- Cash and cash equivalents of USD 310 million;
- FFO of USD 330 million through to the end of 2016;
- Raising of long term capital consisting mainly of debentures in a total amount of USD 170 million (executed as of date of the report);

On the other hand, our assumptions regarding the Company's uses as at January 1, 2016 are:

- Repayment of long term debt of USD 270 million by the end of 2016;
- Capital investments of USD 200 - 220 million by the end of 2016;
- Investment in working capital of USD 100 million in 2016;
- Repayment of short term bank credit and factoring of trade receivables facilities of USD 220 million (we assume repayment for liquidity purposes only);
- Distribution of a dividend of 75% of the net profit for 2016;

While in recent years Bazan operated very close to its financial covenants and even breached them several times we estimate that, due to the updating of its covenants carried out in 2015 and due to its improved performances, the risk of breaching the financial covenants in the short term has decreased.

Rating forecast

The positive rating outlook reflects our estimate that Bazan will retain its leading position in the energy market in Israel and will also maintain a debt to adjusted EBITDA ratio of up to 4.5x throughout the entire business cycle, also in the years during which it carries out periodic maintenance repairs and when the market conditions will be challenging. The positive rating outlook also reflects our expectations that the Company will maintain its conservative policies with regard to liquidity management and a balanced dividend policy. We still perceive a debt EBITDA ratio that remains below 6.0x as appropriate for the current rating, i.e. rating of ilBBB+.

Positive Scenario

We will consider raising the rating if our forecasts indicate that Bazan will continue presenting a cover ratio that is consistent with the ratio we defined as appropriate for a higher rating, i.e. debt to adjusted EBITDA ratio of up to 4.5x, while continuing to maintain a conservative financial policy for managing liquidity and balanced distribution of dividends.

Negative Scenario

We will consider changing the rating outlook to stable if the Company fails to present a cover ratio that is consistent with the ratio we defined as appropriate for a higher rating over the coming year, as defined above. We will consider a negative rating if the Company fails to comply with cover ratios that are consistent with the current rating, as defined above. In our opinion, such scenario could occur if there will be erosion of the refining and petrochemical margins, lower than expected productivity due to technical malfunctions, sharp rise in oil prices or application of an aggressive dividend policy. We may also take negative rating measures if Bazan's liquidity profile fluctuates.

Rating adjustments

Sectoral diversification: Unaffected

Capital structure: Unaffected

Liquidity: Unaffected

Financial policies: Unaffected

Administration, strategy and corporate governance: Unaffected

Comparison with benchmark groups: Unaffected

Methodology and related articles

- **Opinions and Interpretations: The connection between the global rating scale and the domestic rating scale**, January 25, 2016.
- **Methodology - General: Domestic credit rating scales**, September 22, 2014
- **Methodology - Core Articles: General methodology for corporate rating**, November 19, 2013
- **Methodology - methodological framework for rating non-financial companies**, February 24, 2014
- **Methodology - General: Criteria for issue rating of non-financial corporations on Standard & Poor's Maalot domestic scale**, September 22, 2014
- **Methodology - Core Articles: Methodology for assessing the liquidity profile of companies**, December 16, 2014
- **Methodology: Corporate ratings - Financial ratios and adjustments**, November 19, 2013
- **Methodology: Rating of a corporate group**, November 19, 2013
- **Methodology - General: The use of the rating outlook and CreditWatch**, September 14, 2009
- **Methodology - Timing of payments, periods of grace, guarantees and the use of D (payment default) and SD (selective default) ratings**, October 24, 2013
- **Methodology - General: Definitions of S&P's ratings**, February 1, 2016
- **Methodology - General: Conversion tables for S&P's global rating scales and domestic rating scales**, January 19, 2016
- **Key factors in rating of companies in the construction material industry**, November 19, 2013
- **Methodology: Key factors in rating of companies in the fuel refining and marketing industry**, November 19, 2013

General information (as at May 31 2016)

Bazan Ltd.	
Issuer Rating	
Domestic Rating - long term	ilBBB+/Positive
Issue Rating	
<u>Senior unsecured debt</u>	
Series A	ilBBB+
Series D	ilBBB+
Series E	ilBBB+
Series F	ilBBB+
Series G	ilBBB+
March 2004 Series, index linked, maturity in 2019	ilBBB+
November 2004 Series, maturity by 2019	ilBBB+
Issuer Rating History	
Domestic Rating - long term	
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	May 31, 2016 11:15 AM
Time event first became known	May 31, 2016 11:15 AM
Rating ordered by	Rated Company