

Valuation & Strategy

# *Modiin Energy LP.*

## Incremental Borrowing Rate estimation

*Strictly Private  
and Confidential*

*May 2021*





May 2021

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This report has been prepared by PricewaterhouseCoopers Advisory Ltd. (“**PwC Israel**”) in connection with the estimated Incremental Borrowing Rate of Modiin Energy LP (the “**Company**” or “**Modiin Energy**”), as of January 18, 2021 (the “**Valuation Date**”).

This report (“**Report**”) has been prepared solely for Modiin Energy. It has been prepared in accordance with our letter of engagement dated April 27, 2021 (“**Engagement Letter**”).

This Report has been prepared solely for the purposes stated herein and should not be relied upon for any other purpose.

Our Report is not intended to be the basis for investment decisions and any action you take must ultimately remain a decision for you, taking into account matters outside the scope of our work of which you are aware.

The information used by PwC Israel in preparing this Report has been obtained from a variety of sources as indicated within the Report.

While our work has involved analysis of financial information and/or accounting records, it has not included an audit in accordance with generally accepted auditing standards. Moreover, except where otherwise stated in the Report, we have not subjected the financial information in the Report to checking or verification procedures. Accordingly we assume no responsibility and make no representations with respect to the accuracy or completeness of any information provided to us, except where otherwise stated herein, and no assurance is given.

Notwithstanding the paragraph above, in no circumstances shall we be liable to pay any damages to you for losses arising out of or in any way connected with the provision of information to us by you or your failure to provide information to us or any fraudulent act, misrepresentation or wilful default on your part.

Our conclusions are based upon the information available as of the date of the Report. Economic conditions, market factors and changes in the performance of the business may result in our conclusions becoming quickly outdated and may require updating from time to time or before any major decisions are taken based on the Report.

Except to the extent finally determined to have resulted from our gross negligence or intentional misconduct, our liability to pay damages for any losses incurred by Modiin Energy as a result of breach of contract, negligence or other tort committed by us, regardless of the theory of liability asserted, is limited to no more than three times the total amount of fees paid to us under this engagement letter for the services rendered during the last full year (12 months) before such losses incurred. In addition, we will not be liable in any event for lost profits or any consequential, indirect, punitive, exemplary or special damages. Also, we shall have no liability to you arising from or relating to any third party hardware, software, information or materials selected or supplied by you.



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By its very nature, valuation work cannot be regarded as an exact science and the conclusions arrived at in many cases will of necessity be subjective and dependent on the exercise of individual judgement. There is, therefore, no indisputable single value and we normally express our valuation opinions as falling within expected ranges, although, at your request, we have determined a single figure valuation estimate which is in our opinion reasonable and defensible, others might wish to argue for a different value.

If you require any clarification or further information, please do not hesitate to contact either contact Mr. Shalom Sofer, CPA (Isr.), at +(972)-3-7954946.

Very truly yours,

*PricewaterhouseCoopers Advisory Ltd.*  
PricewaterhouseCoopers Advisory Ltd.

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## Section 1

# ***Background and Scope of work***

## ***Scope of work and sources of Information***

### **Scope of work**

- PwC Israel has been engaged by Modiin Energy to estimate Modiin Energy's Incremental Borrowing Rate, as of Valuation Date, for financial reporting purposes only.
- The results of our valuation, as presented in this Report, can be used for financial reporting purposes only.

### **Purpose of Valuation**

- The purpose of this Report is to present the following issues:
  - The Convertible Bonds terms;
  - Valuation method applied;
  - Relevant parameters which were used for the estimation of the cost of debt, as of Valuation Date; and
  - The estimated cost of debt for senior debt, as of Valuation Date.

### **Basis of Valuation**

- The cost of debt estimation was done by using the Company's debt rating and the duration of the Convertible Bonds.
- The Valuation was based on parameters provided by the terms and conditions of the Convertible Bonds. The Company's debt rating was derived using Moody's Global Oilfield Services Industry Rating Methodology and variables we identified as necessary inputs for the valuation.
- Our valuation results are reliant on the various estimations and assumptions provided to us by Management, which were not verified independently by us. We have relied on Management to fairly represent all relevant information provided to us. If any of the information provided is incorrect or includes material omissions, this could affect materially the valuation results set out in this report.

## ***Scope of work and sources of Information***

### **Source of information**

- During the course of our work, we have relied on data and information made available to us through different sources. Figures and estimations are based upon information and database provided by Modiin Energy as well as the knowledge and experience of PwC Israel.
- The principal sources of information provided to us by Management were the terms and conditions of the Convertible Bonds.
- Other sources of information:
  - Bloomberg databases;
  - Yahoo Finance;
  - Rating Methodology in accordance with Global Oilfield Services Industry, Moody's Investors Service Ltd. ("**Moody's**"), dated May 5, 2017; and
  - Modiin Energy's financial statements for FY2020.

### **Financial Instrument – Convertible Bonds**

- Convertible bonds are a financial instrument that can be converted into another asset, usually to ordinary shares of the issuing company. The conversion ratio is predetermined, and defines the total par value of the bonds required for conversion into one share of the issuing company.
- Modiin Energy's Convertible Bonds were issued with a Principal Amount of NIS 55.3 million on January 18, 2021.
- The Convertible Bonds carry a semi-annual coupon at a rate of 2.5%, and the principal amount will be repaid in three payments, as follows:
  - 30% of the principal amount will be repaid on December 31, 2022;
  - 30% of the principal amount will be repaid on December 31, 2023; and
  - 40% of the principal amount will be repaid on December 31, 2024.
- Conversion Period: a Bondholder may exercise its Conversion Right from (and including) January 18, 2021, and until (and including) the Maturity Date (December 31, 2024).
- The current Conversion Ratio is approximately NIS 4.9.

## ***Background***

### **General**

- Modiin Energy LP. was incorporated in 1992, under the laws of Israel, and commenced operations on the same date.
- The partnership deals with one area of activity - oil and gas exploration, development and production. Modiin Energy also began operating abroad in 2016, completing their strategy for locating low-risk oil and gas assets, which are not core activities of major energy companies.
- Through its subsidiaries, Modiin Energy holds the following oil assets:
  - Mountain View Project in California - Modiin Energy holds approximately 25.8% of the oil property rights from this project;
  - Grapevine Project in California - Modiin Energy holds approximately 23.3% of the oil property rights from this project;
  - Cassini Project in California - Modiin Energy holds approximately 36.5% of the oil property rights from this project;
  - Shideler Project in California - Modiin Energy holds approximately 37.5% of the oil property rights from this project;
  - NPB Project in Colorado - Modiin Energy holds approximately 50.0% of the oil property rights from this project; and
  - Shimshon Project in Israel - Modiin Energy holds approximately 10.6% of the oil property rights from this project.

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## Section 2

# ***Step 1 - Estimation of Modiin Energy's credit rating***

## ***Estimation of Modiin Energy’s credit rating***

### **IBR valuation technique**

- Using Moody’s Global Oilfield Services Industry Rating Methodology, we estimated Modiin Energy’s implied rating, as of Valuation Date.
- Accordingly, in order to estimate the IBR, as of Valuation Date, we performed the following steps:
- **Step 1:** Estimation of Modiin Energy’s credit rating using Moody’s Global Oilfield Services Industry Rating Methodology; and
- **Step 2:** Estimation of the appropriate IBR in order to extract the Convertible Bond cost of debt.
- The following table presents the rating factors taken into account when determining the indicated rating (For the definition of each factor, please see Appendix 1):

<b>Factor</b>	<b>Factor Weighting</b>	<b>Sub-Factor</b>	<b>Sub- Factor Weighting</b>
Scale	20%	EBITDA	10%
		Assets	10%
Business Profile	25%	Business Profile	25%
Profitability & Efficiency	20%	EBIT Margin	10%
		EBIT / Assets	10%
Leverage and Coverage	20%	EBITA / Interest	10%
		Debt/ EBITDA	10%
Financial Policy	15%	Financial Policy	15%
<b>Total</b>	<b>100%</b>	<b>Total</b>	<b>100%</b>

- Each sub-factor is calculated, assigned a rating and then mapped to the corresponding numerical score of the assigned rating according to the methodology.
- The weighted average of all sub-factors is then mapped to the appropriate credit rating for the company, as presented below.

## ***Estimation of Modiin Energy’s credit rating (cont’d)***

### **Factor 1 – Scale**

- Larger scale can be an indicator for a company’s ability to withstand industry cycles and competitive forces. Scale is often correlated to market position, geographic and product diversity, ability to innovate, and ability to obtain financing to undertake major capital projects.

<b>Sub-Factor</b>	<b>Aaa</b>	<b>Aa</b>	<b>A</b>	<b>Baa</b>	<b>Ba</b>	<b>B</b>	<b>Caa</b>	<b>Ca</b>
EBITDA (USD Millions)	≥20,000	20,000-10,000	10,000-2,500	2,500-1,000	1,000-400	400-100	100-25	<25
Assets (USD Billions)	≥100	100-50	50-20	20-8	8-4	4-2	2-0.5	<0.5

### **Factor 2 – Business Profile**

- In the oilfield services industry, a more stable business profile is one that can meet multiple customer needs and is less vulnerable to fluctuating industry conditions. Higher business profile scores are assigned to companies with better: market positions, product line diversity, diversified fleet of equipment, or greater geographic diversity, operating capabilities and technical expertise, and cash flow stability throughout the industry cycle.

- The criteria are as follows:

#### **Sub-Factor Business Profile**

<b>Aaa</b>	Industry is not compatible with a Aaa business profile
<b>Aa</b>	Recognized global industry leader; diverse fleet of latest generation equipment; long track record of superior operational performance; no EBITDA volatility throughout the industry cycle
<b>A</b>	Leading global competitor; diversified fleet of mostly latest generation equipment; long track record of above average operational expertise; little EBITDA volatility driven by industry cycles
<b>Baa</b>	Global competitor; diversified fleet of old and new generation assets; fleet has little EBITDA concentration risk; long track record of operational expertise; modest EBITDA volatility driven by industry cycles
<b>Ba</b>	Geographically diversified competitor; fleet has modest EBITDA concentration risk; limited operating track record; high EBITDA volatility driven by industry cycles
<b>B</b>	Competitor in more than one geographic market; fleet has high EBITDA concentration risk; older than average fleet; newer company or short operating track record; very high EBITDA volatility driven by industry cycles
<b>Caa</b>	Competitor in a single geographic market; fleet has very high EBITDA concentration risk; most of the fleet is nearing the end of its useful life or a start up with new equipment; weak operating history or very short operating track record; EBITDA volatility throughout the industry cycles
<b>Ca</b>	Competitor in a single geographic market; fleet has extremely high EBITDA concentration risk; most of the fleet in imminent need of replacement and significant inventory of stacked equipment; high EBITDA volatility throughout the industry cycles

## ***Estimation of Modiin Energy's credit rating (cont'd)***

### **Factor 3 – Profitability and Efficiency**

- Profitability is a key measure of success of the business and effectiveness of management. Most oilfield services companies have large investments in fixed assets that are necessary to maintain and grow market share. The fixed assets require on-going maintenance spending and need to be replaced on a regular basis to take advantage of new technology and to offer a competitive service. However, high fixed costs cause greater margin volatility in a cyclical industry. Companies with greater profitability and capital efficiency are better positioned to maintain investment levels throughout the industry cycle.
- The Profitability and Efficiency criteria are as follows:

<b>Sub-Factor</b>	<b>Aaa</b>	<b>Aa</b>	<b>A</b>	<b>Baa</b>	<b>Ba</b>	<b>B</b>	<b>Caa</b>	<b>Ca</b>
EBIT Margin	≥65%	65%-50%	50%-35%	35%-20%	20%-10%	10%-5%	5%-2%	<2%
EBIT / Assets	≥35%	35%-24%	24%-15%	15%-8%	8%-4.5%	4.5%-2%	2%-0%	<0%

### **Factor 4 – Leverage and Coverage**

- Financial leverage and coverage measures are indicators for a company's financial flexibility and long-term viability. Financial flexibility is critical to oilfield services companies to maintain their fleets and service equipment and to have access to the capital markets for large capital investments that are needed from time to time.
- The Leverage and Coverage criteria are as follows:

<b>Sub-Factor</b>	<b>Aaa</b>	<b>Aa</b>	<b>A</b>	<b>Baa</b>	<b>Ba</b>	<b>B</b>	<b>Caa</b>	<b>Ca</b>
EBITDA / Interest	≥30	30-20	20-10	10-7	7-4	4-2	2-1	<1
Debt / EBITDA	<0.25	0.25-1	1-2	2-3	3-4	4-5.5	5.5-7	≥7

## ***Estimation of Modiin Energy’s credit rating (cont’d)***

### **Factor 5 – Financial Policy**

- We assess the issuer’s desired capital structure or targeted credit profile, history of prior actions, and adherence to its commitments. Attention is paid to management’s operating performance and use of cash flow through different phases of economic cycles. Also of interest is the way in which management responds to key events, such as changes in the credit markets and liquidity environment, legal actions, competitive challenges, and regulatory pressures.
- Management’s appetite for M&A activity is assessed with a focus on the type of transactions (i.e. core competency or new business) and funding decisions. Frequency and materiality of acquisitions and previous financing choices are evaluated. A history of debt-financed or credit-transforming acquisitions will generally result in a lower score for this factor. We also consider a company and its owners’ past record of balancing shareholder returns and debt holders’ interests. A track record of favoring shareholder returns at the expense of debt holders is likely to be viewed negatively in scoring this factor.
- The Financial Policy criteria are as follows:

#### **Sub-Factor Financial Policy**

<b>Aaa</b>	Expected to have extremely conservative financial policies; very stable metrics; public commitment to very strong credit profile over the long term
<b>Aa</b>	Expected to have very stable and conservative financial policies; stable metrics; minimal event risk that would cause a rating transition; public commitment to strong credit profile over the long term
<b>A</b>	Expected to have predictable financial policies that preserve creditor interests. Although modest event risk exists, the effect on leverage is likely to be small and temporary; strong commitment to a solid credit profile
<b>Baa</b>	Expected to have financial policies that balance the interest of creditors and shareholders; some risk that debt funded acquisitions or shareholder distributions could lead to a weaker credit profile
<b>Ba</b>	Expected to have financial policies that tend to favor shareholders over creditors; above average financial risk resulting from shareholder distributions, acquisitions or other significant capital structure changes
<b>B</b>	Expected to have financial policies that favor shareholders over creditors; high financial risk resulting from shareholder distributions, acquisitions or other significant capital structure changes
<b>Caa</b>	Expected to have financial policies that create elevated risk of debt restructuring in varied economic environments
<b>Ca</b>	Expected to have financial policies that create elevated risk of debt restructuring even in healthy economic environments

## ***Estimation of Modiin Energy’s credit rating (cont’d)***

### **Overall Rating**

- To determine the overall rating, we converted each of the sub-factor scores into a numeric value based upon the scale below:

<u>Aaa</u>	<u>Aa</u>	<u>A</u>	<u>Baa</u>	<u>Ba</u>	<u>B</u>	<u>Caa</u>	<u>Ca</u>
1	3	6	9	12	15	18	20

- The numerical score for each sub-factor is then multiplied by the weight for that sub-factor, and then summed to produce a composite weighted-factor score. The composite weighted factor score is then mapped back to an alphanumeric rating based on the ranges in the following table:

<b>Score Indicated Rating (Moody's)</b>	<b>Composite Weighted Factor Score</b>
<b>Aaa</b>	$X < 1.5$
<b>Aa1</b>	$1.5 \leq X < 2.5$
<b>Aa2</b>	$2.5 \leq X < 3.5$
<b>Aa3</b>	$3.5 \leq X < 4.5$
<b>A1</b>	$4.5 \leq X < 5.5$
<b>A2</b>	$5.5 \leq X < 6.5$
<b>A3</b>	$6.5 \leq X < 7.5$
<b>Baa1</b>	$7.5 \leq X < 8.5$
<b>Baa2</b>	$8.5 \leq X < 9.5$
<b>Baa3</b>	$9.5 \leq X < 10.5$
<b>Ba1</b>	$10.5 \leq X < 11.5$
<b>Ba2</b>	$11.5 \leq X < 12.5$
<b>Ba3</b>	$12.5 \leq X < 13.5$
<b>B1</b>	$13.5 \leq X < 14.5$
<b>B2</b>	$14.5 \leq X < 15.5$
<b>B3</b>	$15.5 \leq X < 16.5$
<b>Caa1</b>	$16.5 \leq X < 17.5$
<b>Caa2</b>	$17.5 \leq X < 18.5$
<b>Caa3</b>	$18.5 \leq X < 19.5$
<b>Ca</b>	$X \geq 19.5$

## ***Estimation of Modiin Energy's credit rating***

### ***Results***

#### **Factors Calculations Outcome**

- The following table presents a summary of the parameters, implied sub-factor score, corresponding numeric score and the weighted score, as of December 31, 2020:

<b>Factor</b>	<b>Factor Weight</b>	<b>Sub-Factor</b>	<b>Sub-Factor Weight</b>	<b>Value</b>	<b>Assigned Rating</b>	<b>Corresponding Numeric Score</b>	<b>Weighted Score</b>
Scale	20%	EBITDA	10%	(1.73)	Ca	20	2.00
		Assets	10%	0.01	Ca	20	2.00
Business Profile	25%		25%	Competitor in more than one geographic market; fleet has high EBITDA concentration risk; older than average fleet; newer company or short operating track record; very high EBITDA volatility driven by industry cycles	B	15	3.75
Profitability and Efficiency	20%	EBIT Margin	10%	(2.57)	Ca	20	2.00
		EBIT / Assets	10%	(0.44)	Ca	20	2.00
Leverage and Coverage	20%	EBITDA / Interest	10%	Negative EBITDA	Ca	20	2.00
		Debt / EBITDA	10%	Negative EBITDA	Ca	20	2.00
Financial Policy	15%		15%	Expected to have financial policies that balance the interest of creditors and shareholders; some risk that debt funded acquisitions or shareholder distributions could lead to a weaker credit profile	Baa	9	1.35
<b>Total</b>	<b>100%</b>		<b>100%</b>				<b>17.10</b>

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## Section 3

# ***Step 2 - Estimation of the appropriate IBR rating***

## ***Estimation of the Incremental Borrowing Rate Rating***

- The tables below presents the Company's credit risk rating, as of Valuation Date:

<b>Company</b>	<b>Rating- Moody's (International)</b>	<b>Rating- S&amp;P (International)</b>	<b>Rating- S&amp;P (Israel long-term)</b>
Modiin Energy	Caa1	CCC+	ilBB

- **According to the assumptions and table presented above, based on Modiin Energy's IBR rating the Convertible Bond cost of debt is estimated at 9.5%, as of Valuation Date.**

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# Appendix 1

## *Definitions*

## Definitions

Board Rating Factor	Rating Sub-Factor	Definition
<b>Factor 1 - Scale</b>	<b>EBITDA Assets</b>	Scale is measured (estimated in the case of forward-looking expectations) using EBITDA and total assets. For companies with significant working capital assets, we may adjust total assets to take into account expected changes in working capital resulting from seasonal or fluctuating industry conditions. Also, for companies with significant intangible assets such as goodwill, we consider the relative materiality of those values and their susceptibility to impairment and may adjust total assets accordingly.
<b>Factor 2 - Business Profile</b>	<b>Choose the most representative Business Profile</b>	<p>Industry is not compatible with a Aaa business profile</p> <p>Recognized global industry leader; diverse fleet of latest generation equipment; long track record of superior operational performance; no EBITDA volatility throughout the industry cycle</p> <p>Leading global competitor; diversified fleet of mostly latest generation equipment; long track record of above average operational expertise; little EBITDA volatility driven by industry cycles</p> <p>Global competitor; diversified fleet of old and new generation assets; fleet has little EBITDA concentration risk; long track record of operational expertise; modest EBITDA volatility driven by industry cycles</p> <p>Competitor in more than one geographic market; fleet has high EBITDA concentration risk; older than average fleet; newer company or short operating track record; very high EBITDA volatility driven by industry cycles</p> <p>Competitor in a single geographic market; fleet has very high EBITDA concentration risk; most of the fleet is nearing the end of its useful life or a start up with new equipment; weak operating history or very short operating track record; EBITDA volatility throughout the industry cycles</p> <p>Competitor in a single geographic market; fleet has extremely high EBITDA concentration risk; most of the fleet in imminent need of replacement and significant inventory of stacked equipment; high EBITDA volatility throughout the industry cycles</p>
<b>Factor 3 - Profitability and Efficiency</b>	<b>EBIT Margin EBIT / Assets</b>	<p>The profitability indicator used in the scorecard is earnings before interest and taxes (EBIT) divided by revenue (EBIT margin). EBIT captures the impact of depreciation on the fixed asset base and the need to invest in a company's equipment.</p> <p>To measure capital efficiency and return on investment, the ratio of EBIT to total assets is used. A higher efficiency ratio indicates a greater ability to maintain investment levels in an oilfield services company's fleet and equipment which often is an important differentiating factor for customers.</p>
<b>Factor 4 - Leverage and Coverage</b>	<b>EBITA / Interest Debt / EBITDA</b>	<p>This ratio is calculated as consolidated earnings before interest, taxes, depreciation, and amortization (EBITDA) divided by consolidated interest expense.</p> <p>This ratio is calculated as total debt divided by EBITDA. For seismic services companies that have a multiclient seismic data library, we use EBITDA less multi-client capex for purposes of computing this ratio.</p>
<b>Factor 5 - Financial Policy</b>	<b>Choose the most representative Business Profile</b>	<p>Expected to have extremely conservative financial policies; very stable metrics; public commitment to very strong credit profile over the long term</p> <p>Expected to have very stable and conservative financial policies; stable metrics; minimal event risk that would cause a rating transition; public commitment to strong credit profile over the long term</p> <p>Expected to have predictable financial policies that preserve creditor interests. Although modest event risk exists, the effect on leverage is likely to be small and temporary; strong commitment to a solid credit profile</p> <p>Expected to have financial policies that balance the interest of creditors and shareholders; some risk that debt funded acquisitions or shareholder distributions could lead to a weaker credit profile</p> <p>Expected to have financial policies that tend to favor shareholders over creditors; above average financial risk resulting from shareholder distributions, acquisitions or other significant capital structure changes</p> <p>Expected to have financial policies that favor shareholders over creditors; high financial risk resulting from shareholder distributions, acquisitions or other significant capital structure changes</p> <p>Expected to have financial policies that create elevated risk of debt restructuring in varied economic environments</p> <p>Expected to have financial policies that create elevated risk of debt restructuring even in healthy economic environments</p>

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# Appendix 2

## ***Contact Information***

# *Contact information*

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