Research Update:

Delek & Avner (Tamar Bond) 'BBB-' Debt Ratings Affirmed On Expected Senior Debt Sale And Repayment; Outlook Negative

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Rating Action Overview

- Delek Drilling entered into a conditional agreement on Sept. 2, 2021, to sell its interest in Tamar to two companies fully owned by MDC Oil & Gas Holding Company LLC, which is a corporation from the same group as Mubadala Investment Company PJSC, a company owned by the government of Abu Dhabi.
- The proceeds of the sale will be used for, among other things, the full redemption of the rated senior bonds.
- We expect the closure of the sale and the repayment of the debt to occur in fourth-quarter 2021.
- We have therefore affirmed our 'BBB-' on the senior debt.
- The outlook is still negative, reflecting the increasing competitive pressures that are resulting in greater-than-expected deterioration of the Tamar project's cash flow generation.

Project Description And Key Credit Factors

In May 2014, Delek & Avner (Tamar Bond) Ltd. issued $2 billion of limited-recourse secured bonds and lent the bond proceeds to Delek Drilling Limited Partnership and Avner Oil Exploration Limited Partnership (after their merger in May 2017, they are together known as Delek Drilling). Delek Drilling currently owns a noncontrolling 22% interest in the lease for the production of natural gas and condensate from the Tamar field, located in the Mediterranean Sea approximately 100 kilometers west off the coast of Haifa in Israel. The other parties to the lease include the field's operator, Chevron Mediterranean Ltd. (25%), as well as the Tamar partners: IsramCo (28.75%), Tamar Petroleum Ltd. (16.75%), Dor Gas Exploration (4%), and Everest Infrastructure (3.5%). The lease expires on Dec. 1, 2038, and may be extended for an additional term of 20 years in accordance with the provisions of the Israeli Petroleum Law.

The Tamar project has been in operation since March 31, 2013. Production activity is carried out under a joint operating agreement (JOA) among the Tamar partners. Each Tamar partner shares revenue from the agreement for the sale of gas and condensate produced by the Tamar project and participates in the expense in accordance with its respective interest. Delek Drilling services the loan advanced by the issuer via its proportionate share of Tamar project revenue, which is in turn the only source of payment for the bonds.

The issuer currently has three pari passu series of bonds outstanding, with an aggregate balance of $640 million, and net debt after cash in the secured accounts of approximately $500 million. Unusually for projects that we rate, the bonds have a bullet maturity. However, the bonds benefit from a principal repayment feature, based on the combination of a cash-sweep-like accumulation mechanism and a cash reserve.

To address risks arising from Delek Drilling's noncontrolling interest in the Tamar field, the role Delek Drilling plays under the JOA and its financing, and the repayment mechanism of the bonds, we rate the debt based on our Principles Of Credit Ratings. Our analytical approach borrows from our project finance methodology.

Strengths

- Steady operating performance, supported by an experienced operator and low running costs.
- Proven gas reserves, which have increased since financial closing while debt has reduced by 60% (and net debt by almost 70%).
- Despite the start of the Leviathan field's commercial operations, the Tamar project remains very important to local gas supply, since local demand growth prospects are supported by the Israeli government's commitment to increase power generation from gas.
- Until 2028, contracts featuring take-or-pay volumes and floor prices will continue to largely underpin sales.

Risks

- Despite contractual protections, debt service remains exposed to volume and price risk.
- The Leviathan field has started to change the dynamics of the local and regional gas market, introducing competition.
- In July 2020, the Tamar project began exporting gas to Egypt, which increases its counterparty and country risk exposure.
- An aggressive repayment profile, exposing the debt to refinancing risk and potential liquidity strain after each maturity date.
- Delek Drilling's 22% interest in the Tamar field lease does not grant strategic control, unlike in most projects we rate.
- The debt is exposed to cash flow interruption if Delek Drilling defaults under the JOA, although this is only a remote possibility, in our view.

Rating Action Rationale

We expect the sale to close by the fourth quarter of 2021. Delek Drilling entered into a conditional agreement on Sept. 2, 2021, to sell its 22% noncontrolling interest in the Tamar field, which is pledged to the issuer, Delek & Avner (Tamar Bond) Ltd. The new interest holders will be two single purpose vehicles (SPVs) fully owned by MDC OIL & Gas Holding Company LLC, which is part of the Mubadala Investment Co. PJSC group, owned by the government of Abu Dhabi. The sale of Delek Drilling's rights in the Tamar project prior to Dec. 17, 2021, is required under Israel's Gas Framework.

We expect the proceeds to be applied to the repayment of the senior debt. As we understand, Delek & Avner (Tamar Bond) Ltd. will use the proceeds of the sale to repay in full the outstanding senior principal and interest, among other uses. At closure, the proceeds would be placed into an escrow account and used to repay the debt approximately 17 days after bondholders are given notice.

Higher gas production in the eastern Mediterranean could increase market competition over the long term. The start of Leviathan's operations in December 2019 made Israel a gas exporter. In addition, and over the long term, with potential new developments in the eastern Mediterranean, or increased production capacity of existing projects, the region could become a gas export hub. On the other hand, a contraction in either local gas demand or Egyptian exports could also intensify the risk of reduced production levels.

Outlook

The negative outlook reflects our view that competitive pressure from the Leviathan field could further erode the Tamar project's cash flow generation in the next 24 months. A contraction in either local gas demand or Egyptian exports could also intensify the risk of reduced production levels.

Downside scenario

We could lower our rating if the bond financing were exposed to higher refinancing risk or weaker liquidity because Tamar's project revenue had materially reduced. We would also lower the rating if we considered the divestment of Delek Drilling's beneficial interest would threaten the issuer's ability to service the bonds in line with the terms.

Finally, we could lower the rating if the Tamar partners, including Delek Drilling, were to engage in unexpected expansion commitments, which could reduce net cash flows for the repayment of the bonds as a result of Delek Drilling being obliged to pay its participating interest in related joint account expenses.

Upside scenario

We could revise the outlook to stable if the Tamar project demonstrated resilience to increased competitive pressure from the Leviathan field by retaining its existing offtakers under committed terms, and signing firm new long-term contracts with counterparties displaying strong creditworthiness, thereby supporting stable cash flow generation and limiting its refinancing risk exposure. Before such an action, we would also expect clarity regarding the divestment process of Delek Drilling's beneficial interest.

Rating Score Snapshot

Operations phase SACP (Senior Debt)

- Operations phase business assessment: 10 (in line with our assessment of the weakest 2029-2033 phase)
- Preliminary operations phase SACP: bbb+
- Downside impact on preliminary SACP: a- (+1 notch)
- Adjusted operations phase SACP: a-
- Debt structure adjustment: -2 notches (material dependence on cash trapped and cash reserves)
- Liquidity: Neutral (no impact)
- Comparative rating analysis: -1 notch
- Operations counterparty ratings adjustment: None
- Financial counterparty ratings adjustment: None
- Operations phase SACP: bbb-

Modifiers (Senior Debt)

- Parent linkage: De-linked
- Structural protection: Neutral
- Extraordinary government support: No
- Sovereign rating limits: aa-
- Full credit guarantees: No
- Senior debt issue rating: bbb-

Related Criteria

- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | Project Finance: Project Finance Operations Methodology, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Project Finance Transaction Structure Methodology, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Key Credit Factors For Oil And Gas Project Financings, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Project Finance Framework Methodology, Sept. 16, 2014

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Corporates | Project Finance: Project Finance Construction And Operations Counterparty Methodology, Dec. 20, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Delek & Avner (Tamar Bond) Ltd. 'BBB-' Debt Ratings Affirmed; Outlook Revised To Negative On Increasing Competition, Oct. 8, 2020

Ratings List

Ratings Affirmed	
Delek & Avner (Tamar Bond) Ltd.	
Senior Secured	BBB-/Negative