



Delta Galil Industries Ltd.

Rating Action - May 2015

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Contacts:

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

Liat Kadisch, CPA, Team Leader
Liatk@midroog.co.il

Delta Galil Industries Ltd.

Series Rating	A1	Outlook: Stable
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Midroog announces reaffirmation of an A1/stable rating for bonds (series A, B, K, E) issued by Delta Galil Industries Ltd. ("**Delta**" or the "**Company**") in circulation, and up to NIS 200 million par value in Series B bonds that the Company will be issuing. The Company will be using the issue proceeds for its ongoing investments and activity.

The rating relates to the issue structure based on data submitted to Midroog up to May 18, 2015. If there are changes to the rating structure, Midroog may reconsider and revise the rating.

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

Series	Security No.	Original Issue Date	Annual Coupon	Linkage	Book Value Of Bonds Payable As Of Mar. 31, 2015 (NISm)	Remaining repayment yrs
K	6270110	Jan. 2010	7.0%*	-	82.2	2015-2016
E	6270136	Apr. 2012	7.6%**	-	167.6	2015-2021
A	6270144	Aug. 2013	5.0%***	-	408.4	2015-2028
B	6270151	Sept. 2014	3m Telbor + 2.1****	-	198.5	2024

* The Company hedges the bond balance through a cash flow swap with a banking corporation at 6.08% dollar interest.

** The Company hedges the bond balance through a cash flow swap with a banking corporation at 6.18% dollar interest.

*** The Company hedges the bond balance through a cash flow swap with a banking corporation, from which 90% at 4.075% dollar interest and the rest of the balance at 4.41% dollar interest.

**** The Company hedges the bond balance through a cash flow swap with a banking corporation, from which 90% at LIBOR+ 2.875% and the rest of the balance at LIBOR +2.55%.

Summary of Key Rating Rationale

The Company's rating reflects its substantial scope of activity, with over \$1 billion in revenues, which should continue to demonstrate organic growth in the year to come, and its good business status as a developer, manufacturer and international marketer of intimate apparel. This status is based on the Company's cutting-edge capabilities in product development and design and on its global production network, which includes both outsourcing and in-house production, facilitating competitiveness and flexibility. The Company also has a relatively wide geographical spread. On the other hand, the rating is unfavorably affected by Delta's subcontractor status in most of its activity, which creates an inherent risk on the side of price flexibility and profitability over time, partly due to its exposure to large, dominant customers in a price-oriented competitive environment. In recent years however the Company increased its brand activity to a degree that

improved operating profitability (EBIT %), which is in the range of 6%-7%, and where we expect it to stay in the short to medium run.

The rating is influenced favorably by the Company's conservative, consistent and transparent business and financial policy. The Company's leverage level is relatively moderate, which mitigates the business risks involved in its activity. We expect that the incline in leverage levels during the last year will continue in 2015, due to bond issues, which went chiefly to liquidity and had the effect of slowing the coverage ratios. The Company's rating is appropriate to our assessment that over time, its coverage ratios are likely to be in the range of 3.5-4.0 for adjusted gross debt/EBITDAR and 4.5-5.5 for adjusted gross debt/FFOR. The financing coverage ratio (EBIT/Gross finance) is expected to be in the range of 3.5-4.5. In our opinion, in the short run, the coverage ratios are likely to be in the upper part of these ranges.

The Company's liquidity is good, and relies over time on a relatively good ability to generate cash from activity, and conservative leverage policy. In the short run, we estimate that FCF could run negative due to growing capital investments. The Company has large liquidity balances that are likely to grow following the planned issue, and in the foreseeable future, we assess that part will be used for a significant acquisition, in keeping with the Company's strategy. Midroog will assess material acquisitions 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 sustaining coverage ratios that are appropriate to the rating level.

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

	Q1 2015	Q1 2014	FY 2014	FY 2013	FY 2012	FY 2011
Revenues	253	238	1032	975	818	679
Change in Revenues	6.2%	4.8%	5.9%	19.2%	20.5%	9.5%
Gross profit	73	72	318	294	210	161
Gross profit (%)	28.8%	30.4%	30.8%	30.2%	25.7%	23.7%
EBIT before one-time items and other income, net	14	14	71	67	48	37
% EBIT	5.4%	5.8%	6.9%	6.9%	5.9%	5.4%
Net profit	9	9	47	43	57	28
EBITDA	18	18	89	86	63	49
FFO	12	10	67	66	45	39
CFO	(20)	(7)	53	46	73	36
Capex	(10)	(10)	(36)	(23)	(95)	(16)
Liquidity balances	146	53	167	99	48	66
Financial debt	230	136	232	162	137	123
Equity/total assets	46.3%	52.5%	45.4%	49.4%	49.7%	49.0%
Debt/Cap	41.8%	29.7%	41.7%	33.9%	33.5%	36.8%

Debt/EBITDAR	3.8	2.9	3.8	3.2	3.4	3.4
Debt/FFOR	5.1	4.0	5.3	4.3	4.9	4.4
EBIT/Gross financing	3.7	4.4	4.7	5.3	4.9	4.7

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

	Q1 2015	Q1 2014	FY 2014	FY 2013	FY 2012	FY 2011
Revenues						
Delta USA	112	92	449	403	340	312
Global upper market	66	70	267	275	292	276
Delta Israel	28	26	127	111	90	91
Schiesser	49	53	202	194	177	NR
EBIT before one-time items						
Delta USA	5	4	27	26	12	2
Global upper market	4	6	21	25	22	28
Delta Israel	0	(0)	8	8	6	13
Schiesser	6	5	18	15	11	NR
% EBIT before one-time items						
Delta USA	4.4%	4.2%	6.0%	6.5%	3.5%	0.6%
Global upper market	6.6%	8.2%	7.7%	9.0%	7.7%	10.2%
Delta Israel	0.7%	(1.6%)	6.6%	7.6%	6.9%	14.2%
Schiesser*	12.4%	9.2%	9.1%	7.6%	6.4%	NR

* Schiesser was consolidated starting July 2012. The figures in the above table of segment results are pro forma for the entire fiscal year, based on the Company's figures.

Key Rating Factors

Established business profile, trending toward strength and growth

Delta is a leading manufacturer of intimate apparel and socks for international retail chains and international brands. The Company has a global supply chain and operates in a number of target markets in Europe, North America and Israel. In recent years the Company has consistently acted to improve its production and distribution capabilities, and to our opinion, has established a strong position among its major customers. However, the Company's business position is weakened by its subcontractor status regarding most of its sales, and its exposure to big, dominant customers, as well as the absence of dominant brands in most of the territories where it operates, a parameter that affects the level and stability of profitability. The wide diversification of its business partly compensates for that risk element. Moreover, the Company has a long-term strategy of expanding the marketing of the brands it owns and creating

distinction and comparative advantages. This strategy is reflected in its acquisition of the branded operations of Schiesser and expanding its branded activity in Israel and the U.S. The Company is also acting to reduce its risks in its global manufacturing and supply chain by moving production to Southeast Asia, investing in joint ventures, and consolidating plants. To establish its status even further, the Company invests resources in design and development, keeping its finger on the pulse of local and global developments in the intimate apparel industry, and in the tastes of its customers; and in the development and design of fashion collections.

For 2014 the Company reported annual growth of approximately 6% (approximately 6.2% in the first quarter of 2015), driven by organic growth in most of its segments. Most of the growth was at Delta USA segment, which entered into new categories, notably Active Wear, and licenses agreements added in recent years. We foresee this category being a major growth driver in the global undergarments industry, and the Company has proven experience and the technology suited to the growth trend. The growth in activity at Delta USA segment was accompanied by an increase in subcontract manufacturing for large U.S. retail chains, led by Wal-Mart. This line of business is characterized by exposure to large customers, high days of inventory, and moderate profitability.

The Company's retail activity in Israel also grew, with noteworthy significant growth by same-store sales, alongside expansion of the chain of stores, at the expense of eroded profitability. In our view, expanding the chain in the very tough Israeli competitive environment could weigh on profitability, to the degree that the market weakens. Global Upper-Market segment growth was negative in 2014 and in the first quarter of 2015 due to a combination of factors, led by a decrease in sales to a certain customer (in 2014) following its acquisition by a competitor, and the sharp depreciation in the euro/USD exchange rate (starting in the fourth quarter of 2014).

Our base scenario assumes revenue growth of about 4% to 5% in 2015, based on expansion in new categories (including the Avia franchise), new licensing agreements (Marc O'Polo and Lacoste), organic growth, and the maturation of investments in the store chain. The Company presented gradual improvement in operating profitability in recent years, mainly due to the rising volume of sales, increasing branded activity and continual efficiency measures in manufacturing, the supply chain, and organizational changes as well. Also, profitability received a boost from relatively low cotton prices. We project that the Company will sustain EBIT at about 6.5% of total turnover, versus its 3-year average of approximately 6.6%, which will be supported mainly by increasing the volume of activity.

Wide business and geographical spread, but EBIT concentrates in a number of key customers

The diversity of the Company's business by segment, geography, product categories and market segments is relatively broad. The diversity of sales among the segments improved due to growth in Delta USA's operations, which is expected to continue in the year to come. Schiesser's activity made a good contribution to profitability and stability, being a branded business line. The North American activity accounted for more than 55% of revenues, Europe accounted for about 32% (of which about half was Germany), and Israel accounted for the remaining 12%. The Company also operates in diverse product categories, with its traditional undergarments business continuing to

dominate, and an increase in hosiery. Its penetration into Active Wear should improve its product range and diversity.

In recent years, the Company has been highly exposed to a number of major customers, including: Nike in socks, Victoria's Secret in bras and nightwear (both belong to the Global Upper-Market segment) and Wal-Mart discount chain (which belongs to the Delta USA segment), exposure to which rose in the last year.

In our opinion, the exposure to the two key customers, Wal-Mart and Nike, which together account for approximately 25% of total revenues (versus approximately 20% a year ago), is material to the Company's profitability. In our opinion, the Company's long-standing relationship with its main customers and its moves to broaden product categories in working with Wal-Mart and Nike are mitigating factors.

Competitive business environment, relatively low entry barriers, and large dominant customers

The inherent risks to which the Company, half of whose activity derives from private label sales to big retailers, is exposed, include: relatively low entry barriers, a large number of strong, quality competitors, exposure to commodity prices, labor costs and their effect on profitability, and exposure to customer credit risks. Among the noteworthy industry trends is that the prices of commodities and energy have remained low; strengthening demand in big economies, chiefly the U.S. and Europe, and growth by the Active Wear category.

The Company is likely to sustain its strategy for growth and investment in fixed assets and brand acquisitions

Delta has been acting to further establish its status as a significant international player in intimate apparel, with an emphasis on buying brands with medium to high profiles that have significant volumes of activity, within its existing categories or new ones. Accordingly, we continue to assume that the Company's high cash balances will serve, *inter alia*, for M&A. In parallel, the Company is acting to grow existing segments by buying new franchises and entering into new product categories. We accordingly project that the Company will be incurring relatively heavy capex on production and sales infrastructure in the next two years, compared with previous years.

Conservatism and transparency contribute to stability and reduce risk

We have a high opinion of the business and financial management at Delta, which is a favorable factor for the rating. These are reflected, to our opinion, in the transparency of reportage and quality of the data, in meeting forecasts, in consistent dividend distribution, in the moderate, conservative leverage policy, and in the controlling shareholder's positive contribution to the Company's business positioning.

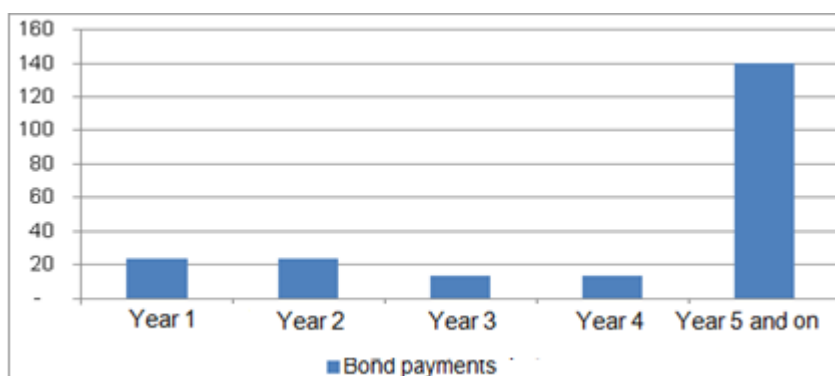
Increase in debt (together with an increase in cash balances) will continue to slow coverage ratios until an acquisition is made

In recent years, the Company gradually enlarged its financial debt while growing its extent of activity and profit. Its gross debt/CAP ratio remained steady at 33% until 2014. During 2014, debt grew following bond issues, whose proceeds went mostly to the liquidity balances, which in turn boosted the leverage ratio to about 43% as of March 31, 2015. The equity/total assets ratio also eroded, from about 50% to a level of approximately 46%, alongside, as we said, an increase in liquidity balances. The Company's financing costs coverage (EBIT/gross finance) eroded slightly, to 4.7 in 2014 compared to 5.3 in 2013. Funds from Operations (FFO) remained steady in 2014 despite improvement in EBITDA, mainly because of the rise in financing costs. The Company increased the extent of its capex in 2014 (mainly in buying brands and expanding stores) to support growth in its activity, and Free Cash Flow (FCF) was negligible. We project that investment in fixed assets will grow considerably this year (mainly on building the plant in Vietnam and substantial investments in the Company's offices in the U.S. and Israel), alongside an increase in days of inventory. Thus, we assume negative Free Cash Flow in 2015 as well. For 2015, we project similar trends of increasing debt (mainly by the planned bond issue and relatively low repayment) alongside rising cash balances, and as a corollary, erosion in leverage level, at least in the short run. As said above, pursuant to its strategy, the Company examines mergers and acquisitions in its field of activity and insofar as it carries out any, they should lead to an improvement in leverage ratios in the medium run. We project that in keeping with the Company's policy, as mentioned above, an acquisition would not involve significant additional leverage (beyond the planned bond issue, as described above), and coverage ratios would remain in the range of 3.5-4.0 for adjusted gross debt/EBITDAR and 4.5-5.5 for adjusted gross debt/FFOR. In the short term, these ratios are expected to remain within the upper part of the ranges said above.

Good liquidity and reasonable financial flexibility

Over time, the Company has presented good liquidity levels, relying mainly on a high ability to generate permanent cash flow, deriving from the profitability level it is expected to sustain, and due to its leverage level, which should remain moderate, and supports increasing the planned investment in fixed assets without further significant increase in debt. As mentioned above, Free Cash Flow is likely to be negative in the year to come. Among other things, we assess that days sales of inventory will increase somewhat (about 85 as of December 31, 2014 and about 93 as of March 31, 2015) mainly due to the anticipated growth in the activity of Delta USA. The Company's repayment needs are relatively modest in the next few years, mainly due to bullet issues in 2014-2015 and a significant scope of signed, unexploited bank credit facilities.

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



Rating Outlook

Factors that could improve the rating:

- Material improvement in the volume and diversification of revenues while sustaining high profitability
- Sustaining the long-term gross debt/EBITDAR coverage ratio below 2.0x over time.

Factors that could lower the rating:

- Long-term deviation from a gross debt/EBITDAR ratio of 4.0x
- Significant decline in activity with leading customers to an extent that materially impacts revenues and profit over time
- Mergers and acquisitions which could increase the level of the Company's business risk and/or leverage

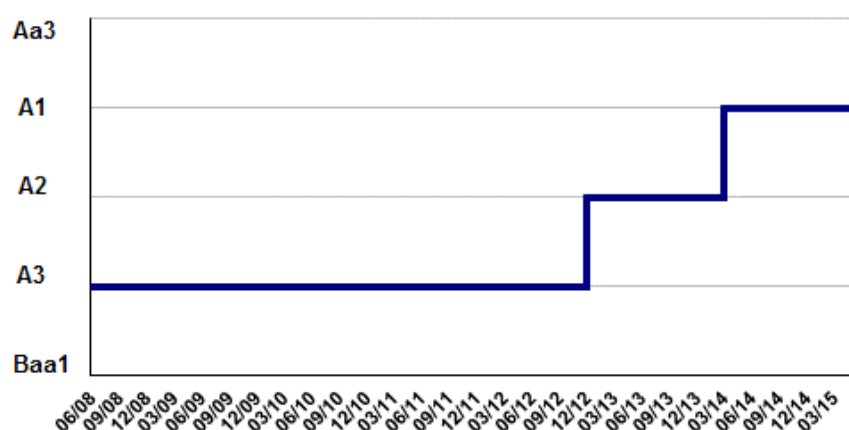
About the Company

Delta designs, develops, manufactures, markets and sells intimate apparel and socks, kid's leisurewear and Active Wear apparel. The Group markets its products through three marketing channels: manufacturing for leading international private labels such as Nike, Calvin Klein, Tommy Hilfiger, Triumph, Under Armour, Spanx, and Maidenform, and for the home brands of leading chain stores such as Marks & Spencer, Target, Wal-Mart, Victoria's Secret, Kohl's, Marmaxx, Odlo, Ross Stores, Lane Bryant, LuLulemon, Karstadt, Kaufhof and others; manufacturing and marketing under licensing agreements granted to the Company such as Converse, Tommy Hilfiger, Maidenform, Wilson, Kenneth Cole and more; marketing in Israel under brand names licensed to it which include, among others, Power Rangers, Paul Frank, Disney, NICI, Keds, Nike, and more, as well as under Delta's own brands which include Matchtonim, Yodfat, Touch, Punch, Comfort and Delta. In Germany the Company sells its products under its own brand names Schiesser Revival, Schiesser and Uncover, as well as under a brand name licensed to it - Siedensticker. Schiesser sells retail in Germany and Western Europe

through its chain of Schiesser stores, and operates in wholesale as well. 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 55.3% stake in the share capital and voting rights of the Company, taking into account the 6.4% stake held by Sterling Macro, a fund managed by Mr. Dabah. Another material shareholder is Mr. Noam Lautman, who owns an approximately 10.1% interest in the Company's share capital and voting rights.

Rating History



Related Reports

[Delta Galil Industries Ltd. - Rating Action, September 2014](#)

[Delta Galil Industries Ltd. - Rating Action, May 2014](#)

[Delta Galil Industries Ltd. - Rating Action, March 2014](#)

[Rating of Industrial and Trading Companies - Methodology Report, October 2013](#)

[Methodology for Adjusting Financial Ratios, November 2010](#)

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

Date of report: May 18, 2015



KEY FINANCIAL TERMS

Interest	Net financing expenses from Income Statement
Cash Interest	Financing expenses from income statement after adjustments for non-cash flow expenditures from statement of cash flows
Operating profit (EBIT)	Profit before tax, financing and onetime expenses/profits
Operating profit before amortization (EBITA)	EBIT + amortization of intangible assets.
Operating profit before depreciation and amortization (EBITDA)	EBIT + depreciation + amortization of intangible assets.
Operating profit before depreciation, amortization and rent/leasing (EBITDAR)	EBIT + depreciation + amortization of intangible assets + rent + operational leasing.
Assets	Company's total balance sheet assets.
Debt	Short term debt + current maturities of long-term loans + long-term debt + liabilities on operational leasing
Net debt	Debt - cash and cash equivalent long-term investments
Capitalization (CAP)	Debt + total shareholders' equity (including minority interest) + long-term deferred taxes in balance sheet
Capital investments	Gross investments in equipment, machinery and intangible assets
Capital Expenditures (CAPEX)	
Funds From Operations (FFO)*	Cash flow from operations before changes in working capital and before changes in other asset and liabilities
Cash Flow from Current Operations (CFO)*	Cash flow from operating activity according to consolidated cash flow statements
Retained Cash Flow (RCF)*	Funds from operations (FFO) less dividend paid to shareholders
Free Cash Flow (FCF)*	Cash flow from operating activity (CFO) - CAPEX - dividends

* It should be noted that in IFRS reports, interest payments and receipts, tax and dividends from investees will be included in the calculation of the operating cash flows, even if they are not entered in cash flow from operating activity.

Obligations Rating Scale

Investment grade	Aaa	Obligations rated Aaa are those that, in Midroog's judgment, are of the highest quality and involve minimal credit risk.
	Aa	Obligations rated Aa are those that, in Midroog's judgment, are of high quality and involve very low credit risk.
	A	Obligations rated A are considered by Midroog to be in the upper-end of the middle rating, and involve low credit risk.
	Baa	Obligations rated Baa are those that, in Midroog's judgment, involve moderate credit risk. They are considered medium grade obligations, and could have certain speculative characteristics.
Speculative Investment	Ba	Obligations rated Ba are those that, in Midroog's judgment, contain speculative elements, and involve a significant degree of credit risk.
	B	Obligations rated B are those that, in Midroog's judgment, are speculative and involve a high credit risk.
	Caa	Obligations rated Caa are those that, in Midroog's judgment, have weak standing and involve a very high credit risk.
	Ca	Obligations rated Ca are very speculative investments, and are likely to be in, or very near to, a situation of insolvency, with some prospect of recovery of principal and interest.
	C	Obligations rated C are assigned the lowest rating, and are generally in a situation of insolvency, with poor prospects of repayment of principal and interest.

Midroog applies numerical modifiers 1, 2 and 3 in each of the rating categories from Aa to Caa. Modifier 1 indicates that the bond ranks in the higher end of the letter-rating category. Modifier 2 indicates that the bonds are in the middle of the letter-rating category; and modifier 3 indicates that the bonds are in the lower end of the letter-rating category.



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Midroog Ltd., Millennium Tower, 17 Ha'Arba'a Street, Tel Aviv 6473917

Tel: 03-6844700, Fax: 03-6855002, www.midroog.co.il

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