Delta Galil Industries Ltd.

Monitoring Report | March 2016

Contacts:

Nir Israel, CPA, Analyst, Primary Rating Assessor
niri@midroog.co.il

Liat Kadisch, CPA, Senior Team Leader, Secondary Rating Assessor
Liatk@midroog.co.il

Sigal Issachar, Head of Corporate Finance and Financial Institutions
i.sigal@midroog.co.il

Delta Galil Industries Ltd.

Series Rating	A1.il	Outlook: Stable

Midroog announces reaffirmation of an A1.il/stable rating for bonds (series A, B, T, E) issued by Delta Galil Industries Ltd. ("**Delta**" or the "**Company**") in circulation.

Following are the series of bonds in circulation issued by the Company and rated by Midroog:

Series	Security No.	Rating	Rating outlook	Final repayment
A	6270144	A1.il	Stable	31.8.2028
B	6270151	A1.il	Stable	30.9.2024
T	6270110	A1.il	Stable	19.7.2016
E	6270136	A1.il	Stable	31.12.2021

Summary of Key Rating Rationale

The Company's rating reflects its substantial extent of activity over a range and variety of business lines, in different categories of the apparel business, in different geographical territories and through multiple distribution channels. The Company possesses high capabilities in product development and design and a global production network, which involves both outsourcing and in-house production, facilitating competitiveness and operational flexibility. The Company has achieved organic growth in recent years through entering into new categories, such as Active Wear, expanding its basket of owned brands and licenses, and growth in same store sales.

Delta's status as a subcontractor for large U.S. retail chains and for international brands reduces its selling prices flexibility, and together with exposure to commodity prices, remains a risk factor for the Company, in our opinion. However, a significant extent of the Company's activity (approximately 53% of sales) derives from owned brands or license agreements, sales that are characterized by relative stability and high profit margins. The Company aims to increase this portion through M&A.

The industry risk of the apparel market, which we assess at medium, is unfavorable for the rating. In our view, the industry risk is a factor of the industry's moderate growth, intense competition that constrains profit margins, medium exposure to economic cycles, seasonality, and exposure to cotton prices.

We assess that the Company will achieve only moderate growth in the year to come, with the growth drivers mentioned above continuing to contribute to revenues, but in the short run, strategic changes at a key customer, Wal-Mart, will offset some of that growth.

The rating is favorably influenced by our high esteem of the business and financial management at Delta, the Company meeting forecasts over the years, its conservative financial management, a high level of monitoring and control, and proven experience in successfully integrating acquired activities. These factors mitigate the risk inherent in the Company's acquisitions strategy.

The rating is unfavorably affected by exposure to major customers, mainly the Company's activity with Wal-Mart and Nike, due to the size of these customers versus the scope of the Company's activity. In our opinion, the Company's long-term relations with its key customers and expansion of the range of product categories sold to Wal-Mart and Nike slightly mitigate the concentration risk.

The Company's profitability is reasonable for its rating grade. In our opinion, the Company's operating margins will be in the range of 6%-7% in the short to medium term, based on stability in cotton prices (which in turn is based on the prices of futures), positive influence of consolidating the new operations, and various efficiency measures, against the negative influence of the anticipated increase in wage costs and rent. The intense competition and low price flexibility in the industry alongside exposure to exchange rates could weigh on profitability.

The Company has a strong financial profile, reflected in moderate leverage and strong, stable cash flow from operations. The Company's debt/CAP ratio as of December 31, 2015 was about 44%, and is not expected to rise, based on expectations of moderate positive FCF. Our base scenario assesses EBITDA and FFO in the range of $85-95 million and $55-$65 million respectively. The gross adjusted financial debt/EBITDAR[1] coverage and gross adjusted financial debt/FFOR ratios are expected, we estimate, to be in the range of 2.5-3 and 3.5-4.5 respectively in the short to medium term. The EBIT/gross financial expenses ratio is likely to remain in the range of 4.0-5.0 (three-year average), a fast ratio that also contributes to the Company's financial flexibility. We foresee an increase in investments in fixed assets in the short to medium term, to expand production infrastructure, but believe the Company will continue to generate positive FCF, even after distributing dividends or

[1] Gross adjusted debt – internal value of debt plus financial derivative and deposit made as collateral for the derivative, obligations on vehicle purchases, obligations on machinery purchases, performance-contingent liability on acquisition of activity, obligations to minimal lease financing payments and capitalization of certain future operational leasing payments (according to Midroog's methodology).

buying back shares[2], according to our assumption that dividend distribution will remain conservative.

The Company's liquidity is high, and relies on a high balance of liquid assets, moderate positive FCF and moderate repayment needs. The Company's financial flexibility is supported by underwritten, unexploited credit facilities of a significant amount, moderate leverage, and a ample covenant headroom. We assume that the destination of the liquid balance in the foreseeable future is to finance a significant acquisition, in keeping with the Company's strategy. Midroog will examine material investments the Company makes from the perspectives of business and financial risk.

The Company's stable rating outlook is supported, in our opinion, by stability in profitability level while maintaining coverage ratios that are appropriate to the rating level.

Delta Galil (Consolidated): Key Financial Figures, $M:

	FY 2015	FY 2014	FY 2013	FY 2012	FY 2011
Sales	1,080	1,032	975	818	679
Change in sales	4.7%	5.9%	19.2%	20.5%	9.5%
Operating profit	72	71	67	48	37
Operating profit %	6.6%	6.9%	6.9%	5.9%	5.4%
Net profit	44	47	43	57	28
EBITDA	92	89	86	63	49
FFO	70	67	63	45	40
Liquidity balances	168	167	99	48	66
Gross adjusted debt[1]	275	261	169	150	130
Gross adjusted debt/CAP	44.0%	44.6%	34.8%	35.5%	38.1%
Gross adjusted debt /EBITDAR	2.9	2.8	1.9	2.3	2.6
Gross adjusted debt /FFOR	3.8	3.8	2.6	3.2	3.2
EBIT/Gross financial expenses	4.4	4.7	5.3	4.9	4.7

[2] In February 2016, the Company's board approved a plan to buy back the Company's shares. The total cost of the shares to be bought back is up to $7.5 million US.

Delta Galil (Consolidated) - Segment Results, $M:

Sales	FY 2015	FY 2014	FY 2013	FY 2012	FY 2011
Delta USA	491	449	403	340	312
Global upper market	288	267	275	292	276
Delta Israel	126	127	111	90	91
Schiesser	185	202	194	99	0

Profit/loss by sector, net*	FY 2015	FY 2014	FY 2013	FY 2012	FY 2011
Delta USA	30	27	26	12	2
Global upper market	26	21	25	22	28
Delta Israel	7	8	8	6	13
Schiesser	14	18	15	12	0

* Operating profit/loss before non-recurring items.

Moderate industry risk due to pricing pressures and exposure to cotton prices

Delta operates in the global apparel industry as a wholesaler and retailer. Its products include underwear, leisurewear, sleepwear, Active wear and socks. We believe demand in the industry is exposed, to a moderate degree, to cyclicality and is affected by macroeconomic elements that influence private consumption. Delta's activity in relatively basic categories of the clothing industry is a mitigating factor against fluctuating demand due to economic cyclicality.

Pricing pressure on clothing manufacturers is inherently high, including due to meager distinction in certain categories, pricing pressure on retailers, medium customer loyalty, and growing online sales, all of which create a fiercely competitive environment. The very low level of cotton prices affects selling prices to wholesalers. In wholesale, the Company operates as a subcontractor for big, dominant customers with powerful bargaining positions that, due to the low product distinction in some of the categories, impose constant pricing pressure, which intensifies competition among the players in the industry. The industry is also exposed to competition by reverse integration, as in some cases, the customers "circumvent" the players in the industry and work directly with the manufacturing plants.

The clothing industry is exposed to changes in consumer tastes, such as the "fast fashion" and "value fashion" trends, and to rising sales by Internet, which requires the players to adjust their business models. These changes have been bad for product distinction in the industry, causing

competition to mount and price reduction. The Company's exposure to these changes is mitigated by its activity in relatively basic apparel, which is less exposed to changing tastes.

According to Moody's forecast (from December 2015), in 2016, American apparel companies operating in the international markets will achieve growth of 3%-5% in operating profit following growth of 4.6% in 2014 and 10.4% in 2013. Most of that growth will stem from the developing countries, based on expectations of modest growth in the macroeconomic parameters of the U.S. and Europe, and the strong dollar, which erodes income and hurts tourists' spending on apparel.

The industry is sensitive to the price of cotton, which is a material input for clothing manufacture. In 2015, cotton prices stayed at the low level observed at year-end 2014 and were a positive element in profitability for the companies in the industry. The industry's exposure to exchange rates is reflected in the weakening of the euro against the dollar in the last year, which dragged on the profitability of the industry's companies.

The industry is exposed to regulatory changes and mainly to changes in free trade agreements, which affect taxation of goods. In October 2015, the trade ministers of 12 countries in the Trans-Pacific Partnership announced reaching a framework agreement abolishing or reducing quotas on textiles and apparel imports between the member states. The agreement was signed in February 2016 and should be a favorable factor for apparel companies, based on expectation of lower costs.

Broad business dispersal diminished by exposure to dominant customers

The Company's business positioning is based on a relatively high volume of activity, with sales of about $1.08 billion in 2015, and on spreading activity over multiple continents, product lines and marketing avenues.

The Company's sales and profits derive mostly from wholesale sales to a range of big customers under brands that it owns, license agreements and private label activity. Among the Company's wholesale customers are major department store chains and international apparel brands that operate in a number of continents and bring the Company a wide geographical spread.

Over half the Company's sales stem from brands that it owns or to which it has license agreements, but the company has no strong, dominating own brand in its US activity (which contributed about 57% of its total sales in 2015). The Company has a long-term strategy of expanding marketing of branded products in general, and under brands it owns in particular, in order to create distinction and relative advantages. In 2015, Delta acquired Loomwork Apparel Inc.'s design, import and marketing activity in branded apparel, including sleepwear, leisurewear and intimate apparel, and accessories, for approximately $38 million. The main brand acquired is P.J. Salvage, which is sold mainly to upper chains in the U.S. In 2016 the Company also intends to launch products under the

Columbia and Juicy Couture brands, and to expand its work with the Lacoste and Marco O'Polo brands.

The Company's business positioning is diminished by its function as wholesaler operating with large customers, mainly giant global companies for which the Company is a subcontractor that develops products according to the customer's needs, manufactures products efficiently (usually using its own subcontractors) and manages a supply and inventory chain.

In recent years the Company has acted consistently to improve its manufacturing and distribution capabilities and in our opinion, has established strong status among its main customers. In 2015 it continued to improve its manufacturing and global supply chain by buying out a partner in a socks factory in Turkey and investing in a new plant being constructed in Vietnam. In the Company's opinion, the new plant should commence operation during the second half of 2016, and in our opinion, will improve the Company's competitive status and operational spread. The Company invests resources in its design and development departments and its products are characterized by technological innovation, which gives it a competitive advantage and enables it to operate with large customers in high-margin growth categories.

Delta is materially exposed to two large customers (Wal-Mart and Nike), which is unfavorable for its credit risk profile. In 2014 the Company began selling Active Wear products to Wal-Mart, under the Avia brand, sales which were a significant growth engine in recent years. Wal-Mart's results suffered in the last year and the chain announced it would be scaling back shelf space to expand the aisles in its chain stores. In our opinion, the Company's long-term ties with its key customers and increase in range of product categories sold to Wal-Mart and Nike slightly mitigate the concentration risk.

In our opinion, implementation of Wal-Mart's new strategic plan increases the risk of changes in the customer's demand and could reduce the volume of sales to Wal-Mart in the short to medium term, as happened after similar events in the past. In our base scenario, we assume that in the short run, the Delta USA segment's growth will be hurt by Wal-Mart's cutback plan, but it will be moderated by our estimate of growing Avia sales, the base effect of consolidating the activity of P.J. Salvage, and the start of new licenses and expansion of existing ones (Columbia and Lacoste). Our base scenario assumes that in the range of the forecast, sales to Nike will grow modestly due to entry into new categories (such as basic and seamless) and the introduction of new products in existing categories. The expected growth in sales to Nike will, in our opinion, contribute to the results of the "Global Upper Market" segment. In aggregate, our base scenario assumes a modest growth of approximately 1% (in original currency terms) in total sales in the short to medium term. This growth is based on the assessments described above and a modest growth forecast for the main economies in which the Company operates.

Expanding brand activity and further efficiency measures should compensate for pricing pressures and leave the Company's margins intact

The Company reported eroded operating profitability for 2015, to approximately 6.6% (versus an average of approximately 6.9% in the last two years), mainly due to erosion of the euro exchange rate (Scheisser's main activity currency) against the USD. The damage to operating profitability was moderated by the appreciation of the USD against the main currencies in which the Company's operating and procurement costs are denominated, and the consolidation of P.J. Salvage and the socks plant in Turkey.

In wholesale, which constitutes the lion's share of the Company's sales, Delta faces constant pricing pressure stemming from the industry trends described above and has relatively little pricing flexibility. Even so, in our view, the Company's activity in growth categories (such as Active Wear), its basket of products characterized by technological innovation, improving manufacturing efficiency, and its strategy to increase its branded activity slightly mitigate the industry risk and contribute to profitability.

The Global Upper Market segment (about 27% of sales in 2015) is characterized by relatively high profitability over time, due to the high quality and technological innovation of the products in this segment. Buying out the partner in the Turkish plant and efficiency measures in manufacturing in Egypt are expected to contribute to profitability. The Schiesser segment is also characterized by relatively good profitability, thanks to the strength of the brand, efficient self-production in the Czech Republic and in Slovakia, and the Company's activity mainly through factory outlets, which suits present consumer trends and is characterized by lower costs.

Our base scenario assumes that the Company's operating profitability will be in the range of 6%-7% in the short to medium term based on the stability in cotton prices (based on futures), the positive effect of consolidating the new activities, efficiency in manufacturing in Egypt and improvement at Delta USA after closing down the retail activity of the Little Miss Matched brand, against the negative influence of anticipated increases in wage and rent costs. The Company's profitability will continue to be susceptible to fluctuations due to pricing pressures and currency exposure.

Leverage is expected to remain moderate, and strong cash flows will continue to support fast coverage ratios

The Company's leverage ratio, as expressed in its debt/CAP ratio, was approximately 44% as of December 31, 2015, which stands out favorably for the rating grade. We expect the debt/CAP ratio

to improve to a level below 40%, as we expect moderate FCF, as described above, to be directed to repaying debt, along with use of cash, though we assume the Company will maintain material cash reserves.

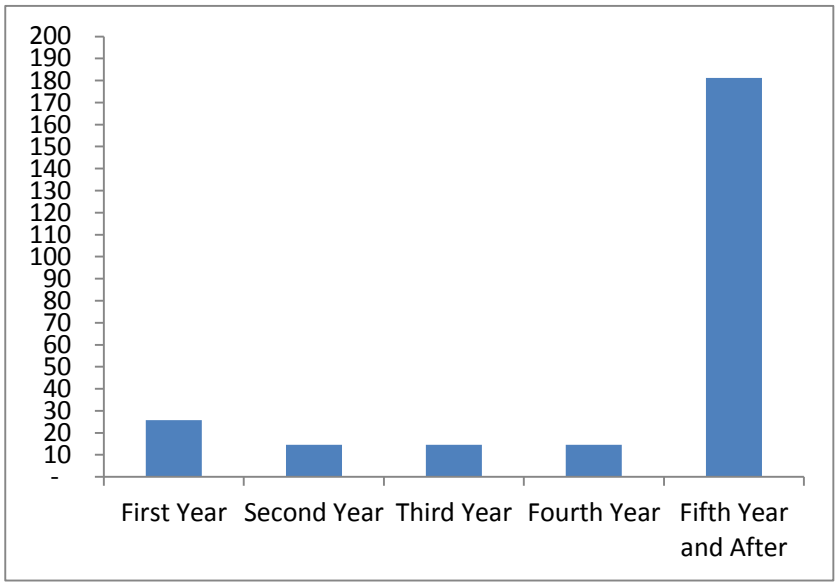
Midroog's base scenario assesses EBITDA of around $85-95 million and FFO of $55-65 million in the short to medium term. These cash flows will support coverage ratios that should range around gross adjusted financial debt/EBITDAR and gross adjusted financial debt/FFOR of 2.5-3 and 3.5-4.5 respectively, in the short to medium term. The coverage ratios are appropriate for the rating, alongside the stability and high visibility of cash flows. We expect EBIT/gross financial expenses to remain in the range of 4.0-5.0, according to the three-year average.

High liquidity and financial flexibility are expected to support future M&A

The Company has high balance of liquid assets, standing as of December 31, 2015 at approximately $168 million. We project that the Company will be incurring heavy capex in production and sales infrastructure in the year to come relative to its three-year average, with emphasis on investments in the new plant in Vietnam. Our base scenario assumes capex in the range of $35-$40 million in 2016. The extent of capex may drop to approximately $25 million in 2017 as investments in the Vietnamese plant and in the new offices in Caesarea wind down. We project that the Company will be distributing dividends or buying back shares at a rate of about $14-$15 million a year, which is the level of annual dividends paid in the last two years. Based on these assumptions, we estimate positive moderate FCF, that will enable, as described above, a certain decrease in debt, including through utilization of cash and depending on M&A needs, according to the Company's strategy.

The Company has good financial flexibility and relies on a high ability to generate cash flow, moderate repayment needs, a significant extent of unutilized underwritten credit facilities, moderate leverage and ample covenant headroom.

Amortization Schedule of Long-term Debt Principal as of December 31, 2015, in US $M:



Rating Outlook

Factors that could improve the rating:

- Improvement in the mix of sales, with an emphasis on increasing the mix of profitable, stable activity
- Sustaining the gross adjusted financial debt/EBITDAR coverage ratio below 2.0x over time

Factors that could lower the rating:

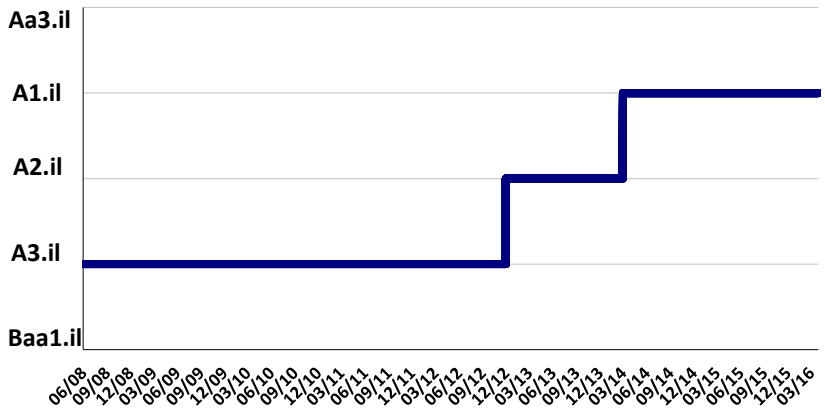
- Long-term deviation from gross adjusted financial debt/EBITDAR ratio of 4.0x
- Mergers and acquisitions which could increase the level of the Company's business risk and/or leverage

About the Company

Delta designs, develops, manufactures, markets and sells intimate apparel and socks, children's apparel, leisure wear and Active Wear apparel. The Group's customers include leading retail chains such as Wal-Mart, Target, and Victoria's Secret, as well as leading labels such as Nike, Calvin Klein, Tommy Hilfiger, and more.

The Company sells its products under licenses (such as Avia, Tommy Hilfiger and Lacoste) and brands it owns (such as P.J. Salvage, Karen Neuberger and more) and as part of private label activity. In Israel, the company operates through its chain of Delta stores, selling the owned brands (such as the Delta brand) and licensed brands (such as Nike, Disney and Keds) and also in wholesale. In western Europe, the Company sells through Schiesser, own brands (such as the Schiesser brand) and licensed brands (Lacoste, Marc O'Polo and so on). Schiesser operates in retail through Schiesser stores and in wholesale. The Company designs and develops its products primarily in Israel, Germany and the U.S., while production is mostly carried out by the Group's subcontractors and plants in the Middle East, Eastern Europe and the Far East. The Company's controlling shareholder is Mr. Isaac Dabah, who serves as CEO of the Company. Mr. Dabah owns an approximately 53.8% stake in the share capital and voting rights of the Company, taking into account the 5.3% stake held by Sterling Macro, a fund managed by Mr. Dabah. Another interested party is Mr. Noam Lautman, who owns an approximately 10% interest in the Company's share capital and voting rights.

Rating History



Related Reports

Delta Galil Industries Ltd. - Rating Action, May 2015

Rating Industrial Companies – Methodology Report, December 2015

Midroog Rating Scales and Definitions

The reports are published on Midroog's website: www.midroog.co.il.

General Information

Date of report: March 31, 2016
Date of previous report: May 18, 2015
Date of initial rating: June 17, 2008
Name of rating initiator: Delta-Galil Industries Ltd.
Name of party that paid for the rating: Delta-Galil Industries Ltd.

Information from the Issuer

In its ratings, Midroog relies, *inter alia*, on information received from the authorized organs of the issuer.

Millenium Tower, 17 Ha'Arba'a St., Tel-Aviv, Israel 64739 Tel. +972-3-6844700 Fax. +972-3-6855002 www.midroog.co.il

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Obligations Rating Scale

Local Long-Term Rating Scale

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Aa.il	Issuers or issues rated Aa.il are those that, in Midroog judgment, have very strong creditworthiness relative to other local issuers.
A.il	Issuers or issues rated A.il are those that, in Midroog judgment, have relatively high creditworthiness relative to other local issuers.
Baa.il	Issuers or issues rated Baa.il are those that, in Midroog judgment, have relatively moderate credit risk relative to other local issuers, and could involve certain speculative characteristics.
Ba.il	Issuers or issues rated Ba.il are those that, in Midroog judgment, have relatively weak creditworthiness relative to other local issuers, and involve speculative characteristics.
B.il	Issuers or issues rated B.il are those that, in Midroog judgment, have relatively very weak creditworthiness relative to other local issuers, and involve significant speculative characteristics.
Caa.il	Issuers or issues rated Caa.il are those that, in Midroog judgment, have extremely weak creditworthiness relative to other local issuers, and involve very significant speculative characteristics.
Ca.il	Issuers or issues rated Ca.il are those that, in Midroog judgment, have extremely weak creditworthiness and very near default, with some prospect of recovery of principal and interest.
C.il	Issuers or issues rated C are those that, in Midroog judgment, have the weakest creditworthiness and are usually in a situation of default, with little prospect of recovery of principal and interest.

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