STANDARD & POOR'S Maalot

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November 30, 2011

Oil Refineries Ltd.

'ilA-' Rating Placed On CreditWatch With Negative Implications On Weak Performance And Increased Debt

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Overview

- We believe that refining margins, recently returned to their lowest levels since 2009, while oil has reached $100-$110 a barrel, are unlikely to recover significantly in 2012.
- Israel-based oil refiner and petrochemical company, Oil Refineries Ltd., reported weaker financials than we forecast in the third quarter, while its debt increased markedly.
- We are placing the 'ilA-' corporate credit rating on Oil Refineries Ltd. on CreditWatch with negative implications.
- We aim to resolve the CreditWatch within the next few weeks, after receiving updated information from the company regarding its financial flexibility and ability to generate cash flow, while maintaining a debt-to-EBITDA ratio of no more than 6.0x in 2012.

Rating Action

On Nov. 30, 2011, Standard & Poor's Maalot placed its 'ilA-' corporate credit rating on Israel-based oil refiner and petrochemical company, Oil Refineries Ltd. (ORL), on CreditWatch with negative implications.

Rationale

The CreditWatch placement reflects our view that the weak refining margins witnessed in the past six months may continue to some extent through 2012. We would consider downgrading ORL in the coming weeks if we conclude that the company has limited ability to deleverage to levels we consider commensurate with an 'ilA-' rating, i.e. a ratio of debt to EBITDA of no more than 6.0x in 2012.

In the nine months to Sept. 30, 2011, ORL's EBITDA, adjusted by S&P Maalot, reached $112 million, compared with our forecast of $304 million for the full year 2011. Moreover, we understand that the petrochemical division, which supported the consolidated EBITDA in the first half of 2011 with exceptional margins, returned

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to more historically moderate levels in the second half. As a result, we anticipate that EBITDA will likely be in the range of $20 million-$30 million in the fourth quarter, bringing the full year EBITDA, in our view, to $130 million-$145 million.

The combination of weaker-than-expected EBITDA and dearer crude oil has pushed our forecasts for ORL's adjusted debt to $2.8 billion as of Dec. 31, 2011 compared with our previous forecast of $2.6 billion. In our view, the debt level could have been higher had the company not acted to reduce its inventory levels. In our rating scenario we see debt-to-EBITDA exceeding 20x by the end of 2011, compared to our previous forecast of 8.5x.

As we stated in our last publication, we still put extra weight on ORL's results after the hydrocracker commissioning, together with the company's use of natural gas and other complementary projects being in place. As a result, the company's ability to finalize the program on time, without ramp-up issues, remains a main driver for the rating. We understand that the hydrocracker construction is on track and expected to start contributing in the second half of 2012.

On top of these ongoing issues, we estimate the probability that the eurozone will return to recession at about 40% (see "Economic Research: The Specter Of A Double Dip In Europe Looms Larger," published Oct. 4, 2011). We believe such a scenario would dampen demand for diesel in Europe and would support a prolonged period of low cracking margins. Under this scenario, we believe that ORL would find it harder still to reach coverage ratios that we consider commensurate with the current rating.

Liquidity

Based on our criteria, we assess ORL's liquidity as less than adequate. We estimate that the ratio of sources of liquidity to uses of liquidity will be below 1.0x over the next 15 months, assuming the company does not manage to refinance its short-term credit. Our assessment reflects: material capital expenditure (capex) which cannot be curtailed; and limited cash flow from operations. At this stage, we don't see liquidity as a constraint for the current rating. We understand that the company intends to renew its committed credit facilities of more than $650 million in 2012.

Under our prudent assumptions for the refining cracking margins in 2012, and under the current working-capital level, we project the following sources of liquidity as of Sept. 30, 2011:

- $135 million of cash, of which about $50 million are tied, in our view, to operations;
- $450 million of available committed facilities under the ECA and domestic syndicate agreements;
- Cash flow from operations of about $280 million in 2012.

We project that the uses of liquidity as of Sept. 30, 2011 include:

- $900 million of short-term credit lines and utilized amounts under the receivables program, out of total facilities of $1.1 billion. While we regard the short-term debt against crude oil as having low refinance risk, the banks' lack of pledges increases the refining risk;
- Refinancing long-term maturities of $53 million in the fourth quarter of 2011 and about $193 million in 2012;

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- $400 million-$450 million of capex;
- Working capital investment: We project no significant change in working capital, in line with the company's policy of maintaining inventories in 2012 at their current levels, and assuming oil trades at $110 a barrel. Restoring inventory to historical levels of 1.2 million tons will require, in our opinion, further investment of $100 million-$150 million;
- Dividend: Minimal dividend distribution in 2012.

We understand that in September 2011 ORL received a waiver until the end of 2012 regarding its financial covenants under the capex program financial package. While we believe the banking system has strong incentives to ensure the completion of the capex program, the limited headroom under the financial covenants may push ORL to diversify its liquidity sources.

In addition, while a $350 million contract with the Yam Tethys Partnership decreases the reliance on one gas supplier, we believe it also places an additional liquidity burden on the company in the short term (additional uses of $110 million-$130 million in the next 18 months), assuming that the natural gas supply from Egypt flows freely.

We view the financial profile of shareholder Israel Petrochemical Enterprises (IPE; 30.7%; not rated) as a constraint on ORL's liquidity, given the need to distribute dividends to serve IPE's high debt levels. As a result, we have factored in maximum dividend distributions under ORL's financial covenants (50% of net profit) from 2013.

CreditWatch

We aim to resolve the CreditWatch within the next few weeks, after receiving updated information from the company regarding its financial flexibility and its ability to generate cash flow that will support a debt-to-EBITDA ratio of 6.0x in 2012 under two scenarios:

- Base case scenario: modest recovery of refining margins in 2012;
- Double dip scenario in 2012.

Currently we believe that any negative rating action will be limited to one notch.

Ratings List

	To	**From**
Oil Refineries Ltd.	ilA-/Watch Neg	ilA-/Stable
Private series	ilA-/Watch Neg	ilA-
Series A	ilA-/Watch Neg	ilA-
Series B	ilA-/Watch Neg	ilA-
Series C	ilA-/Watch Neg	ilA-

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