

Research Update:

# Israel Aerospace Industries Ltd. Affirmed At 'A-' On Strong Operating Performance; Outlook Stable

July 11, 2024

## Rating Action Overview

- Aerospace and defense company Israel Aerospace Industries Ltd. (IAI) continues to exhibit a robust operating performance, with a rising backlog and solid revenue visibility.
- A gradually strengthening competitive position and high demand on its platforms and services, coupled with improving profitability, means we have reassessed IAI's business risk profile to satisfactory from fair.
- We forecast that IAI will continue to exhibit a strong net cash position through 2024 and 2025, underpinning a minimal financial risk profile.
- We affirmed our 'A-' long-term issuer credit rating on IAI to 'A-' and our 'A-2' short-term issuer credit rating.
- The stable outlook reflects that very supportive defense market conditions, ongoing contract wins, and a prudent financial policy that targets maintaining a strong net cash position should allow IAI to maintain comfortable headroom under the 'A-' rating.

### PRIMARY CREDIT ANALYST

**David Matthews**  
London  
+ 44 20 7176 3611  
david.matthews  
@spglobal.com

### SECONDARY CONTACT

**Sivan Mesilati**  
RAMAT-GAN  
+ 97237539735  
Sivan.Mesilati  
@spglobal.com

## Rating Action Rationale

**IAI continues to experience high demand for its products and services and a record order backlog, driven by the war between Russia and Ukraine and the war between Israel and Hamas, but also robust demand from the wider aerospace and defense industry.** IAI is benefitting from wider defense industry tailwinds. The company will continue to benefit from sizable advance payments on large contracts that it has recently signed (including a \$1.2 billion deal for the supply of air defense systems, a \$3.5 billion deal to supply Arrow 3 to Germany, and several other large deals currently under advanced negotiation). In our estimation, these cash receipts will drive IAI's cash on balance sheet to more than \$3 billion through 2024, resulting in the company comfortably maintaining a strong net cash position. We also note that IAI should attract a good interest rate on its dollar deposits that will benefit the company's net finance cost/income.

**Our view of IAI's competitive advantage and improved profitability underpins our reassessment of its business risk profile.**

Under our base-case scenario and given the strong new order intake, we project revenue will continue to grow to about \$5.7 billion in 2024 and more than \$6 billion in 2025. IAI's improving competitive advantage on and high demand for many of its products and services such as BARAK, Arrow 2&3, and various radars/munitions mean it is well placed to capture customer demand, both from the Israeli Ministry of Defense and from overseas governments and militaries. At the same time, we expect that S&P Global Ratings-adjusted EBITDA will rise to comfortably more than \$800 million through 2025, with margins rising to about 13% or more over the next 12-18 months. This solid competitive advantage, coupled with improved profitability mean we have reassessed IAI's business risk profile to satisfactory from fair. Although this does not impact our overall rating on IAI, these strengths, coupled with IAI's strong net cash position, mean that we now view that IAI's stand-alone credit quality (SACP) is stronger and the ratings therefore slightly less affected by potential downgrade of its ultimate owner, Israel.

**We expect free cash flows to remain robust, reflecting a prudent financial policy.** Despite potentially lumpy working capital patterns, we expect IAI to continue to generate positive free operating cash flow. In our forecast, we assume \$50 million to \$100 million annually for bolt-on acquisitions. IAI's robust backlog will fuel organic growth, so we do not expect management to pursue any significant M&A, at least through 2024. We also think that any chance of an IPO will remain shelved in the short term. We note that IAI has accumulated about \$400 million of dividends that will be paid to the Israeli treasury. We think that IAI could pay these dividends, if necessary, through 2024 and 2025, and retain comfortable headroom under its ratings if the company performs in line with and receives sizable advance payments as per our base case. We expect IAI to continue to service its normal dividend, in line with the company's dividend policy and considers that Israeli state-owned companies have a generic policy of distributing 50% of their net income as a dividend.

## Outlook

The stable outlook reflects that very supportive defense market conditions, ongoing contract wins, and a prudent financial policy that targets maintaining a strong net cash position should allow IAI to maintain comfortable headroom under the 'A-' rating.

## Downside scenario

We could lower the rating if we saw that the current market conditions were short-lived, the company looked unlikely to execute well on its backlog over time, or if it reported EBITDA margins below 10% because of fierce competition, the inability to introduce new technologies, or cost overruns. In addition, we could lower the rating if a change in the company's financial policy would result in adjusted funds from operations (FFO) to debt deteriorating and staying below 60%. Unexpected large-scale mergers and acquisitions (M&A) or dividends could also weigh on our assessment of IAI's financial risk profile.

## Upside scenario

We see an upgrade as remote over the next 12 months, considering the size of the company and its EBITDA base, compared with those of larger, rated defense peers, and the limitations on

increasing its market share outside Israel. We consider that an IPO, or material M&A, is unlikely until at least the end of the Israel-Hamas war.

We may upgrade IAI if it expands its operating perimeter and relative competitiveness, compared with global peers, amid improving S&P Global Ratings-adjusted EBITDA margins to sustainably more than 14%, while maintaining a strong net cash position. We note that any downgrade of Israel (A+/Negative/A-1+) could weigh on our rating on IAI.

## **Company Description**

IAI develops civil aerospace products, defense systems, unmanned aerial vehicles (UAVs), space systems, and electronic equipment. The company is divided into four divisions, including military aircraft, system missiles and space, electronics (ELTA), and aviation. In 2023, IAI sold about 71% of its products outside Israel, with about 29% of sales in Israel. Some of the company's top products include UAVs, military satellites, and high-end radars.

IAI is fully owned by the Israeli state and is one of the largest industrial companies in Israel, with close to 15,000 employees. The company's main competitors in Israel include Rafael Advanced Defense Systems Ltd. and Elbit Systems. Outside Israel, it competes with various original equipment manufacturers and tier 1 companies in the aerospace and defense industry.

## **Our Base-Case Scenario**

### **Assumptions**

- The company's backlog rising to more than \$20 billion.
- Production rates remain broadly unaffected by the war and the call up of Israel Defense Forces (IDF) reservists.
- S&P Global Ratings-adjusted EBITDA margins to rise to 13% or more over the next 12-18 months, despite rising research and development (R&D) costs.
- Working capital to be strongly positive in 2024, supported by the receipt of sizable advance payments.
- Average capital expenditure (capex) trending toward-\$300 million through 2024.
- No significant M&A activity. Annual potential bolt-on acquisitions of \$50 million to \$100 million in 2024.
- Potential dividends of 50% of IAI's net income, as per the generic policy for Israeli stated-owned companies, but none in our base case until at least the conclusion of the Israel-Hamas war.
- No sizable special dividends to the Israeli treasury in the short term.
- No IPO.

### **Key metrics**

## Israel Aerospace Industries Ltd.--Key metrics\*

Mil. US\$	--Fiscal year ended Dec. 31--				
	2021a	2022a	2023a	2024f	2025f
Revenue (bil. US\$)	4.48	4.97	5.33	>5.7	>6.1
Adj. EBITDA	440	465	605	>700	>800
EBITDA margin (%)	9.8	9.4	11.4	>12.5	>13
Capex	240	203	200	>200	>200
FOCF	(94)	502	622	>2,000	>500
Dividends	0	2	2	0	0
Acquisitions	7	0	52	about 50	about 100
Adjusted debt to EBITDA (x)	N.M.	N.M.	N.M.	N.M.	N.M.
Adjusted FFO to debt (%)	N.M.	N.M.	N.M.	N.M.	N.M.

\*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. Capex--Capital expenditure. FOCF--Free operating cash flow. FFO--funds from operations. N.M.--Not meaningful.

## Liquidity

We assess IAI's liquidity as strong. Over the 24 months from June 30, 2024, we anticipate that sources of income will cover uses by more than 1.5x.

Our assessment is supported by the company's sizable cash on the balance sheet and its limited debt maturities in the coming years. These can be refinanced easily in the Israeli capital market, given the company's current yields.

IAI does not use bank lines for meaningful short-term funding. Instead, it uses its considerable advances from customers as primary funding sources. We do not view this as a major concern, given the company's credit quality and the fact that it is a government-related entity (GRE). As of June 30, 2024, the company's outstanding guarantees were about \$2.1 billion.

We expect principal liquidity sources over the 12 months from June 30, 2024, will comprise:

- Estimated cash balance of about \$2.5 billion of cash and marketable securities; and
- FFO of comfortably more than \$700 million, taking into account early retirement payments.

We expect principal liquidity uses over the 12 months from June 30, 2024, will comprise:

- Debt maturities of close to \$158 million, including short-term debt, after which the company will have no gross debt;
- Capex trending toward \$300 million per year;
- Potential working capital swings, depending on customer advances, which, in turn, depend on the timing of new contract engagements and the adherence to the project timetable;
- Seasonal, intrayear working capital swings of up to \$200 million, which could become significantly negative if Israel's Ministry of Defense delays any sizable payments;
- Dividends of 50% of IAI's net income, as per the generic policy for Israeli state-owned companies; and

- No significant acquisitions.

## Covenants

IAI has several financial covenants, including minimal equity, gearing, and leverage ratios. As of June 30, 2024, the company met all the covenants. Under our base case, IAI will continue to maintain sufficient headroom under the covenants in the coming 12-18 months.

## Environmental, Social, And Governance

ESG factors have an overall neutral influence on our credit rating analysis of IAI. The company has a well-diversified end-market base and strong barriers to entry, thanks to its technological edge and competitive position as an aerospace and defense company that typically benefits from long-term contracts with governments.

Social risks are moderate, but in line with those of peers in the aerospace and defense sector. IAI relies on skilled labor to execute its projects on time and on budget. In addition, the company is responsible for workers' safety amid the use of large and dangerous equipment. IAI has a good safety track record, with few accidents in recent years.

We view the company's governance as satisfactory, reflecting its extensive planning process and ability to adapt to operational issues and changing market conditions.

## Government Influence

We view the likelihood of timely and sufficient extraordinary financial support to IAI from the Israeli government, if needed, as moderately high, although under our criteria this does not result in any uplift to the SACP. We base this view on our assessment of IAI's:

- Very important role in Israel's economy, given its range of defense products, some of which are important for the Ministry of Defense. In this respect, the link between the two goes beyond the sales to the state; and
- Limited links to the government. IAI is currently fully owned by the government, which will likely remain in control of more than 50% of the company after any potential IPO. In our view, the ownership has limited influence on the government's propensity to provide timely extraordinary support. This view is supported by the government's general policy and track record with other GREs.

Our view of potential governmental support does not include the ongoing contribution from the government, namely in the form of R&D subsidies, which is a relatively common feature in the aerospace and defense industry. Contributions from the government also include favorable contracts and access to preferential funding or guarantees. However, the Israeli government places numerous restrictions on IAI, including on technology exports and the acquisition of companies overseas. We incorporate these factors into our SACP assessment.

## Ratings Score Snapshot

Issuer Credit Rating	A-/Stable/A-2
Business risk:	Satisfactory
Country risk	Intermediate
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk:	Minimal
Cash flow/leverage	Minimal
Anchor	a-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	a-
Likelihood of government support	Moderately high (no impact to SACP)

## Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## **Related Research**

- Israel's Economic Recovery To Be Slower Than Past Comebacks, Despite A Rebound In GDP In The First Quarter, May 20, 2024
- Israel, May 13, 2024
- Israel Aerospace Industries Ltd. Upgraded To 'A-'; Outlook Stable, Dec 28, 2023

## **Ratings List**

### **Ratings Affirmed**

---

#### **Israel Aerospace Industries Ltd.**

---

Issuer Credit Rating A-/Stable/A-2

---

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.spglobal.com/ratings](http://www.spglobal.com/ratings) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.spglobal.com/usratingsfees](http://www.spglobal.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.