March 21, 2018

FITCH Affirms ICL's BBB- Rating with a Stable Outlook

The Company hereby reports that Fitch Ratings ("Fitch") has affirmed the company's Long-Term Issuer Default Rating (IDR) at BBB- with a Stable Outlook.

The Fitch report is attached.

Name of the authorized signatory on the report and name of authorized electronic reporter: Lisa Haimovitz
Position: SVP, Global General Counsel and Company Secretary
Signature Date: March 21, 2018

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<u>Fitch מאשררת את דירוג האשראי -BBB של כיל עם תחזית יציבה</u>

החברה מתכבדת להודיע כי, חברת דירוג האשראי פיץ', אישררה את דירוג האשראי הבינלאומי של החברה ל-BBB- עם תחזית דירוג יציבה.

דוח הדירוג מצורף.

שם מורשה חתימה על הדוח ושם מורשה חתימה אלקטרונית: לייזה חיימוביץ
תפקידה: סמנכ"ל בכיר, יועצת משפטית גלובאלית ומזכירת חברה
תאריך החתימה: 21 במרץ 2018.

FITCH AFFIRMS ISRAEL CHEMICALS AT 'BBB-'; OUTLOOK STABLE

Fitch Ratings-London/Moscow-21 March 2018: Fitch Ratings has affirmed Israel Chemicals Ltd's (ICL) Long-Term Issuer Default Rating (IDR) at 'BBB-' with a Stable Outlook. Fitch has simultaneously affirmed the senior unsecured rating of ICL's USD800 million 4.5% senior unsecured notes due 2024 at 'BBB-'.

The rating affirmation reflects ICL's comfortable positioning within the current rating guidelines, as its funds from operations (FFO) net adjusted leverage (leverage) should decline to below 3x in 2018 aided by the planned USD1 billion divestment of the fire safety and oil additives business. Leverage should fall towards 2.5x over the next three years underpinned by manageable capex, continued cost-saving efforts in its commodity business, and by growth in advanced crop nutrition and specialty chemicals. Accordingly, ICL's progress in implementing growth and optimisation initiatives across its business segments remains of central importance for the pace of deleveraging.

KEY RATING DRIVERS

Cost Savings Key in Fertilisers: ICL's Essential Minerals division reported broadly flat sales and earnings in the potash segment with a 20% operating margin, but faced further weakness in the already under-pressure phosphate segment where margins remain in the single digits. We forecast potash prices will be flat in 2018 against the previous year, and a USD10/ton annual drop in 2019-2020 until prices reach the longer-term USD200/ton equilibrium. We therefore expect ICL's potash margins to fall by 2pp-3pp by 2020 as price pressure is mitigated by ICL's shift to polysulphate in the UK from 2018, improved logistics in Spain and further optimisation at its Dead Sea operations.

ICL's phosphate operations include Israeli-based phosphate production located on the upper part on the global phosphoric acid cost curve and the joint venture (JV) in China, which is on track to start generating neutral or positive operating margins from 2018. The JV cost-cutting remains critical for ICL's overall phosphate margins to recover towards the double-digit level by 2020 as Chinese operations are shifted further away from commoditised phosphate-based fertilisers towards specialised phosphate-based products. ICL's plans to further expand its specialty fertiliser segment through developing advanced crop nutrition solutions may also add to Essential Minerals' cash flows.

Specialty Chemicals Resilient: ICL's recently announced sale of the fire safety and oil additives business is expected by the company to be finalised later in 1H18. It will lead to a USD110 million to 120 million operating income reduction, or approximately 2pp margin reduction in the ICL's specialty chemicals business from 2H18. We view the divestment as part of ICL's strategy of disposing of less operationally integrated businesses. It should also improve the company's credit profile as we expect most of the USD950 million cash proceeds to be used for debt reduction which, will equate to almost one-third of the end-2017 USD3 billion net debt amount.

In March 2018 ICL restated its focus on growth in the specialty chemicals business, aiming at above-market top-line growth and margin improvement. In our forecasts, we conservatively assumed specialty chemicals volumes to increase in line with global GDP and to see low single-digit price increases. We also expect operating margins to return to 20% from around 18.5% (excluding the divested business) as research and development (R&D) activities across the less dispersed specialty product portfolio start to gradually pay off. Overall, we expect the specialty chemicals business to continue generating 46%-48% of sales and nearly 55% of operating income.

Divestments and Lower Capex: Nearly USD1.2 billion in cash proceeds from 2017-2018 divestments will allow ICL to reduce its net debt to USD2.1 billion-USD2.2 billion at end-2018 from around USD3.0 billion-USD3.3 billion in 2015-2017, with leverage falling to 2.8x from above 3x during 2015-2017. We expect the debt levels to remain under control as ICL's move away from capital-intensive growth will allow it to keep capex manageable at below USD700 million per annum, made up mainly of USD400 million-USD500 million maintenance capex and bolt-on optimisation initiatives, underpinning positive pre-dividend free cash flow (FCF) generation.

Lower Dividend Payout Expected: We do not anticipate ICL will revert to its previous 70% dividend payout ratio and forecast a 50% payout in the future. This leads to marginally negative FCF and net debt remaining within the USD2.2 billion-USD2.3 billion range over the coming years. However, ICL's progress with cost optimisation underpins our forecast of operational cash-flow growth and deleveraging towards 2.6x-2.5x in 2020-2021. Should ICL revert to a 70% payout in 2020, this would marginally increase its leverage, by 0.1x in 2020 and by 0.2x in 2021.

DERIVATION SUMMARY

ICL's business profile is a combination of relatively volatile fertiliser and resilient specialty chemicals segments. ICL's Essential Minerals division has a higher exposure to specialty fertilisers, comparable margins but smaller scale than its US fertiliser peer The Mosaic Company (BBB-/Stable), and weaker cost positioning across its fertiliser products than its EMEA peers PJSC PhosAgro (BBB-/Stable) and OCP S.A. (BBB-/Negative). ICL's Specialty Solutions has stronger margins but weaker scale and brand recognition than its EMEA specialty peers with concentrated end-markets, such as Akzo Nobel N.V. (BBB+/RWN) or Royal DSM N.V. (A-/Stable).

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
- commodity fertiliser pricing aligned with Fitch's global fertiliser price assumptions
- potash cost savings due to shift to polysulphate in the UK from 2018 and improved logistics in Spain from 2019
- phosphate operating margin improvement to above 10% by 2020 on the Chinese JV transformation
- specialty chemicals volumes to track global GDP growth with margin improvement towards 20% by 2020
- annual capex within the USD600 million - 700 million range and dividend payouts at 50%
- USD950 million proceeds from the fire safety and oil additives business sale in 2018 and no further M&A activities

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
- Positive FCF translating into FFO adjusted net leverage sustained at/or below 2.5x

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Negative FCF leading to FFO adjusted net leverage above 3.5x
- Market pressure leading to sustained margin deterioration with EBITDAR margin falling below 15%

LIQUIDITY

Strong Liquidity, Healthy Profile: ICL's end-2017 liquidity was strong as its committed undrawn credit lines remain consistently above USD1 billion (end-2017: USD1,568 million) and comfortably cover its short-term debt (end-2017: USD822 million, including a USD331 million receivables securitisation facility).

Fitch expects ICL to maintain its healthy debt maturity profile underpinned by its proven access to long-term funding from international financial institutions and public debt markets.

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Summary of Financial Statement Adjustments
- An 8x multiple was used to capitalise USD50 million of operating leases as ICL is based in Israel
- USD64 million in-the-money foreign-currency and interest-rate swap was deducted from long-term debt
- EBITDA was adjusted up by USD23 million for various non-recurring P&L items
- Cash flow from operations and working capital excludes USD45 million of non-recurring provision changes

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017)
https://www.fitchratings.com/site/re/901296
Exposure Draft: Corporate Rating Criteria (pub. 14 Dec 2017)
https://www.fitchratings.com/site/re/907387

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