STANDARD & POOR'S Maalot

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May 31, 2011

Oil Refineries Ltd.

'ilA-' Ratings Affirmed On Continued Progress Of Investment Plan; Outlook Stable

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Overview

- The refining industry continues to be at the bottom of its business cycle, and this is likely to remain so, in our opinion, in the second half of 2011.
- The company has completed building the mild hydrocracker and has begun using natural gas, while the full hydrocracker will be completed in 12 months time; on completion of its investment plan, the company is likely to see a material improvement in its business position.
- We are affirming the 'ilA-' rating for Oil Refineries Ltd. (ORL), which operates in refining and petrochemicals.
- The stable outlook reflects a balance between the advanced stage of the company's investment plan and the weakness of the refining industry, which will be seen in the relative weak performance in the coming quarters, and in the debt coverage ratios which are higher than we consider commensurate with the current rating.

Rating Action

On May 30, 2011, Standard & Poor's Maalot affirmed its 'ilA-' corporate credit rating on Israel-based oil refiner and petrochemical company, Oil Refineries Ltd. (ORL). The outlook is stable.

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Please note that this translation was made for the company's use only and under no circumstances obligates Maalot. In the case of any discrepancy with the official Hebrew version published on May 30, 2011, the Hebrew version shall apply.

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Rationale

The rating on ORL reflects our view of the company's dominant position as the largest refinery in Israel (accounting for some two thirds of the refinery market); the partial integration of its petrochemical and aromatic activities; and the contribution expected on completion of the company's investment plan by mid 2012. The rating is constrained however by: the company's leveraged capital structure; a very weak refining environment; rising price of oil and volatility in working capital demands; dividend pressure from shareholders; construction risks; and its being a single-asset company.

We believe that the refining market in Europe still faces structural challenges, including material refining capacity while loss-making refineries still operate. We believe these structural problems will likely continue to support weak refining margins in the next 18 months. In addition, the uncertainty regarding the European economic recovery will likely encourage more volatility: in the last four quarters the URAL Med Crack swung between $7/bbl to -$4/bbl. In our base case scenario, we continue to assume that the URAL Med, which serves as a benchmark to the local refiners, will be around $2.0-$2.5/bbl in the years 2011-2012 (after having averaged $2.90 in 2010).

The completion of other projects in the company's investment plan (exploiting the synergy with Carmel Olefins and the completion of the full hydrocracker) is likely, in our opinion, to lead to a significant improvement in ORL's business profile in comparison to its European peers. However, we continue to factor in the construction and integration risks. In determining the current rating, we have assumed no change in the group's strategy, following changes in the company's senior management.

In the last four quarters, ORL's adjusted EBITDA was $205 million, compared with $226 million in 2009 (taking 100% of Carmel Olefins). We consider these results to be weak, even if excluding the refinery's periodical turnaround. However, at this stage, we give great weight to contributions expected in the near future on completion of the investment plan, while the current level of activity is likely to continue to perform relatively weakly.

Against a background of rising crude oil prices and intensive capital expenditure investment through 2010, ORL's (adjusted) financial debt reached $2.6 billion in March 2011. We believe that debt will likely remain at this level in the coming quarters (under the assumption of Brent settling at $100-$110/bbl level in 2011 and 2012). We anticipate that debt to EBITDA will likely reach 8.5x in 2011 and 6.0x in 2012, higher than our previous expectations due mostly to the rise in the price of crude oil. We would consider lowering the rating if the company were to enlarge its current capital expenditure program materially (investing in a power plant or overseas expansion) or in the event of higher demand for working capital, which would limit the company's ability to reduce its debt coverage ratios significantly until the end of 2013.

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 18 months. Our assessment reflects: material amount of

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short-term debt under ORL's uncommitted credit facilities; material capital expenditure, which cannot be curtailed; and limited cash flow from operations. At this stage, we don't see the liquidity as a constraint for the current rating.

Under our prudent assumption for the refining cracking margins in 2011-2012, and under the current working-capital level, we project the following sources of liquidity as of Dec. 31, 2010:

- $700 million of available committed facilities under the ECA (export credit agency) and domestic syndicate agreements.
- Inventory surpluses of $300-$350 million (above 1.2 million tons). During the first quarter of 2011, ORL de-stocked most of its inventory surpluses ($200-$250 million), which it used to finance working capital needs.
- Cash flow from operations of about $190 million in 2011 and about $300 million in 2012.

We project the following uses of liquidity as of Dec 31, 2010:

- $780 million of short-term debt and utilized amounts under the receivables program (which we view as short-term financing), 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 $176 million a year.
- $400-$450 million of capital expenditure program over the next 24 months.
- Dividends of several million dollars in 2012.

In addition, while the agreement with the Yam Tethys Partnership decreases the reliance on one supplier, we believe it also places an additional liquidity burden of $350 million on the company in the short term (and additional uses of $120-$150 million in the next two years), assuming that the natural gas supply from Egypt will resume shortly.
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.

Outlook

The stable outlook reflects the advanced phase of ORL's capital expenditure program and the current low cracking margin environment, which suggests limited likelihood of higher coverage ratios in 2011 and in 2012 than what we would deem commensurate with an 'ilA-' rating. In our view, under our prudent assumption for refining cracking margins, ORL will likely be able to finalize its capital expenditure program in the third quarter of 2012 and meet shareholders' dividend needs without a significant increase in the debt burden or debt to EBITDA ratio rising above 6.0x in 2012.
A positive rating action is possible upon the completion of the hydrocracker construction and a recovery in the cracking margins, which would support debt to EBITDA of about 4.0x-5.0x.
Conversely, negative rating pressure could arise if ORL were to add further material layers to its investment program (such as a power plant or acquiring

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activities abroad) together with an aggressive dividend policy, which would support high debt ratios for longer periods. Furthermore, the company's increased dependence on short-term debt could also put downward pressure on the rating.

Ratings List

	Current rating
Oil Refineries Ltd.	ilA-/Stable
Private series	ilA-
Series A	ilA-
Series B	ilA-
Series C	ilA-