FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Leviathan Bond Ltd's Notes 'BB'; Outlook Stable

Fri 21 Aug, 2020 - 8:50 AM ET

Fitch Ratings - London - 21 Aug 2020: Fitch Ratings has assigned Leviathan Bond Ltd's USD2.25 billion notes due between 2023 and 2030 a 'BB' rating. The Outlook is Stable.

RATING RATIONALE

The rating reflects the project's high quality reserves, the use of commercially proven technology and strong operating set-up, with Noble Energy Mediterranean Ltd providing day-to-day operating services.

At the same time, the offtake base limits the rating as we view the two largest offtakers, Dolphinus Holdings Limited in Egypt and National Electricity Production Company (NEPCO) in Jordan, which is backed by the Government of Jordan, as having below investment grade credit standing. The Israeli offtake is diversified and we view the risk of contract renewal as low.

The project debt is structured as staggered bullet maturities, which are expected to be partially refinanced. This allows for some deleveraging, but exposes the project to a degree of refinancing risk, although there is a cash reserving mechanism.

KEY RATING DRIVERS

Diversified Offtake Base, Exposure To Lower-rated Counterparties: Revenue Risk - Midrange

The project benefits from a diversified offtake structure with long-term contracts with offtakers in Jordan and Egypt as well as currently 12 companies in Israel. The export volumes make up more than half of Leviathan's gas sales and imply a reliance on the offtakers in Jordan and Egypt to perform on their payment obligations.

Leviathan's 15-year gas sales and purchase agreement (GSPA) with NEPCO is for an annual contracted quantity of 3BCM. NEPCO is the national electricity company of the Hashemite Kingdom of Jordan (BB-/Stable) and is wholly owned by the Jordanian government. NEPCO is the sole carrier of electric power in the country. We view Leviathan's gas as strategically important to Jordan as the country does not have any domestic sources of energy other than renewables and is otherwise reliant on the import of relatively expensive LNG. Leviathan's piped natural gas is therefore important to the country's economic development, as reflected in the government's guarantee of NEPCO's obligations to Leviathan.

The project also has a 15-year GSPA with Dolphinus in place for the export increasing gradually to 4.7BCM per year to Egypt. Dolphinus is the local marketing company acting as the intermediary between Leviathan and the ultimate offtaker, Egyptian Natural Gas Holding Company (EGAS, not rated). The GSPA expressly allows for the export of Leviathan gas as LNG in addition to domestic use. This provides a strong incentive for Egypt to make full use of the contractual volumes even as it develops its domestic gas fields in the Eastern Mediterranean.

Furthermore, East GAS together with Delek Drilling and Noble Energy acquired a 39% stake in the Eastern Mediterranean Gas Pipeline (EMG), which also gives it the exclusive right to transport gas through the EMG pipeline from Israel to Egypt. This demonstrates Egypt's intention of maintaining a long-term relationship with Leviathan.

We view the Israeli GSPAs as systemic in nature as the gas supply in Israel is currently limited to Tamar and Leviathan and Karish/ Tannin from 2021. The gas demand of the Israeli economy is forecast to grow significantly in the medium term with the gasification of the transport system and replacement of coal-fired power plants.

The project's volume risk is limited through the long-term nature of most offtake contracts, and the take-or-pay requirements under the GSPAs. The contracts also allow for additional sales in excess of contractual volumes if Leviathan has capacity to meet nominations.

The gas sales prices are based on various pricing formulas, including linkages to the electricity production tariff determined by the Public Utility Authority-Electricity for most GSPAs in Israel and the Brent barrel price for the NEPCO and Dolphinus GSPAs. This exposes the project to price risk, which is limited by the provision of floor prices set in the individual contract.

Experienced Operator: Operating Risk - Midrange

The operation of oil & gas facilities is at the higher end of complexity within the infrastructure space, but the project benefits from Noble Energy being an experienced operator of gas fields in the Eastern Mediterranean region with demonstrated performance on Tamar and the Yam Thetys/Mari-B fields.

There is also a good alignment of interest with Delek Drilling through Noble Energy's participation as a partner in the Leviathan lease. Furthermore, the joint operating agreement clearly outlines the responsibilities of the parties.

The project uses commercially proven technology and a relatively high level of equipment redundancy. The project further benefits from the lessons learned from Tamar, which reduces outage risk.

Cost budgets are agreed between the operator and the Leviathan partners under the joint operation agreement, which should ensure good cost control. However, the project remains exposed to the risk of cost overruns.

Sufficient Resources, High Quality Reservoir: Supply Risk - Stronger

The technical advisor views Leviathan as a high quality gas reservoir with a relatively strong drive mechanism that should result in the reservoir pressure remaining high, even as gas volumes reduce, as well as reducing the need for well drilling.

The reservoir is expected to produce 322 BCM in the 1P scenario, and 376 BCM in the 2P scenario as of June 2020. In the Fitch Rating Case (1P) the reservoir is expected to produce until 2064 without any further discoveries. Additional existing gas volumes currently classified as contingent (1C and 2C) will be added to the 1P and 2P reserves once additional wells are approved for drilling and the volumes become commercial, but we give no credit to those volumes in the Fitch Rating Case.

New Assets, Expansion Outside Project Parameter: Infrastructure Development and Renewal - Midrange

Similarly to most other oil & gas fields, the operation of Leviathan will require investments to sustain production and address the operational issues that can be expected to arise in such complex ventures. Fitch believes the operator's experience means the field's operational and development requirements will be appropriately managed and anticipated.

We do not expect that the project will have to raise additional finance to fund large capex requirements in our Fitch Rating Case. The works relating to the Phase 1B capacity extension involving the drilling of four additional wells are excluded from this financing.

Some Refinancing Risk: Debt Structure - Midrange

We assess Debt Structure as Midrange due to the senior secured nature of the debt, the absence of exposure to variable interest rates, swaps or other derivatives, which we view as stronger features, and significant exposure to refinancing risk, which is a weaker feature.

The cash flow servicing and securing the debt relate to the share (45.34%) of ownership interest that Delek Drilling has in the Leviathan gas field. This structure results in lower control over operations compared with the standard project structure and is considered a weakness. We view the structure positively based on the strong alignment of interest between the partners and Noble Energy as operator and the clear provisions of the joint operating agreement.

Funds for debt service flow through accounts in the names of Delek Drilling, which are separated from other company cash flows and pledged to the lenders. The debt issuance through a special purpose vehicle passes the issuance proceeds on to Delek Drilling and debt service is reliant on the back-to-back agreement with Delek Drilling on the basis of its pledge of the Leviathan working interest. As a listed company, we view Delek Drilling as sufficiently insulated from any potential financial pressure at Delek Group Ltd. Moreover, Israeli bankruptcy law is protective of lenders' rights.

Leviathan Bond Ltd raised USD2.25 billion. The bond documentation allows for total indebtedness of up to USD2.5 billion. The senior secured notes comprise staggered bullet maturities that allow the project to deleverage, but also provide the company with flexibility to refinance certain amounts over the project's long remaining operating term, in particular if larger reserves are confirmed and additional capex is required. The reserve accounts (the USD100 million debt payment fund funded from issuance proceeds and the principal reserve fund funded through cash trapping of up to USD150 million starting 12 months prior to a maturity) support debt service and allow for moderate deleveraging, justifying a Midrange assessment overall.

Financial Profile

We deem the project life cover ratio (PLCR), as a measure of debt service coverage, and net debt to EBITDA, as a measure of leverage, to be the most relevant financial metrics. The PLCR increases over time reflecting the long debt free tail. The minimum FRC PLCR of 1.69x occurs in 2030. Net debt to EBITDA is gradually reducing.

PEER GROUP

The closest peers in Fitch's portfolio are Dolphin Energy Ltd (DEL; A+/Stable) and Ras Laffan Natural Gas Company II & 3 (Rasgas; AA-/Stable). Both are large-scale natural gas producing projects in Qatar and benefit from a strong offtaker base and high resiliency to price declines given their low cost bases. For Rasgas, we also factor in its status as an integral part of Qatar's oil & gas industry. Initially both projects also had some bullet maturities, but these could be redeemed out of cash flow. Consequently the projects are rated well above Leviathan.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Fitch deems an upgrade unlikely at this stage. The project is exposed to lower rated counterparties.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Repeated or extended payment delays of NEPCO or Dolphinus, a marked deterioration of the political situation in the region or similar sustained external shocks that would threaten Leviathan's ability to continue gas exports to Jordan or Egypt.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

TRANSACTION SUMMARY

The project is a refinancing/monetisation of the sponsors' interest in the Leviathan gas reservoir. The Leviathan gas field is owned by Delek Drilling LP (45.34%), Noble Energy (39.7%) and Ratio Oil (15%). The stakes owned by Noble Energy and Ratio Oil are not subject to this refinancing. The gas field was discovered in 2010 and reached first gas in 2019 on time and below budget. Phase 1A consists of 1,200MMscfd production capacity. The gas reservoir is located offshore Israel in the Eastern Mediterranean Sea, approximately 120km west of Haifa. The gas extracted from the wells is gathered at the field in a subsea manifold and delivered to an offshore fixed platform via 115km gathering flowlines. Gas to the domestic and export markets is transported from the platform via a pipeline to the Israel Natural Gas Lines onshore grid. Other gas exports may occur via additional pipelines connected to the fixed platform.

FINANCIAL ANALYSIS

Fitch Base Case: We assume a 2P production profile in Fitch's Base Case, Fitch's base case Brent price forecasts. For the gas price assume a price of USD4.7/mcf for 2020 for any uncontracted volumes. In the long term, we assume USD5.5/mcf for uncontracted volumes in line with the international hub prices.

We further apply a 5% stress on opex and capex. Interest rates for the refinance debt are increased between 25bp-100bp based on the debt term compared with current expected interest rates. We reflect Fitch's sovereign inflation assumptions.

Fitch Rating Case: In the Fitch Rating Case, we assume the 1P production profile, Fitch's stressed Brent price forecasts and a gas price of USD4.3/mcf for 2020 for any uncontracted volumes. In the long term we assume USD5.0/mcf for uncontracted volumes.

We further increase the stress on opex and capex to 10% reflecting a realistic downside scenario. Interest rates for the refinance debt and inflation rates are assumed in line with the Fitch base case.

DATE OF RELEVANT COMMITTEE

24 July 2020

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING	P
Leviathan Bond Ltd		

ENTITY/DEBT	RATING			P
• Leviathan Bond Ltd/Debt/1	LT	BB Rating Outlook Stable	New Rating	
• Leviathan Bond Ltd/Debt/1 LT	LT	BB Rating Outlook Stable	New Rating	B C

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Infrastructure and Project Finance Rating Criteria (pub. 24 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Third-party Model (24 March 2020)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Leviathan Bond Ltd	EU Issued

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Asia-Pacific   Europe   Israel