



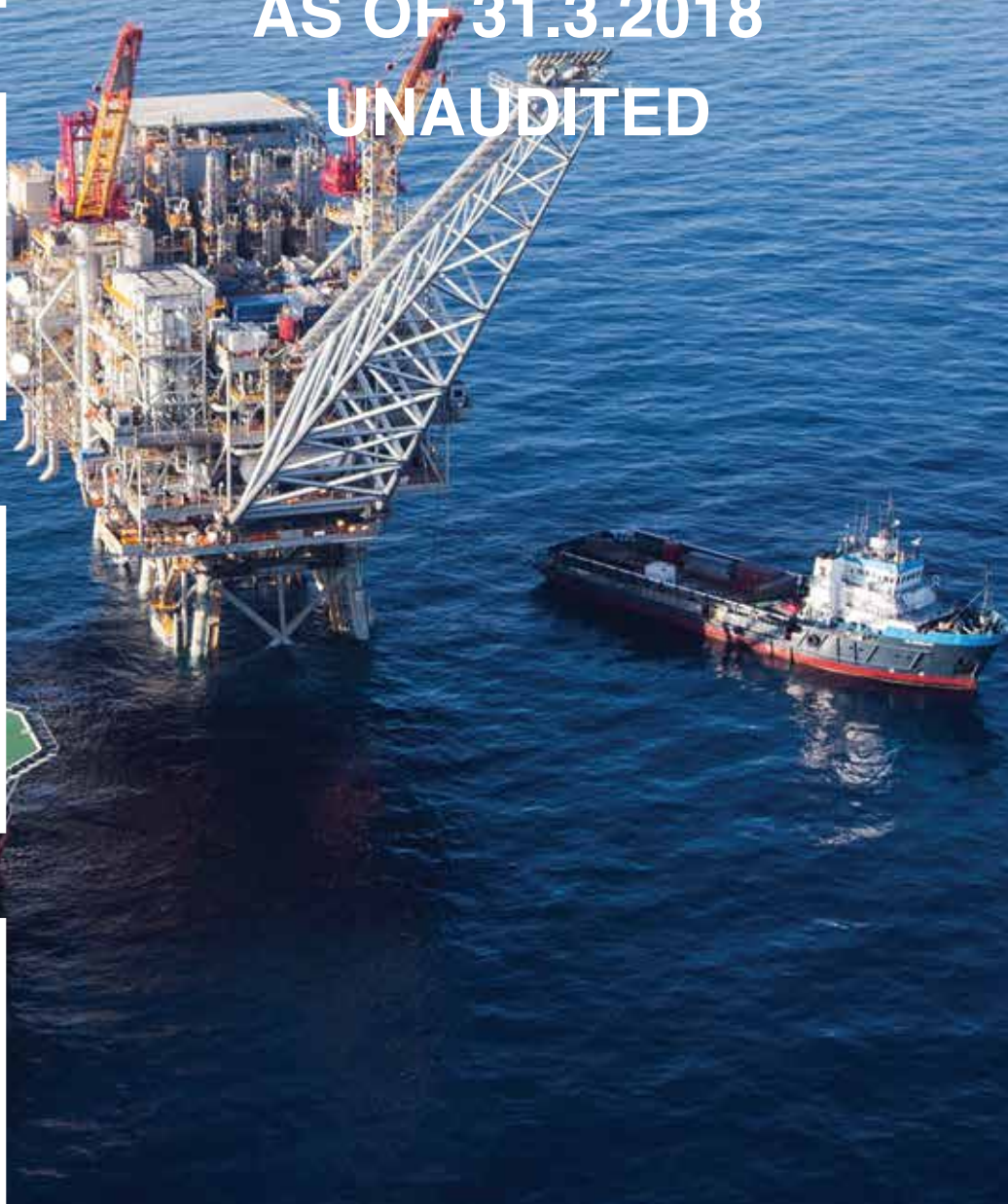
Delek Drilling

# 2018

## FINANCIAL STATEMENTS

### AS OF 31.3.2018

### UNAUDITED







# 2018

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Dolek Drilling

# 2018

## Partnership Description

*This report is a translation of Delek Drilling - Limited Partnership's Hebrew-language Update to Chapter A (Description of the Partnership's Business) of the Periodic Report for 2017 of Delek Drilling. It is prepared solely for convenience purposes. Please note that the Hebrew version constitutes the binding version, and in the event of any discrepancy, the Hebrew version shall prevail.*

## **Update to Chapter A (Description of the Partnership's Business) of the Periodic Report for 2017 of Delek Drilling – Limited Partnership (the “Partnership”)<sup>1</sup>**

### **1. Section 1.1 of the Periodic Report – The Partnership's operations and a description of the development of its business**

With respect to the notice of the Partnership and Delek Group Ltd. (the “**Delek Group**”) of April 12, 2018, according to which the condition for effecting a full exchange tender offer which Delek Group sought to carry out for the shares of Delek Energy Systems Ltd., (“**Delek Energy**”) see the Partnership's immediate report of April 12, 2018 (ref. no.: 2018-01-030633), the details appearing in which are hereby included by way of reference.

### **2. Sections 4.3.5 and 4.3.6 of the Periodic Report – Motion to the court for instructions regarding the interpretation and manner of implementation of Section 19 of the Taxation of Profits from Natural Resources Law, 5771-2011 (the “Motion”)**

On April 17, 2018, the Supreme Court ruled that the appeal filed by the general partner of the Partnership on December 31, 2017 with the Supreme Court from the judgment of the District Court in a motion of November 1, 2017 and the appeal filed with the Supreme Court in re Isramco Negev 2, will be scheduled for a hearing on the same date and before the same tribunal. On May 2, 2018, the Supreme Court ordered that the general partner is required to file its summations by June 24, 2018; the respondents are required to file their summations by October 24, 2018; and the general partner is entitled to file responding summations by December 17, 2018. In addition, a hearing was scheduled for completion of oral argumentation for March 18, 2019.

In this context it is noted that on May 8, 2018, the supervisor filed a motion with the Tel Aviv District Court for instructions, in which the court was moved to order the general partner, *inter alia*, to bear the supervisor's expenses in the framework of the motion and in the framework of the appeal that was filed as aforesaid. The general partner intends to file a response that will specify its objection to the said motion.

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<sup>1</sup> The update includes material changes or innovations which occurred in the Partnership's business from the date of release of the periodic report for 2017 which was published on March 21, 2018 (ref. no.: 2018-01-022209) (the “**Periodic Report**”) until shortly before the date of this report on any matter that must be described in the Periodic Report. The update relates to the section numbers in Chapter A (Description of the Partnership's Business) of the Periodic Report.



3. **Section 7.4.5(c) of the Periodic Report – Plan for the development of Leviathan Reservoir**

As of the date of this Report, the Ensco DS-7 rig has completed the drilling of the bottom part of the Leviathan-3 well to its final depth and is currently drilling the bottom part of the Leviathan-7 well to its final depth. Thereafter, the drilling rig will carry out a completion of the production wells at the Leviathan project.

4. **Section 7.5 of the Periodic Report – the 399/Roy license (the “Roy License”)**

On April 15, 2018, Ratio Oil Exploration (1992) - Limited Partnership (“**Ratio**”) announced that the Petroleum Commissioner at the Ministry of Energy (the “**Commissioner**”) had announced that he was extending the validity of the Roy License until July 14, 2018 subject to the changing of the work plan in the Roy License, as follows:

<b><u>Period</u></b>	<b><u>Concise Description of the Planned Work Plan</u></b>
2018 forth	<p>In accordance with the binding work plan in the Roy License, the following actions are required to be performed:</p> <ul style="list-style-type: none"> <li>• By July 1, 2018 – signing of a contract with a drilling contractor and delivery thereof to the Commissioner.</li> <li>• By January 15, 2019 – commencement of drilling in the area of the Roy License.</li> <li>• Three months from completion of the drilling – submission of a summary report of the results of the well.</li> </ul>

It is clarified that in view of the fact that the Partnership has an option only in the Roy License, and has no access to information of the joint venture, the description of the planned work plan and the timetables of the said actions are based on public reports of Ratio only.

**Caution concerning forward-looking information** – the above description regarding the planned actions in the Roy License, including timetables for the performance thereof, is forward-looking information, within the meaning thereof in the Securities Law, 5728-1968, and is based on public reports of Ratio only. Actual performance of the work plan, including the timetables, may be materially different than as specified above and is contingent, *inter alia*, on the applicable regulation, on technical ability and on economic merit.

5. **Section 7.11.4(b) of the Periodic Report – Agreements for the Sale of Natural Gas from the Leviathan Project**

With respect to fulfillment of all of the conditions precedent in the agreement for the supply of natural gas between the Leviathan partners and I.P.M. Beer Tuvia Ltd., see the Partnership’s immediate report of May 9, 2018 (ref. no.: 2018-01-036747), the details appearing in which are hereby included by way of reference.

6. **Section 7.20 of the Periodic Report – Financing**

- a. Following the provisions of Section 7.20.1(a) of the Periodic Report regarding financing documents which were executed on February 20, 2017 (as amended on May 9, 2017 and August 24, 2017) between the Partnership and a consortium of

local and foreign finance providers headed by HSBC Bank Plc. and J.P. Morgan Limited whereby the Partnership shall be provided with a limited recourse loan in the sum of up to approx. \$1.75 million (hereinafter in this Section the “**Financing Agreement**” and the “**Loan**”, respectively), for the purpose of financing its share in the balance of the investment in the development of the Leviathan project, Note that on March 29, 2018, all of the preliminary conditions for the withdrawal of money out of the second facility were fulfilled, according to the conditions for providing the loan facilities.

- b. Following Section 7.20.2(a) of the Periodic Report, it is noted that the Partnership met the financial covenants to which it had committed within the issuance of the bonds to the public as specified in Section 7.20.1(e) of the Periodic Report, as specified below:

Financial covenant	The ratio checked as of March 31, 2018 and as of the report date
The economic capital of the Partnership	Approx. \$4,441 million
The economic capital to debt ratio	Approx. 11
Distribution	-

- c. Following Section 7.20.2(b) of the Periodic Report, it is noted that the Partnership met the financial covenants to which it committed within the Financing Agreement as stated in section 7.20.1(a) of the Periodic Report, as specified below:

Financial covenant	The ratio checked as of March 31, 2018	The ratio checked as of April 26, 2018 – date of withdrawal of the money <sup>2</sup>	The checked ratio as of the Report release date
The required debt coverage ratio	6.7	5.3	5.3

7. **Section 7.25.15 of the Periodic Report – an agreement for the sale of the Partnership’s rights in the “Tanin” I/16 and “Karish” I/17 leases of August 16, 2016 (hereinafter: the “Agreement” and the “Leases”, respectively)**

With respect to the notice of Energean Israel Limited according to which on March 22, 2018 it made a final investment decision (FID) regarding the development of the leases, see immediate report of the Partnership of March 27, 2018 (ref. no.: 2018-01-

<sup>2</sup> According to the provisions of Section 7.20.4(a) of the Periodic Report, meeting the required debt coverage ratio will be measured, *inter alia*, at the time of each withdrawal. Commencing on March 21, 2018 (the Periodic Report release date) and until the release of this Report the Partnership carried out 3 withdrawals, with the last withdrawal being made on April 26, 2018. For each of the said withdrawals the Partnership met the required ratio.

025047), the details appearing in which are included herein by way of reference. For details regarding the consideration received upon the making of such investment decision and regarding the value of the consideration from the sale of the leases, see Note 4E to the financial statements as of March 31, 2018 (Chapter C of this Report), Annexes B and C to the Board of Directors' Report (Chapter B of this Report) and very material valuations which are attached hereto.

8. **Section 7.26 of the Periodic Report – Legal Proceedings**

- a. Further to the provisions of Section 7.26.1 of the Periodic Report, on April 12, 2018, the deceased petitioner's counsel filed an agreed motion for his substitution with his widow, subject to the filing of a supplementary affidavit on her behalf, and the motion was approved by the court on the same day. On May 6, 2018, an examination was held of an affiant for the State. Examinations of the other affiants in the proceeding (affiants on behalf of the State, the petitioner and the respondents) were scheduled for May 22, 2018 and June 26, 2018.
- b. Following the provisions of Section 7.26.2 of the Periodic Report regarding a claim filed by the Partnership and Noble Energy Mediterranean Ltd. ("**Noble**") on March 12, 2015 (hereinafter jointly in this Section: the "**Plaintiffs**") to the District Court in Jerusalem against the State of Israel, through its representatives of the Ministry of Energy (the "**Defendant**"), which includes mainly the return of royalties paid by the Plaintiffs, in excess and with reservation, to the Defendant, for revenues deriving from gas supply agreements executed between third party customers and the Yam Tethys Partners, it is noted that on April 9, 2018, the Defendant filed a motion for change of the hearing date and extension of the date for filing the affidavits on its behalf. In such motion, the State moved for the testimony affidavits on its behalf to be filed until May 15, 2018 (*in lieu* of April 1, 2018) and for the pretrial date scheduled for April 15, 2018 to be postponed accordingly. On April 9, 2018, the court awarded the Defendant's motion for an extension and it was ruled that the State shall file affidavits in lieu of direct testimony on its behalf until May 15, 2018 and a summary pretrial was scheduled for July 18, 2018.
- c. Following the provisions of Section 7.26.6(a) of the Periodic Report, as of this time, the mediation proceedings with regard to the Eran/353 license has not been exhausted yet, and on May 6, 2018 the parties moved the court to allow them to give an update regarding the outcome thereof by July 6, 2018. As of the date of this report, no decision has yet been issued in the motion.

9. **The following table contains production data of natural gas and condensate in Q1/2018 in the Tamar Project:**<sup>3,4</sup>

		Natural Gas	Condensate
Total output (attributed to the Partnership's capital right holders) in the period (in MMCF for natural gas and in thousands of barrels for condensate)		21,925	32.4
Average price per output unit (attributed to the Partnership's capital right holders) (Dollar per MCF and per barrel)		5.45	50.4
Average royalties (any payment derived from the output of the producing asset including from gross income from the petroleum asset) paid per output unit (attributed to the Partnership's capital right holders) (Dollar per MCF and per Barrel)	The State	0.61	5.62
	Third Parties	0.09	0.87
	Interested Parties	0.38	3.52
Average production costs per output unit (attributed to the Partnership's capital right holders) (Dollar per MCF and per barrel) <sup>5</sup>		0.4	1.9
Average net proceeds per output unit (attributed to the Partnership's capital right holders) (Dollar per MCF and per barrel)		3.97	38.49

Date: May 15, 2018

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**Delek Drilling – Limited Partnership**  
**via Delek Drilling Management (1993) Ltd., General Partner**  
Signed by: Gabi Last, Director (Stand-in Chairman of the Board)  
and Yossi Abu, CEO

<sup>3</sup> The data presented in the table above with respect to the ratio attributed to the Partnership's capital right holders in the average price per output unit, in the royalties paid, in the costs of the production and in the net proceeds, was rounded up to two digits after the decimal point.

<sup>4</sup> The production data include, in addition to the direct holding of the Partnership in the Tamar Project, also the share of the Partnership in the production data of Tamar Petroleum Ltd. in the following manner: commencing on January 1, 2018 until March 13, 2018, direct and indirect holding in the Tamar Project at a rate of 25.7% and commencing on March 14, 2018 until March 31, 2018 (the closing date of the transaction between Tamar Petroleum Ltd. and Noble for the purchase of 7.5% of Tamar and Dalit leases), direct and indirect holding in the Tamar Project at a rate of 25.7855%.

<sup>5</sup> It is emphasized that the average production costs per output unit include current production costs only and do not include the reservoir's exploration and development costs.





Delek Drilling



# 2018

**Board of Directors  
Report on the State of the  
Partnership's Affairs**

*This report is a translation of Delek Drilling - Limited Partnership's Hebrew-language Board of Directors' Report of the General Partner. It is prepared solely for convenience purposes. Please note that the Hebrew version constitutes the binding version, and in the event of any discrepancy, the Hebrew version shall prevail.*

May 15, 2018

## **Delek Drilling Limited Partnership**

### **Report of the Board of Directors of the General Partner for the Period Ended March 31, 2018**

The board of directors of Delek Drilling Management (1993) Ltd. (the “**General Partner**”) hereby respectfully submits the board of directors’ report for the three-month period ended March 31, 2018 (the “**Report Period**”).

### **Part One – Explanations of the Board of Directors on the State of the Partnership's Business**

#### **1. Main figures from the description of the Partnership's business**

The limited partnership of Delek Drilling (the “**Partnership**” or “**Delek Drilling**”) was founded on July 1, 1993 according to a partnership agreement between the trustee, Delek Drilling Trusts Ltd. as limited partner of the first part, and Delek Drilling Management (1993) Ltd. as general partner of the second part.

#### **Main changes that occurred in the Report Period:**

For a comprehensive description of the main changes in the Partnership’s business in the Report Period, see the update to Chapter A (Description of the Partnership’s Business) of the Periodic Report for 2017 (the “**Periodic Report**”), and the Condensed Interim Financial Statements as of March 31, 2018, which are attached below.

#### **2. Results of operations**

##### **A. General**

As of the date of approval of the Financial Statements, the Partnership’s primary business is the exploration, development and production of natural gas, condensate and petroleum, including the production and sale of natural gas and condensate from the Tamar reservoir in the area of the Tamar lease (the “**Tamar Project**”), promotion of the expansion of the production system of the Tamar Project, development of Phase 1A of the development plan of the Leviathan reservoir and promotion of the commercialization of the natural gas and condensate therefrom, promotion and planning of Phase 1B of the development plan of the Leviathan reservoir for additional target markets, promotion and planning of the commercialization of the natural gas and the development of the Aphrodite reservoir, examination of various infrastructure alternatives for the transmission of natural gas to additional target markets, exploration activity in the petroleum assets held by the Partnership, including to oil targets, along with the examination of entry into additional petroleum assets in Israel and in the Mediterranean Basin. The Partnership is also

engaged in the promotion of various natural gas-based projects, aiming to increase the sales volume of natural gas from the petroleum assets held by the Partnership, and in the examination and promotion of various alternatives for the sale of the Partnership's holdings in the Tamar Project, in accordance with the provisions of the Gas Framework (for details with respect to the Gas Framework, see Note 12J1 to the Financial Statements for 2017).

The Partnership's net profit in the Report Period amounted to approx. \$88.3 million, compared with approx. \$78.9 million in the same period last year.

The increase in profit in the Report Period relative to the same period last year mainly derives from the revaluation of amounts receivable (royalties and the debt component) in relation to the sale of the Karish and Tanin leases, offset in view of the decrease in the Partnership's share of the Tamar reservoir due to the disposition of some of the Partnership's interests in the Tamar reservoir in July 2017.

## B. Analysis of statements of comprehensive income

Below are main figures with regards to the Partnership's income statements  
(Dollars in thousands):

	1-3/2018	1-3/2017	2017
<b>Revenues:</b>			
From natural gas and condensate sales	106,606	145,047	501,926
Net of royalties	21,278	22,697	80,256
	<b>85,328</b>	<b>122,350</b>	<b>421,670</b>
<b>Expenses and costs:</b>			
Cost of gas and condensate production	8,502	10,379	35,188
Depreciation, depletion and amortization expenses	10,309	15,078	94,898
Oil and gas exploration expenses, and other direct expenses	1,375	1,989	7,840
G&A expenses	2,299	2,633	10,629
<b>Total expenses and costs</b>	<b>22,485</b>	<b>30,079</b>	<b>148,555</b>
Other revenues (expenses)	(988)	-	566,542
Partnership's share of earnings (losses) of company accounted for at equity, net	(5,360)	-	10,042
<b>Operating profit</b>	<b>56,495</b>	<b>92,271</b>	<b>849,699</b>
Financial expenses	(15,804)	(18,681)	(75,044)
Financial income	48,360	9,071	46,872
Net financial income (expenses)	32,556	(9,610)	(28,172)
<b>Profit before levy</b>	<b>89,051</b>	<b>82,661</b>	<b>821,527</b>
Petroleum and gas profit levy	(757)	(3,796)	(4,305)
<b>Net profit</b>	<b>88,294</b>	<b>78,865</b>	<b>817,222</b>
<b>Other comprehensive income (loss) in respect of items which may subsequently be reclassified to profit or loss:</b>			
Loss in respect of cash flow hedging transactions	-	-	(3,957)
Profit in respect of financial assets available for sale	-	137	2,237
Carried to profit or loss in respect of the disposition of financial assets available for sale and cash flow hedging transactions	(621)	-	(1,599)
<b>Total other comprehensive income (loss) for the period</b>	<b>(621)</b>	<b>137</b>	<b>(3,319)</b>
<b>Total comprehensive income</b>	<b>87,673</b>	<b>79,002</b>	<b>813,903</b>
Gas sales in BCM <sup>1</sup>	<b>2.4</b>	<b>2.4</b>	<b>9.9</b>
Condensate sales in thousands of barrels <sup>2</sup>	<b>109</b>	<b>114</b>	<b>455</b>

<sup>1</sup> Figures refer to natural gas sales by all Tamar partners and all Yam Tethys partners, rounded off to one tenth of a BCM.

<sup>2</sup> Figures refer to condensate sales (100%) in the Tamar Project, rounded off to thousands of barrels.



**Net revenues** in the Report Period amounted to approx. \$85.3 million compared with approx. \$122.3 million in the same period last year. The decrease in revenues in the Report Period compared with the same period last year primarily derives from the disposition of some of the Partnership's interests in the Tamar reservoir and from an increase in the rate of the overriding royalties to Delek Group Ltd. and to Delek Energy Systems Ltd. (affiliated parties).

**The cost of production of gas and condensate** mainly includes the administrative and operating expenses of the Tamar Project, which include, *inter alia*, conveyance and transportation, payroll, consulting, maintenance and insurance expenses. The cost of production of gas and condensate in the Report Period amounted to approx. \$8.5 million compared with approx. \$10.4 million in the same period last year. The decrease in the Report Period mainly derives from the disposition of some of the Partnership's interests in the Tamar reservoir.

**Depreciation, depletion and amortization expenses** in the Report Period amounted to approx. \$10.3 million compared with approx. \$15.1 million in the corresponding period. The depreciation expenses during the period include depletion depreciation in the Tamar and Yam Tethys projects. The decrease chiefly derives from the disposition of some of the Partnership's interests in the Tamar Project.

**Oil and gas exploration expenses** in the Report Period amounted to approx. \$1.4 million, compared with approx. \$2 million in the same period last year. Oil and gas exploration expenses in the period include, *inter alia*, expenses on geologists, engineers and consulting as well as the G&A expenses of various projects. The decrease in the Report Period chiefly results from a reimbursement received from the operator of the joint ventures.

**G&A expenses** in the Report Period amounted to approx. \$2.3 million, compared with approx. \$2.6 million in the same period last year, and include, *inter alia*, expenses on professional services, payroll expenses and the General Partner's management fees. Furthermore, G&A expenses include expenses in the amount of approx. \$0.4 million (in the same period last year: approx. \$0.4 million), which were recorded against a capital reserve for transactions between a corporation and a controlling interest holder thereof and which mainly derive from costs that are financed by the General Partner and, according the Partnership Agreement, are not borne by the Partnership.

**Other expenses** in the Report Period amounted to approx. \$1 million and derive from the update of other long-term assets.

**Partnership's share of earnings (losses) of company accounted for at equity, net** amounted to an expense in the sum of approx. \$5.4 million which derived from the Partnership's share of the results of Tamar Petroleum in the Report Period and the effect of the decrease in the holding rate, as provided in Note 4D to the financial statements attached below.

**Financial expenses** in the Report Period amounted to approx. \$15.8 million compared with approx. \$18.7 million in the same period last year. Most of the financial expenses derived from interest in respect of bonds in the sum of approx. \$20.5 million, out of which the Partnership capitalized financial expenses in the amount of approx. \$6.5 million, which were attributed to the development of the Leviathan project. In addition, in the Report Period, the Partnership capitalized direct financial expenses in the sum of approx. \$20.8 million in respect of the Leviathan project. The decrease in financial expenses in the Report Period relative to the same period last year chiefly results from the repayment of 20% of the bonds of Tamar Bond in July 2017 in the context of the disposition of some of the Partnership's interests in the Tamar Project.

**Financial income** in the Report Period amounted to approx. \$48.4 million, compared with approx. \$9.1 million in the same period last year. The rise in financial income mainly derives from an update of receivables in connection with the future-production-based royalties component (the "**Royalties**") and receivables in connection with a final investment decision (the "**Debt Component**") that derived from the sale of all of the Partnership's interests in the Karish and Tanin leases, in the sum of approx. \$45 million. Such update mainly derives from a change in the cap rates, bringing forward of the date of the investment decision on the development of the leases, updating of contingent resources and hydrocarbon liquids (condensate and natural gas liquids) and a production rate forecast. For details see Note 4E to the attached financial statements, Annexes B and C to the board of directors' report and the attached Royalties and Debt Component valuations.

**Petroleum and gas profit levy** in the Report Period amounted to an expense of approx. \$0.8 million, compared with approx. \$3.8 million in the same period last year. The amount of the levy in the Report Period is comprised of a levy in respect of the Partnership's revenues from the Yam Tethys project.

### **3. Financial position, liquidity and financing sources**

#### **A. Financial position**

Below is a specification of the main changes in the condensed interim statement of financial position as of March 31, 2018, compared with the statement of financial position as of December 31, 2017:

**Total condensed statement of financial position** as of March 31, 2018 amounts to approx. \$3,230.9 million compared with approx. \$3,055.5 million as of December 31, 2017.

**Current assets** of the Partnership as of March 31, 2018 total approx. \$509.8 million compared with approx. \$511 million as of December 31, 2017, as specified below:

- 1) **Cash and cash equivalents** as of March 31, 2018 total approx. \$140.2 million compared with approx. \$154.8 million as of December 31, 2017. The decrease over the period derived from the distribution of profit to the participation unit holders and from the making of short-term investments.

On the other hand, the Partnership withdrew surplus funds from the accounts of Tamar Bond and a proceed in relation to the sale of the “Karish” and “Tanin” leases, as specified in Note 4E to the condensed interim financial statements attached below.

- 2) **Short-term investments** as of March 31, 2018 total approx. \$303.2 million compared with approx. \$278.8 million as of December 31, 2017, and include, *inter alia*, corporate bonds, short-term deposits, a deposit serving as a safety cushion for the bonds of Tamar Bond, and ETFs.
- 3) **Trade receivables** as of March 31, 2018 total approx. \$41.7 million compared with approx. \$46.5 million as of December 31, 2017.
- 4) **Other receivables** as of March 31, 2018 total approx. \$24.6 million compared with approx. \$30.9 million as of December 31, 2017. The decrease derives primarily from a decrease in the balances of the operator of the joint ventures, and, conversely, the item includes accounts receivable recorded in respect of a dividend declared by a company accounted for at equity in the sum of approx. \$7.2 million and in respect of receivables in relation to the sale of Karish and Tanin leases in the sum of approx. \$14.3 million.

**Non-current assets** of the Partnership as of March 31, 2018 amount to approx. \$2,721 million compared with approx. \$2,544 million on December 31, 2017, as specified below:

- 1) **Investments in petroleum and gas assets** as of March 31, 2018 total approx. \$2,192.1 million compared with approx. \$2,023.7 million as of December 31, 2017. The increase mainly derives from investments for the development of the Leviathan project in the sum of approx. \$177 million. On the other hand, the Partnership recorded depreciation depletion and amortization expenses in respect of the Tamar and Yam Tethys projects in the sum of approx. \$10.3 million.
- 2) **Other long-term assets** as of March 31, 2018 totaled approx. \$309.8 million compared with approx. \$289.5 million as of December 31, 2017. The assets mainly include amounts receivable in respect of the sale of the Karish and Tanin leases in the sum of approx. \$186 million, other receivables in respect of the construction of infrastructures for the export of gas in the sum of approx. \$37.5 million, and advance payments on account of royalties paid to the State, to related parties and to third parties in the sum of approx. \$34.9 million.
- 3) **Long-term deposits in banks** as of March 31, 2018 total approx. \$101.9 million compared with approx. \$101.5 million as of December 31, 2017, which are used as a safety cushion for the bonds of Tamar Bond.
- 4) **Investment in a company accounted for at equity** as of March 31, 2018 includes an investment in the shares of Tamar Petroleum Ltd. in the sum of approx. \$117.2 million, compared with an investment of approx. \$129.8 as of December 31, 2017. The change in the investment in the Report Period

derived from the Partnership's share in the earnings of the company accounted for at equity in the sum of approx. \$3.8 million, net of a dividend receivable in the sum of approx. \$7.2 million and net of an expense deriving from the dilution of the Partnership's holdings in the company accounted for at equity, as stated in Note 4D to the financial statements attached below.

**Current liabilities** as of March 31, 2018 amount to approx. \$479.2 million compared with approx. \$502.2 million as of December 31, 2017, as specified below:

- 1) **Bonds** – current maturities of bonds of Tamar Bond due for payment in December 2018 in the sum of approx. \$309.7 million, after setoff of bonds purchased by the Partnership during the Report Period and net of the issue costs.
- 2) **Trade and other payables** as of March 31, 2018 amounted to approx. \$169.5 million compared with approx. \$122.4 million as of December 31, 2017. The increase mainly derives from an increase in the balance of the operator of the joint venture at the Leviathan project and from interest payable recorded in respect of Series A Bonds and liabilities to banks.

**Non-current liabilities** as of March 31, 2018 amount to approx. \$2,045.1 million compared with approx. \$1,934.9 million as of December 31, 2017, as specified below:

- 1) **Bonds** – in the sum of approx. \$1,345 million consist of Series A Bonds in the sum of approx. \$394.6 million (net of issue expenses) and bonds of Tamar Bond in the sum of approx. \$950.4 million (net of issue expenses) (see Part Four below). Furthermore, the bonds due for payment in December 2018 were classified, as aforesaid, under current maturities.
- 2) **Long-term liabilities to banks** include a loan in the sum of approx. \$577.7 million (net of fees), taken by the Partnership in relation to the financing of the Leviathan project (as stated in Note 10C to the annual financial statements attached below).
- 3) **Other long-term liabilities** as of March 31, 2018 total approx. \$122.4 million, compared with approx. \$121.6 million, as of December 31, 2017, and include gas and petroleum asset retirement obligations in the Yam Tethys, Tamar and Leviathan projects, liabilities in connection with a share-based payment and royalties to the State, as well as a liability in respect of a balance of taxes payable on account of the holders of the Partnership's participation units in relation to the sale of 9.25% of the Partnership's interests in the Tamar and Dalit leases. The increase mainly derives from an update to the asset retirement obligations.

**The capital of the limited partnership** as of March 31, 2018 totals approx. \$706.5 million compared with approx. \$618.5 million as of December 31, 2017. The increase in capital mainly derives from the profit for the period in the sum of approx. \$88.3 million, and an increase in a capital reserve for



transactions between a corporation and a controlling interest holder thereof in the amount of approx. \$0.4 million. Conversely, a decrease was recorded in a capital reserve for financial assets available for sale and cash flow hedging transactions in the sum of approx. \$0.6 million. See Note 2C to the financial statements attached below with respect to the classification of opening balances as retained earnings following the entry into effect of accounting standard IFRS9.

### **Cash flow**

Cash flows generated by the Partnership from operating activities amounted in the Report Period to approx. \$53.5 million, compared with approx. \$106.8 million in the same period last year. The decrease chiefly resulted from a decrease in the operating income due to the disposition of some of the Partnership's interests in the Tamar reservoir and from an increase in trade and other receivables and a decrease in trade and other payables.

Cash flows used for investment activities amounted in the Report Period to approx. \$106.1 million, compared with approx. \$184 million in the same period last year. In the Report Period, the Partnership invested approx. \$139.8 million, mainly in the Leviathan project, and a net sum of approx. \$15 million in short-term financial investments. On the other hand, the Partnership received proceeds in the sum of approx. \$11 million in relation to the sale of the Karish and Tanin leases and there has been an increase due to the operator of the joint ventures of approx. \$43 million.

Cash flows generated from financing activities in the Report Period total approx. \$38 million, compared with approx. \$300.3 million used for financing activities in the same period last year. Cash flows for financing activities in the Report Period mainly derived from the receipt of loans from banks for the purpose of funding the Leviathan project and, conversely, the Partnership distributed profits declared in December 2017 in the sum of approx. \$61 million and also purchased bonds of Tamar Bond which are due for payment in December 2018 in the sum of approx. \$10 million.

### **B. Profit distributions**

On January 18, 2018, the Partnership distributed approx. ILS 209.3 million (ILS 0.1783416 per participation unit), which was approved by the board of directors of the General Partner and the trustee on December 21, 2017.

### **C. Proforma statements**

Further to Note 7C1B to the annual financial statements regarding the sale of 9.25% of the interests in the Tamar and Dalit leases, the Partnership prepared proforma condensed interim financial statements, for the 3-month period ended March 31, 2017, which are attached below, in accordance with the assumptions specified in Note 3 to the said statements.

**Net profit** in Q1/2018 totaled approx. \$88.3 million compared with approx. \$63.6 million in the proforma statements for the same period last year. The

increase in profit in the Report Period mainly derives from the revaluation of accounts receivable in relation to the sale of the Partnership's interests in petroleum and gas assets, from the increase in the gas prices compared with the same period last year and from a decrease in the Partnership's depreciation and amortization expenses deriving from the Yam Tethys reservoir and on the other hand, net losses from a company accounted for at equity were recorded in the Report Period.

**Income net of royalties** in Q1/2018 totaled approx. \$85.3 million compared with approx. \$86.6 million in the proforma statements for the same period last year, a decrease of approx. 2%. The decrease in income in the Report Period compared with the same period last year chiefly derives from an increase in the rate of the royalties to affiliated parties in the Tamar Project, which was partly offset by an increase in the gas prices at the Tamar Project in the Report Period.

**Total expenses and costs** in Q1/2018 totaled approx. \$22.5 million compared with approx. \$22.4 million in the proforma statements for the same period last year.

**Net financial income** in Q1/2018 totaled approx. \$32.6 million compared with financial expenses of approx. \$5.6 million in the proforma statements for the same period last year. The change mainly derives from an increase in the financial income as specified in Section 2B of Part One above.

## Part Two – Exposure to and Management of Market Risks

Over the course of the reported period, no change occurred in the areas of the Partnership's exposure or in the market risks, as reported in the board of directors' report for 2017, except as stated below:

### 1. Report on linkage bases in Dollars in thousands, as of March 31, 2018

	<b>Financial Balances</b>		<b>Non-Financial Balances</b>	<b>Total</b>
	<b>In Dollars or Dollar-Linked</b>	<b>In Non-Linked ILS</b>		
<b><u>Assets</u></b>				
Cash and cash equivalents	131,378	8,845	-	140,223
Short-term investments	302,999	183	-	303,182
Trade receivables	41,739	-	-	41,739
Other receivables	24,350	-	285	24,635
Investments in gas and petroleum assets	-	-	2,192,125	2,192,125
Long-term bank deposits	101,927	-	-	101,927
Investment in company accounted for at equity	-	-	117,236	117,236
Other long-term assets	198,458	-	110,391	309,849
<b>Total assets</b>	<b>800,851</b>	<b>9,028</b>	<b>2,420,037</b>	<b>3,230,916</b>
<b><u>Liabilities</u></b>				
Trade and other payables	158,736	73	10,694	169,503
Bonds	1,654,730	-	-	1,654,730
Long-term liabilities to banks	577,743	-	-	577,743
Other long-term liabilities	-	-	122,397	122,397
<b>Total liabilities</b>	<b>2,391,209</b>	<b>73</b>	<b>133,091</b>	<b>2,524,373</b>
<b>Total net balance sheet balance</b>	<b>(1,589,358)</b>	<b>8,955</b>	<b>2,286,946</b>	<b>706,543</b>

2. **Report on linkage bases in Dollars in thousands, as of December 31, 2017**

	<b><u>Financial Balances</u></b>		<b>Non-</b>	
	<b><u>In Dollars or Dollar- Linked</u></b>	<b><u>In Non- Linked ILS</u></b>	<b><u>Financial Balances</u></b>	<b><u>Total</u></b>
<b><u>Assets</u></b>				
Cash and cash equivalents	140,842	13,993	-	154,835
Short-term investments and deposits	278,632	194	-	278,826
Trade receivables	46,506	-	-	46,506
Other receivables	29,462	-	1,416	30,878
Investments in gas and petroleum assets	-	-	2,023,671	2,023,671
Long-term deposits	101,482	-	-	101,482
Investment in a company accounted for at equity	-	-	129,833	129,833
Other long-term assets	179,885	-	109,587	289,472
<b>Total assets</b>	<b><u>776,809</u></b>	<b><u>14,187</u></b>	<b><u>2,264,507</u></b>	<b><u>3,055,503</u></b>
<b><u>Liabilities</u></b>				
Trade and other payables	96,344	62	25,823	122,355
Declared profits for distribution	-	-	60,381	60,381
Bonds	1,663,740	-	-	1,663,740
Long-term liabilities to banks	468,967	-	-	468,967
Other long-term liabilities	-	-	121,582	121,582
<b>Total liabilities</b>	<b><u>2,229,177</u></b>	<b><u>62</u></b>	<b><u>207,786</u></b>	<b><u>2,437,025</u></b>
<b>Net asset balance</b>	<b><u>(1,452,368)</u></b>	<b><u>14,125</u></b>	<b><u>2,056,721</u></b>	<b><u>618,478</u></b>



### 3. Sensitivity tests

In accordance with Amendment of Y/5767 to the provisions of the Second Schedule to the Securities Regulations (Immediate and Periodic Reports) 5730-1970, the Partnership performed tests of sensitivity to changes in risk factors affecting the fair value of “sensitive instruments”.

#### **Analysis of the sensitivity of contingent proceeds in relation to royalties and receivables in relation to the debt component from the sale of the Karish and Tanin leases to changes in the cap rate (\$ in thousands):**

Sensitive instrument	Profit/(Loss) from Changes		Fair Value	Profit/(Loss) from Changes	
	2%	1%		-1%	-2%
Contingent proceeds in connection with royalties based on future production	(16,511)	(8,697)	114,600	9,707	20,575
Amounts receivable in connection with a final investment decision for the development of the Karish and Tanin leases	(6,487)	(3,344)	86,700	3,561	7,357
<b>Total</b>	<b>(22,998)</b>	<b>(12,041)</b>	<b>201,300</b>	<b>13,268</b>	<b>27,932</b>

#### **Analysis of the sensitivity of contingent proceeds in relation to royalties from the sale of the Karish and Tanin leases to changes in the natural gas price (\$ in thousands):**

Sensitive instrument	Profit/(Loss) from Changes		Fair Value	Profit/(Loss) from Changes	
	10%	5%		-5%	-10%
Contingent proceeds in connection with royalties based on future production	4,019	333	114,600	(3,733)	(5,136)

#### **Tests of sensitivity to changes in the Dollar/ILS exchange rate (\$ in thousands):**

Sensitive instrument	Profit/(Loss) from Changes		Fair Value	Profit/(Loss) from Changes	
	10%	5%		-5%	-10%
	3.865	3.690		3.338	3.163
Cash and cash equivalents	(885)	(442)	8,845	442	885
Bank deposits	(18)	(9)	183	9	18
Trade and other Payables	7	4	(73)	(4)	(7)
<b>Total</b>	<b>(896)</b>	<b>(447)</b>	<b>8,955</b>	<b>447</b>	<b>896</b>

**Tests of sensitivity to changes in the LIBOR curve (\$ in thousands):**

Dollar Interest	Profit/(Loss) from Changes		Fair Value	Profit/(Loss) from Changes	
	10%	5%		-5%	-10%
Foreign bonds	(390)	(195)	83,570	195	390
Liabilities to banks	4,647	2,320	(640,333)	(2,320)	(4,647)
<b>Total</b>	<b>4,257</b>	<b>2,125</b>	<b>556,763</b>	<b>(2,125)</b>	<b>(4,257)</b>

## **Part Three – Disclosure in connection with the Corporation’s Financial Reporting**

### **1. Subsequent events**

For material events after the date of the condensed statement of financial position, see Note 6 to the financial statements as of March 31, 2018, which are attached below.

### **2. Critical accounting estimates**

No material change occurred in the Report Period compared with the reports for 2017, except as stated in Note 2 to the financial statements in relation to the first-time application of new accounting standards.

**Part Four – Details of bonds issued by Delek & Avner (Tamar Bond) Ltd. (in Dollars in thousands) and the issue of bonds by the Partnership (in ILS in thousands)**

<b>Bond Series</b>	<b><u>2018</u></b>	<b><u>2020</u></b>	<b><u>2023</u></b>	<b><u>2025</u></b>
<b>Par value on issue date</b>	400,000	400,000	400,000	400,000
<b>Issue date</b>	May 19, 2014	May 19, 2014	May 19, 2014	May 19, 2014
<b>Par value as of March 31, 2018</b>	320,000	320,000	320,000	320,000
<b>Linked par value as of March 31, 2018</b>	320,000	320,000	320,000	320,000
<b>Value in the Partnership's books as of March 31, 2018</b>	309,599 <sup>3</sup>	,318407	,316665	,315503
<b>Market cap as of March 31, 2018<sup>4</sup></b>	313,924 <sup>3</sup>	325,327	328,645	330,160
<b>Fixed annual interest rate</b>	3.839%	4.435%	5.082%	5.412%
<b>Principal payment date</b>	December 30, 2018	December 30, 2020	December 30, 2023	December 30, 2025
<b>Interest payment dates</b>	Semiannual interest payable on every June 30 <sup>th</sup> and every December 30 <sup>th</sup> as of the date of the issue in 2014-2018	Semiannual interest payable on every June 30 <sup>th</sup> and every December 30 <sup>th</sup> as of the date of the issue in 2014-2020	Semiannual interest payable on every June 30 <sup>th</sup> and every December 30 <sup>th</sup> as of the date of the issue in 2014-2023	Semiannual interest payable on every June 30 <sup>th</sup> and every December 30 <sup>th</sup> as of the date of the issue in 2014-2025
<b>Linkage base: base index<sup>5</sup></b>	None			
<b>Conversion right</b>	None			
<b>Right to prepayment or mandatory conversion<sup>6</sup></b>	Right to prepayment			
<b>Guarantee for payment of the liability</b>	See Note 10C to the annual financial statements.			
<b>Name of the trustee</b>	HSBC BANK USA, NATIONAL ASSOCIATION			
<b>Name of responsible person at the trust company</b>	Jane Yang			

<sup>3</sup> Net of bonds in the par value of \$9,980 thousand purchased by the Partnership.

<sup>4</sup> The bonds are traded in Israel on "TACT-Institutional" on TASE.

<sup>5</sup> The principal and interest of the bonds are in dollars.

<sup>6</sup> The Partnership is entitled to prepay the loan, in whole or in part, at any time, subject to a prepayment fee. Prepayment following certain events set forth in the bonds may be effected without a prepayment fee.

<b>Trustee's address and e-mail</b>	HSBC Bank USA, National Association, as TRUSTEE 452 5th Avenue, 8E6 New York, NY 10018 CTLANYDealManagement@us.hsbc.com
<b>Rating as of the issuance date<sup>7</sup></b>	Moody's: Baa3 S&P: BBB- Midroog Ltd: Aa2 Standard & Poor's Maalot: ilAA
<b>Rating as of the report date<sup>8</sup></b>	Moody's: Baa3 S&P: BBB Midroog Ltd: Aa2 Standard & Poor's Maalot: ilAA
<b>Has the company fulfilled, until March 31, 2018 and in the three months ending on such date, all of the conditions and obligations under the indenture</b>	Yes
<b>Have any conditions establishing cause for acceleration of the bonds been met</b>	No
<b>Pledges to secure the bonds</b>	See Note 10C to the annual financial statements.

<sup>7</sup> See the Partnership's immediate reports of May 29, 2014 (Ref. No. 2014-01-077676), June 8, 2014 (Ref. No: 2014-01-084870) and June 17, 2014 (Ref. No. 2014-01-093135, 2014-01-093132), the information included in which is incorporated herein by reference.

<sup>8</sup> See the Partnership's immediate reports of November 10, 2016 (Ref. No.: 2016-01-075579, 2016-01-075573 and 2016-01075867), January 12, 2017 (Ref. No. 2017-01-004888), June 7, 2017 (Ref. No.: 2017-01-048025), July 12, 2017 (Ref. No.: 2017-01-059785), July 17, 2017 (Ref. No.: 2017-01-061405), July 26, 2017 (Ref. No.: 2017-01-064804 and 2017-01-064525), October 19, 2017 (Ref. No.: 2017-01-100425 and 2017-01-100419), and January 10, 2018 (Ref. No.: 2018-01-003618), the information in which is incorporated herein by reference.

<b>Bonds</b>	<b>Series A</b>
<b>Par value on issue date in ILS in thousands</b>	1,528,533
<b>Issue date</b>	December 26, 2016
<b>Par value as of March 31, 2018 in ILS in thousands</b>	1,528,533
<b>Linked par value as of March 31, 2018 in ILS in thousands</b>	1,406,458
<b>Value in the Partnership's books as of March 31, 2018 in ILS in thousands</b>	1,393,918
<b>Market cap as March 31, 2018 in ILS in thousands</b>	1,400,289
<b>Fixed annual interest rate</b>	4.5%
<b>Principal payment date</b>	December 31, 2021
<b>Interest payment dates</b>	Semiannual interest payable on every June 30th and every December 31st from the date of the issue in 2017-2021
<b>Linkage base: base index</b>	The bond is stated in ILS. The principal and interest are linked to a dollar rate of 3.819
<b>Conversion right</b>	None
<b>Right to prepayment or mandatory conversion<sup>9</sup></b>	Right to prepayment
<b>Guarantee for payment of the liability</b>	See Note 10D to the annual financial statements.
<b>Name of the trustee</b>	Reznik Paz Nevo Trusts Ltd.
<b>Name of person in charge at the trust company</b>	Adv. Michal Avtalion-Rishony
<b>Trustee's address and e-mail</b>	14 Yad Harutzim St., Tel Aviv, michal@rpn.co.il
<b>Rating as of the issue date</b>	A1 stable
<b>Rating as of the report date<sup>10</sup></b>	A1 stable
<b>Has the company fulfilled, by March 31, 2018 and in the three months ending on such date, all of the conditions and obligations under the indenture</b>	Yes
<b>Have any conditions establishing cause for acceleration of the bonds been fulfilled</b>	No
<b>Pledges to secure the bonds</b>	See Note 10D to the annual financial statements.
<b>The Partnership's financial equity as of March 31, 2018, as defined in the indenture<sup>11</sup></b>	\$4,441 thousand
<b>The financial equity to debt ratio as of March 31, 2018, as defined in the indenture<sup>13</sup></b>	Approx. 11

<sup>9</sup> The Partnership has the right to prepay the bonds at any time, in whole or in part, all in accordance with the terms and conditions of the indenture.

<sup>10</sup> See the Partnership's immediate reports of December 22, 2016 (Ref. No.: 2016-01-090873), May 18, 2017 (Ref. No.: 2017-01-042106) and December 25, 2017 (Ref. No.: 2017-01-119985), the information in which is incorporated herein by reference.

<sup>11</sup> In accordance with the Partnership's undertaking on the date of the issue of the bonds – for further details, see Note 10C to the Periodic Report.

## **Additional information**

The board of directors of the General Partner expresses its appreciation of the management of the General Partner of the Partnership, the officers and the entire team of employees for their dedicated work and their significant contribution to the promotion of the Partnership's business.

Sincerely,

**Gabi Last**

Director

(Stand-in Chairman of the Board of Directors)

**Yossi Abu**

CEO

**Delek Drilling Management (1993) Ltd.**

On behalf of: Delek Drilling – Limited Partnership



**Annex A to the Board of Directors' Report**  
**Figures regarding Delek Avner (Tamar Bond) Ltd.**

Further to the provisions of Note 10C to the financial statements for 2017 and to the provisions of Part Four of the Board of Director's Report and following a tax ruling received by the Partnership immediately prior to the bond issuance, below are financial figures which will be disclosed to the holders of bonds of Delek & Avner (Tamar Bond) Ltd.

**Statements of Financial Position (Expressed in US\$ Thousands)**

	<b><u>31.3.2018</u></b>	<b><u>31.3.2017</u></b>	<b><u>31.12.2017</u></b>
	<b><u>Unaudited</u></b>	<b><u>Unaudited</u></b>	<b><u>Audited</u></b>
Assets:			
Current Assets:			
Short term Bank deposits	127,179	80,057	94,127
Interest receivable	15,014	18,768	-
Loans to shareholders	319,701	-	320,000
	<u>461,894</u>	<u>98,825</u>	<u>414,127</u>
Noncurrent Assets:			
Loans to shareholders	958,808	1,600,000	960,000
Long term bank deposits	101,927	100,608	101,482
	<u>1,060,735</u>	<u>1,700,608</u>	<u>1,061,482</u>
	<u>1,522,629</u>	<u>1,799,433</u>	<u>1,475,609</u>
Liabilities and Equity:			
Current Liabilities:			
Interest Payable	15,014	18,768	-
Related parties	129,106	80,665	95,609
Bonds	320,000	-	320,000
	<u>464,120</u>	<u>99,433</u>	<u>415,609</u>
Noncurrent Liabilities:			
Bonds	960,000	1,600,000	960,000
Loans from shareholders	100,000	100,000	100,000
	<u>1,060,000</u>	<u>1,700,000</u>	<u>1,060,000</u>
Equity (Deficit)	<u>(1,491)**</u>	<u>*</u>	<u>*</u>
	<u>1,522,629</u>	<u>1,799,433</u>	<u>1,475,609</u>

\* Less than \$1,000.

\*\* The deficit stems from the initial implementation of IFRS 9, approx. 105 thousand USD\$ (Income) for the current period and approx. 1,597 USD\$ (Expense) for past periods.

**Statements of Comprehensive Income (Expressed in US\$ Thousands)**

	<b>For the Three Month Ended 31.3.2018</b> <hr/> <b>Unaudited</b>	<b>For the Three Month Ended 31.3.2017</b> <hr/> <b>Unaudited</b>	<b>For the Period Ended 31.12.2017</b> <hr/> <b>Audited</b>
Financial expenses	(15,575)	18,854	70,584
Financial income	15,680	(18,854)	(70,584)
	<hr/> 105	<hr/> -	<hr/> -

**SPONSOR FINANCIAL DATA REPORT<sup>12</sup>**  
**Cash flow for the period from January 1, 2018 – March 31, 2018**

		<b>Delek Drilling LP</b>
	<u>Item</u>	<u>Quantity/Actual Amount (In thousands)</u>
A.	Total Offtake (BCM) (100%) <sup>13</sup>	2.4
B.	Tamar Revenues (100%) <sup>9</sup>	471,049
C.	Loss Proceeds, if any, paid to Revenue Accounts	-
D.	Sponsor Deposits, if any, into Revenue Accounts	-
E.	Gross Revenues (before Royalties)	110,634
F.	Overriding Royalties	
	(a) Statutory Royalties	(12,158)
	(b) Third Party Royalties	(9,318)
G.	Net Revenues	89,452
H.	Costs and Expenses:	
	(a) Fees Under the Financing Documents – (Interest Income)	231
	(b) Taxes	-
	(c) Operation and Maintenance Expenses	(9,181)
	(d) Capital Expenditures	(7,165)
	(e) Payments under the Tamar FUA	-
	(f) Insurance	-
I.	Total Costs and Expenses (sum of Items H(a), (b), (c), (d), (e) and (f))	(16,114)
J.	Total Cash Flows Available for Debt Service (Item G minus Item H)	73,337
K.	Total Debt Service (Interest Expense)	-

<sup>12</sup> The aforesaid report is delivered to the trustee for the bonds on a quarterly and annual basis and represents the cash flow deriving for the Partnership from the Tamar project relative to the amounts required for the debt service in such period.

<sup>13</sup> Sections A and B are based on 100% of Tamar partners.

**Annex B to the Board of Directors' Report**  
**Summary of Data on the Valuation of Royalties from**  
**the Karish and Tanin Leases**

Following are details of a highly material valuation with respect to the profit from the revaluation of royalties from the sale of the Partnership's interests in the Karish and Tanin leases (for further details, see Note 4E to the condensed interim financial statements and the valuation attached below):

Identification of the object of the valuation:	Royalties in respect of the sale of all of the interests in the Karish and Tanin leases.
Timing of the valuation:	March 31, 2018.
Value of the object of the valuation shortly before the date of the valuation, if GAAP, including depreciation and amortization, did not warrant a change in its value according to the valuation:	Not applicable.
Value of the object of the valuation determined according to the valuation:	A sum of approx. U.S. \$114.6 million, which is included under other long-term assets of the Partnership.
Identification of the valuator and his/its characteristics, including education, experience in the preparation of valuations for accounting purposes in reporting corporations and in scopes similar to or exceeding those of the reported valuation, and dependence on the party commissioning the valuation, including reference to indemnification agreements with the valuator:	<p>GSE Financial Advisory Ltd. is a subsidiary of Giza Singer Even Ltd. (jointly: the “<b>Valuator</b>”), which is a leading financial consulting and investment banking firm in Israel. The firm has vast experience in supporting the largest companies, the most prominent privatizations and the most important transactions in the Israeli market, which experience was gained thereby over the course of its thirty years of activity. Giza Singer Even is active in three segments, through autonomous and independent business divisions: economic consulting; investment banking; analytical research and corporate governance.</p> <p>The work was performed by a team headed by CPA Eitan Cohen, partner and Head of the Economic Department at Giza Singer Even, who has more than ten years of experience in economic and business consulting, company valuations and financial instruments. Eitan is an accountant holding a B.A. in Economics and Business Administration from the Ben Gurion University and an M.A. in Financial Mathematics from the Bar Ilan University.</p> <p>The Valuator has no personal interest in and/or dependence on the Partnership</p>



	<p>and/or the General Partner of the Partnership, other than the fact that it received a fee for the valuation. Furthermore, the Valuator has confirmed that its fee is not contingent on the results of the valuation.</p>
The valuation model applied by the Valuator:	Discounting expected cash flows while adjusting the discount rates to the risks entailed by the cash flow forecasts.
The assumptions based on which the Valuator prepared the valuation according to the valuation model:	<p>The key assumptions underlying the valuation are as follows:</p> <ol style="list-style-type: none"> <li>1. Dates of production of gas from the Karish reservoir: January 1, 2022 to December 31, 2033;</li> <li>2. Annual production rate from the Karish reservoir: approx. 3.8 BCM of natural gas; condensate production rated from the Karish reservoir according to a ratio of approx. 17.6 condensate barrels per 1 mmcf of natural gas produced from the reservoir;</li> <li>3. Dates of production of gas from the Tanin reservoir: July 1, 2033 to September 30, 2039;</li> <li>4. Annual production rate from the Tanin reservoir: approx. 3.6 BCM of natural gas; condensate production rated from the Tanin reservoir according to a ratio of approx. 5.2 condensate barrels per 1 mmcf of natural gas produced from the reservoir;</li> <li>5. Royalty component discount rate: 11%;</li> <li>6. Effective royalty rate to be paid to the State for the gas and the condensate: 11.5%;</li> <li>7. Gas price formula: The basic price in the contracts according to which the valuation was prepared was estimated based on the formula specified in the price mechanism between Energean and ICL and ORL and between Energean and</li> </ol>

	<p>OPC;</p> <p>8. Condensate price: The condensate price forecast was estimated based on the long-term oil price forecast average of the World Bank<sup>14</sup> and the EIA<sup>15</sup> and based on the assumption that the condensate price will derive from the Brent price with adjustments to oil quality differences;</p> <p>9. Petroleum profit levy: According to the Petroleum Profit Taxation Law, 5771-2011;</p> <p>10. Corporate tax rate: 23%, according to the statutory tax rate throughout the years of the forecast.</p>
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<sup>14</sup> A world Bank Quarterly Report: Commodity Markets Outlook, April 2018

<sup>15</sup> U.S Energy Information Administration: Annual Energy Outlook 2018

**Annex C to the Board of Directors' Report**

**Summary of Data on the Valuation of the Debt  
Component in relation to a Final Investment Decision  
in the Tanin and Karish Leases**

Following are details of a highly material valuation with respect to the revaluation of the debt component in relation to a final investment decision in the Karish and Tanin leases (for further details, see Note 4E to the condensed interim financial statements and Annex 6.2 of the valuation attached below):

Identification of the object of the valuation:	The debt component in respect of the sale of all of the interests in the Karish and Tanin leases.
Timing of the valuation:	March 31, 2018.
Value of the object of the valuation shortly before the date of the valuation, if GAAP, including depreciation and amortization, did not warrant a change in its value according to the valuation:	Not applicable.
Value of the object of the valuation determined according to the valuation:	A sum of approx. U.S. \$86.7 million, which is included under current assets and other long-term assets of the Partnership.
Identification of the valuator and his/its characteristics, including education, experience in the preparation of valuations for accounting purposes in reporting corporations and in scopes similar to or exceeding those of the reported valuation, and dependence on the party commissioning the valuation, including reference to indemnification agreements with the valuator:	<p>GSE Financial Advisory Ltd. is a subsidiary of Giza Singer Even Ltd. (jointly: the “<b>Valuator</b>”), which is a leading financial consulting and investment banking firm in Israel. The firm has vast experience in supporting the largest companies, the most prominent privatizations and the most important transactions in the Israeli market, which experience was gained thereby over the course of its thirty years of activity. Giza Singer Even is active in three segments, through autonomous and independent business divisions: economic consulting; investment banking; analytical research and corporate governance.</p> <p>The work was performed by a team headed by CPA Eitan Cohen, partner and Head of the Economic Department at Giza Singer Even, who has more than ten years of experience in economic and business consulting, company valuations and financial instruments. Eitan is an accountant holding a B.A. in Economics and Business Administration from the Ben Gurion University and an M.A. in Financial Mathematics from the Bar Ilan University.</p>

	<p>The Valuator has no personal interest in and/or dependence on the Partnership and/or the General Partner of the Partnership, other than the fact that it received a fee for the valuation.</p> <p>Furthermore, the Valuator has confirmed that its fee is not contingent on the results of the valuation.</p>
The valuation model applied by the Valuator:	Discounting expected cash flows while adjusting the discount rates to the risks entailed by the cash flow forecasts.
The assumptions based on which the Valuator prepared the valuation according to the valuation model:	<p>The key assumption underlying the valuation are as follows:</p> <p>Debt component discount rate: 7.5%.</p>



Delek Drilling

# 2018

**Financial Statements**  
**31.3.2018**



**May 15, 2018**

**To**

**The Board of Directors of the General Partner of Delek Drilling – Limited Partnership (the “Partnership”)**

**19 Abba Eban, Herzliya**

**Dear Sir/Madam,**

**Re: Consent given simultaneously with the release of a periodic report in connection with the shelf prospectus of the Partnership (the “Offering Document”)**

We hereby notify you that we agree to the inclusion (including by way of reference) in the above referenced Offering Document of our reports that are specified below:

- (1) Review report of May 15, 2018 on condensed financial information of the Partnership as of March 31, 2018, and for the three-month period ended on the same date.
- (2) Special review report of May 15, 2018 on proforma condensed financial information of the Partnership for the three-month period ended on March 31, 2017 pursuant to Section 38B of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

Kost Forer Gabbay & Kasierer  
Certified Public Accountants

Ziv Haft  
Certified Public Accountants

**Delek Drilling – Limited Partnership**  
**Condensed Interim Financial Statements as of March 31, 2018**  
**in U.S. Dollars in Thousands**  
**Unaudited**

*This report is a translation of Delek Drilling - Limited Partnership's Hebrew-language condensed interim financial statements as of March 31, 2018. It is prepared solely for convenience purposes. Please note that the Hebrew version constitutes the binding version, and in the event of any discrepancy, the Hebrew version shall prevail.*

**Delek Drilling – Limited Partnership**  
**Condensed Interim Financial Statements as of March 31, 2018**  
**in U.S. Dollars in Thousands**  
**Unaudited**

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## **Auditors' review report to the partners of Delek Drilling – Limited Partnership**

### ***Introduction***

We have reviewed the accompanying financial information of Delek Drilling – Limited Partnership (the “**Partnership**”), which includes the Condensed Statement of Financial Position as of March 31, 2018 and the Condensed Statements of Comprehensive Income, Changes in the Partnership’s Equity and Cash Flows for the three-month period then ended. The board of directors and management of the Partnership’s general partner are responsible for the preparation and presentation of financial information for this interim period in accordance with IAS 34 “Interim Financial Reporting”, and they are responsible for the preparation of financial information for this interim period under Chapter D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970. Our responsibility is to express a conclusion on the financial information for this interim period, based on our review.

### ***Scope of Review***

We conducted our review in accordance with Review Standard 1 of the Institute of Certified Public Accountants in Israel “Review of Interim Financial Information Performed by the Auditor of the Entity”. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Generally Accepted Auditing Standards in Israel, and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### ***Conclusion***

Based on our review, nothing has come to our attention that causes us to believe that the accompanying financial information is not prepared, in all material respects, in accordance with IAS 34.

In addition to the statements in the previous paragraph, based on our review, nothing has come to our attention which causes us to believe that the accompanying financial information does not meet, in all material respects, the disclosure provisions under Chapter D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

Tel Aviv, May 15, 2018

**Kost Forer Gabbay & Kasierer**  
**Certified Public Accountants**

**Ziv Haft**  
**Certified Public Accountants**

**Delek Drilling – Limited Partnership****Condensed Interim Statements of Financial Position (Dollars in thousands)**

	<b>31.3.2018</b>	<b>31.3.2017<sup>1</sup></b>	<b>31.12.2017</b>
	<b>Unaudited</b>	<b>Unaudited</b>	<b>Audited</b>
<b>Assets:</b>			
<b>Current assets:</b>			
Cash and cash equivalents	140,223	103,343	154,835
Short-term investments	303,182	239,390	278,826
Trade receivables	41,739	53,383	46,506
Trade and other receivables	24,635	36,957	30,878
	<u>509,779</u>	<u>433,073</u>	<u>511,045</u>
<b>Non-current assets:</b>			
Investments in petroleum and gas assets	2,192,125	2,052,423	2,023,671
Investment in a company accounted for at equity	117,236	-	129,833
Long-term deposits in banks	101,927	150,686	101,482
Other long-term assets	309,849	200,882	289,472
	<u>2,721,137</u>	<u>2,403,991</u>	<u>2,544,458</u>
	<u>3,230,916</u>	<u>2,837,064</u>	<u>3,055,503</u>
<b>Liabilities and equity:</b>			
<b>Current liabilities:</b>			
Bonds	309,742	-	319,421
Declared profits for distribution	-	-	60,381
Trade and other payables	169,503	106,898	122,355
	<u>479,245</u>	<u>106,898</u>	<u>502,157</u>
<b>Non-current liabilities:</b>			
Bonds	1,344,988	1,977,745	1,344,319
Long-term liabilities to banks	577,743	-	468,967
Other long-term liabilities	122,397	84,364	121,582
	<u>2,045,128</u>	<u>2,062,109</u>	<u>1,934,868</u>
<b>Equity:</b>			
Partnership's equity	154,791	154,791	154,791
Capital reserves	21,658	25,463	23,995
Retained earnings	530,094	487,803	439,692
	<u>706,543</u>	<u>668,057</u>	<u>618,478</u>
	<u>3,230,916</u>	<u>2,837,064</u>	<u>3,055,503</u>

**The accompanying notes are an integral part of the Condensed Interim Financial Statements.**

May 15, 2018			
Date of approval of the financial statements	Gabi Last Director Stand-in Chairman of the Board Delek Drilling Management (1993) Ltd. General Partner	Yossi Abu CEO Delek Drilling Management (1993) Ltd. General Partner	Yossi Gvura Deputy CEO Delek Drilling Management (1993) Ltd. General Partner

<sup>1</sup> Classified retroactively due to the merger (including the notes that are attached to the Condensed Interim Financial Statements), see Note 2F to the Partnership's annual financial statements as of December 31, 2017.

**Delek Drilling – Limited Partnership****Condensed Interim Statements of Comprehensive Income (Dollars in thousands)**

	For the three-month period ended		For the year ended
	31.3.2018	<sup>2</sup> 31.3.2017	31.12.2017
	Unaudited	Unaudited	Audited
<b>Revenues:</b>			
From natural gas and condensate sales	106,606	145,047	501,926
Net of royalties	21,278	22,697	80,256
	<u>85,328</u>	<u>122,350</u>	<u>421,670</u>
<b>Expenses and costs:</b>			
Cost of production of natural gas and condensate	8,502	10,379	35,188
Depreciation, depletion and amortization expenses	10,309	15,078	94,898
Petroleum and gas exploration expenses and other direct expenses	1,375	1,989	7,840
G&A	2,299	2,633	10,629
<b>Total expenses and costs</b>	<u>22,485</u>	<u>30,079</u>	<u>148,555</u>
Other income (expenses)	(988)	-	566,542
Partnership's share of earnings (losses) of company accounted for at equity, net	(5,360)	-	10,042
<b>Operating profit</b>	<u>56,495</u>	<u>92,271</u>	<u>849,699</u>
Finance cost	(15,804)	(18,681)	(75,044)
Finance income	48,360	9,071	46,872
Finance (cost) income, net	32,556	(9,610)	(28,172)
<b>Profit before levy</b>	<u>89,051</u>	<u>82,661</u>	<u>821,527</u>
Petroleum and gas profit levy	(757)	(3,796)	(4,305)
<b>Net profit</b>	<u>88,294</u>	<u>78,865</u>	<u>817,222</u>
<b>Other comprehensive income (loss) for items which may subsequently be reclassified to profit or loss:</b>			
Loss in respect of cash flow hedging transactions	-	-	(3,957)
Profit in respect of financial assets available for sale	-	137	2,237
Carried to profit or loss for cash flow hedging transactions	(621)	-	(904)
Carried to profit or loss for financial assets available for sale	-	-	(695)
<b>Total other comprehensive income (loss)</b>	<u>(621)</u>	<u>137</u>	<u>(3,319)</u>
<b>Total comprehensive income</b>	<u>87,673</u>	<u>79,002</u>	<u>813,903</u>
Basic and diluted profit per participation unit (in dollars)	<u>0.075</u>	<u>0.067</u>	<u>0.696</u>
The weighted number of participation units for the purpose of said calculation (in thousands)	<u>1,173,815</u>	<u>1,173,815</u>	<u>1,173,815</u>

**The accompanying notes are an integral part of the Condensed Interim Financial Statements.**

<sup>2</sup> Classified retroactively due to the merger (including the notes that are attached to the Condensed Interim Financial Statements), see Note 2F to the Partnership's annual financial statements as of December 31, 2017.



## Delek Drilling – Limited Partnership

### Condensed Interim Statements of Changes in the Partnership's Equity (Dollars in thousands)

	The Partnership's equity	Capital reserve for redemption of participation units	Capital reserve for transactions between a corporation and a control holder thereof	Capital reserve for financial assets available for sale and cash flow hedging transactions	Retained earnings	Total
	Unaudited					
<b>For the three-month period ended March 31, 2018:</b>						
<b>Balance as of January 1, 2018 (audited)</b>	154,791	1,631	13,166	9,198	439,692	618,478
Effect of first-time application of IFRS 9 (see Note 2C)	-	-	-	(2,100)	2,114	14
<b>Balance as of January 1, 2018 subsequently to application of the aforesaid changes</b>	154,791	1,631	13,166	7,098	441,806	618,492
Net profit	-	-	-	-	88,294	88,294
Other comprehensive loss	-	-	-	(621)	-	(621)
Total comprehensive (loss) income	-	-	-	(621)	88,294	87,673
Profits distributed	-	-	-	-	(6)	(6)
Capital reserve for benefits from a control holder	-	-	384	-	-	384
<b>Balance as of March 31, 2018</b>	<b>154,791</b>	<b>1,631</b>	<b>13,550</b>	<b>6,477</b>	<b>530,094</b>	<b>706,543</b>

	The Partnership's equity	Capital reserve for redemption of participation units	Capital reserve for transactions between a corporation and a control holder thereof	Capital reserve for financial assets available for sale and cash flow hedging transactions	Retained earnings	Total
	Unaudited					
<b>For the three-month period ended March 31, 2017<sup>3</sup>:</b>						
<b>Balance as of January 1, 2017 (audited)</b>	154,791	1,631	10,748	12,517	609,228	788,915
Net profit	-	-	-	-	78,865	78,865
Other comprehensive income	-	-	-	137	-	137
Total comprehensive income	-	-	-	137	78,865	79,002
Profits distributed	-	-	-	-	(200,220)	(200,220)
Tax advances at the expense of the tax for which the participation unit holders are liable	-	-	-	-	(70)	(70)
Capital reserve for benefits from a control holder	-	-	430	-	-	430
<b>Balance as of March 31, 2017</b>	<b>154,791</b>	<b>1,631</b>	<b>11,178</b>	<b>12,654</b>	<b>487,803</b>	<b>668,057</b>

The accompanying notes are an integral part of the Condensed Interim Financial Statements.

<sup>3</sup> Classified retroactively due to the merger (including the notes that are attached to the Condensed Interim Financial Statements), see Note 2F to the Partnership's annual financial statements as of December 31, 2017.

**Delek Drilling – Limited Partnership****Condensed Interim Statements of Changes in the Partnership's Equity (Dollars in thousands) (Cont.)**

	The Partnership's equity	Capital reserve for redemption of participation units	Capital reserve for transactions between a corporation and a control holder thereof	Capital reserve for financial assets available for sale and cash flow hedging transactions	Retained earnings	Total
	Audited					
<b>Changes for the year ended December 31, 2017:</b>						
<b>Balance as of January 1, 2017</b>	154,791	1,631	10,748	12,517	609,228	788,915
Net profit	-	-	-	-	817,222	817,222
Other comprehensive loss	-	-	-	(3,319)	-	(3,319)
Total comprehensive income (loss)	-	-	-	(3,319)	817,222	813,903
Profits distributed	-	-	-	-	(680,710)	(680,710)
Declared profits for distribution	-	-	-	-	(60,000)	(60,000)
Tax advances at the expense of the tax for which the participation unit holders are liable	-	-	-	-	(246,048)	(246,048)
Capital reserve for benefits from a control holder	-	-	2,418	-	-	2,418
<b>Balance as of December 31, 2017</b>	<u>154,791</u>	<u>1,631</u>	<u>13,166</u>	<u>9,198</u>	<u>439,692</u>	<u>618,478</u>

The accompanying notes are an integral part of the Condensed Interim Financial Statements.

## **Delek Drilling – Limited Partnership**

### **Condensed Interim Statements of Cash Flows (Dollars in thousands)**

	<b>For the three-month period ended</b>		<b>For the year ended</b>
	<b>31.3.2018</b>	<b>31.3.2017<sup>4</sup></b>	<b>31.12.2017</b>
	<b>Unaudited</b>	<b>Unaudited</b>	<b>Audited</b>
<b>Cash flows – operating activity:</b>			
Profit for the period	88,294	78,865	817,222
Adjustments for:			
Depreciation, depletion and amortization	11,056	15,549	100,179
Petroleum and gas profit levy, net	757	3,774	4,861
Change in fair value of financial derivatives, net	-	(30)	558
Update of asset retirement liabilities	678	538	3,704
Revaluation of short-term and long-term investments and deposits	60	726	(826)
Expenses due to revaluation of share-based payment	243	80	52
Benefit from a control holder included in expenses against a capital reserve	384	430	2,418
Profit from the sale of petroleum and gas assets	-	-	(572,454)
Revaluation of other long-term assets	(45,157)	(4,600)	(25,724)
Partnership's share of losses (earnings) of company accounted for at equity, net	5,360	-	(10,042)
<b>Changes in assets and liabilities items:</b>			
Decrease in trade receivables	4,767	3,574	11,667
Decrease (increase) in trade and other receivables	1,385	1,862	(182)
Decrease (increase) in other long-term assets	(690)	(1,854)	4,711
Increase (decrease) in trade and other payables	(13,650)	7,910	(6,762)
Decrease in other long-term liability	(3)	-	(110)
	(34,810)	27,959	(487,950)
<b>Net cash deriving from current operations</b>	<b>53,484</b>	<b>106,824</b>	<b>329,272</b>
<b>Cash flows - investment activity:</b>			
Investment in petroleum and gas assets	(139,815)	(63,335)	(443,329)
Increase in other long-term assets	(5,120)	-	(31,412)
Proceeds from the sale of petroleum and gas assets	10,850	-	829,898
Loan given to a company accounted for at equity	-	-	(34,000)
Repayment of a loan given to a company accounted for at equity	-	-	34,000
Increase in short-term investments, net	(14,974)	(105,760)	(150,819)
Deposit in long-term deposits in banks	-	(17,676)	(17,676)
Maturity of long-term deposits in banks	-	336	51,307
Disposition of financial assets available for sale	-	-	4,251
Change in respect of the operator of the joint ventures	43,007	2,372	(6,001)
<b>Net cash deriving from (used for) investment activity</b>	<b>(106,052)</b>	<b>(184,063)</b>	<b>236,219</b>

**The accompanying notes are an integral part of the Condensed Interim Financial Statements.**

<sup>4</sup> Classified retroactively due to the merger (including the notes that are attached to the Condensed Interim Financial Statements), see Note 2F to the Partnership's financial statements as of December 31, 2017.

**Delek Drilling – Limited Partnership****Condensed Interim Statements of Cash Flows (Dollars in thousands) (Cont.)**

		For the three- month period ended	For the year ended
	31.3.2018	31.3.2017 <sup>4</sup>	31.12.2017
	Unaudited	Unaudited	Audited
<b>Cash flows - financing activity:</b>			
Receipt of long-term loans from banks (net of raising expenses)	109,150	-	420,534
Profits distributed	(61,091)	(300,224)	(781,116)
Tax advances paid for holders of participation units	-	(70)	(206,993)
Repurchase of Tamar bonds	(10,103)	-	-
Repayment of bonds	-	-	(320,000)
Payments from the exercise of hedging transactions	-	-	(3,957)
<b>Net cash deriving from (used for) financing activity</b>	<b>37,956</b>	<b>(300,294)</b>	<b>(891,532)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(14,612)</b>	<b>(377,533)</b>	<b>(326,041)</b>
<b>Cash and cash equivalents balance at the beginning of the period</b>	<b>154,835</b>	<b>480,876</b>	<b>480,876</b>
<b>Cash and cash equivalents balance at the end of the period</b>	<b>140,223</b>	<b>103,343</b>	<b>154,835</b>
<b>Annex A – Financing and investment activity not involving cash flow:</b>			
Investments in petroleum and gas assets against liabilities	92,438	47,428	94,166
Proceeds from the disposition of petroleum and gas assets against investment in a company accounted for at equity	-	-	119,790
Declared dividend from a company accounted for at equity	7,237	-	-
Declared profits for distribution and tax advances payable at the expense of the unit holders	-	-	98,653
<b>Annex B - Additional information on cash flows:</b>			
Interest paid (including capitalized interest)	8,981	-	109,015
Interest received	1,994	1,386	7,832
Dividend received	-	48	80

The accompanying notes are an integral part of the Condensed Interim Financial Statements.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 1 – General:**

- A.** Delek Drilling – Limited Partnership (the “**Partnership**”) was founded according to a limited partnership agreement of July 1, 1993 between Delek Drilling Management (1993) Ltd. as general partner (the “**General Partner**”) of the first part, and Delek Drilling Trusts Ltd. as limited partner (the “**Trustee**”) of the second part.

The Trustee serves as trustee for the holders of the participation units, under the supervision of the supervisors, CPA Micha Blumenthal, together with Fahn Kanne & Co., CPAs, and Gissin & Keidar (from the date of the merger, see Note 1E to the Partnership’s financial statements as of December 31, 2017 and the notes attached thereto (the “**Annual Financial Statements**”)) (jointly: the “**Supervisors**”). The Supervisors were granted certain supervision powers in the partnership agreement and in the Partnerships Ordinance.

The parent company of the General Partner in the Partnership is Delek Energy Systems Ltd. (the “**Parent Company**”) and the Partnership’s ultimate parent company is Delek Group Ltd. (“**Delek Group**”).

The participation units of the Partnership are listed on the Tel Aviv Stock Exchange (TASE) and traded thereon since 1993.

The address of the Partnership’s registered office is 19 Abba Eban Boulevard, Herzliya.

- B.** As of the date of the approval of the Condensed Interim Financial Statements, the main engagement of the Partnership is in the exploration, development and production of natural gas, condensate and petroleum, including in the production and sale of natural gas and condensate from the Tamar reservoir in the area of the Tamar Lease (the “**Tamar Project**”), the promotion of the expansion of the production system of the Tamar Project, the development of Phase 1A of the development plan of the Leviathan reservoir and the promotion of commercialization of the natural gas and condensate therefrom, the promotion and planning of Stage 1B of the development plan of the Leviathan reservoir for additional target markets, the promotion and planning of natural gas commercialization and the development of the Aphrodite reservoir, in the examination of various infrastructure alternatives for the piping of natural gas to other target markets, exploration activity in the petroleum assets held by the Partnership, including for petroleum purposes, alongside the examination of entrance into other petroleum assets, in Israel and in the Mediterranean basin. The Partnership also engages in the promotion of various natural gas-based projects, aiming to increase the scope of sales of natural gas from the petroleum assets held by the Partnership, and also in the examination and promotion of various alternatives for the sale of the Partnership’s holdings in the Tamar project in accordance with the provisions of the Gas Framework (for further details on the Gas Framework see Note 1G and Note 12J1 to the Partnership’s Annual Financial Statements).

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 1 – General (Cont.):**

- C. The Partnership's Condensed Interim Financial Statements should be read together with the Partnership's Annual Financial Statements. Therefore, notes regarding relatively insignificant updates to information that was already reported in the notes to the Annual Financial Statements were not presented in these Condensed Interim Financial Statements.
- D. The Condensed Interim Financial Statements comply with the provisions of IAS 34.
- E. The Condensed Interim Financial Statements fulfill the disclosure provisions pursuant to Chapter D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

#### **Note 2 - Significant Accounting Policies:**

The Condensed Interim Financial Statements were prepared according to the same accounting policy and calculation methods that were used in the Annual Financial Statements, except as stated below:

##### **A. International Financial Reporting Standard No. 15 (“IFRS 15”):**

Pursuant to the provisions of Note 2L1 to the Annual Financial Statements regarding the first-time application of IFRS 15 – Revenue from Contracts with Customers, the Partnership chose to apply the provisions of IFRS 15 retroactively with relief and without restatement of comparison figures.

With regard to the accounting policy that was applied until December 31, 2017 with respect to recognition of revenues – see Note 2P to the Annual Financial Statements.

The accounting policy which is applied from January 1, 2018 with respect to recognition of revenues is as follows:

In accordance with IFRS 15, revenues from contracts with customers are recognized in profit or loss when control over the asset or service is transferred to the customer. Revenues are measured and recognized according to fair value of the proceeds expected to be received pursuant to the terms and conditions of the contract, less the amounts that were collected for the benefit of third parties (such as taxes). Revenues are recognized in profit or loss to the extent the project partners expect to gain the economic benefits, and the revenues and costs, if applicable, may be reliably measured.

The new IFRS 15 introduces a five step model that applies to revenues which derive from contracts with customers:

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 2 – Significant Accounting Policies (Cont.):**

##### **A. International Financial Reporting Standard No. 15 (“IFRS 15”) (Cont.):**

- Step 1 - Identification of the contract with the customer, including reference to assembly of contracts and accounting for contract modifications.
- Step 2 - Identification of several distinct performance obligations in the contract.
- Step 3 - Determination of the transaction price, including reference to variable consideration, significant financing component, non-cash consideration and consideration that shall be paid to the customer.
- Step 4 - Allocation of the transaction price to each distinct performance obligation based on the distinct relative selling price while using expected prices, if available or estimates and evaluations.
- Step 5 - Recognition of revenues when or as a performance obligation is satisfied, while distinguishing between fulfillment of an obligation at a point in time and fulfillment of an obligation over time.

The application for IFRS 15 did not have an effect on the Partnership’s Condensed Interim Financial Statements.

##### **B. Financial instruments:**

Pursuant to the provisions of Note 2L2 to the Annual Financial Statements regarding the first-time application of International Financial Reporting Standard No. 9 – Financial Instruments (the “**New IFRS 9**”), the Partnership chose to apply the provisions of IFRS 9 without restatement of comparison figures. With regard to the accounting policy that was applied until December 31, 2017 with respect to financial instruments, see Sections J, K, L and Q of Note 2 to the Annual Financial Statements. The accounting policy which is applied from January 1, 2018 with respect to financial instruments is as follows:

##### **1) Financial instruments:**

Financial instruments that are subject to IFRS 9 are measured on the date of first-time recognition at fair value plus transaction costs that can be directly attributed to the purchase of the financial asset, except in the case of a financial asset that is measured at fair value through profit or loss, with respect to which, transaction costs are carried to profit or loss.

The Partnership classifies and measures the debt instruments in its financial statements based on the following criteria:

- (a) The Partnership’s business model for management of the financial assets, and
- (b) The characteristics of the contractual cash flow of the financial asset.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 2 – Significant Accounting Policies (Cont.):**

##### **B. Financial instruments (Cont.):**

##### **1) Financial instruments (Cont.):**

The Partnership measures debt instruments at amortized cost, when:

The Partnership's business model is holding the financial assets in order to collect contractual cash flows; and the contractual terms and conditions of the financial asset provide entitlement on set dates to cash flows that are only interest and principal payments for the outstanding principal amount.

Subsequently to the initial recognition, instruments in this group will be presented according to their terms according to cost plus direct transaction costs, using the amortized cost method.

In addition, on the date of first-time recognition an entity may designate, irrevocably, a debt instrument as measured at fair value through profit or loss if such designation significantly reduces or cancels inconsistent measurement or recognition, for example in the event that the relevant financial liabilities are also measured at fair value through profit or loss.

The Partnership measures debt instruments at fair value through other comprehensive income, when:

The Partnership's business model is both holding the financial assets in order to collect contractual cash flows and sale of the financial assets; and the contractual terms and conditions of the financial asset provide entitlement on set dates to cash flows that are only interest and principal payments for the outstanding principal amount. Subsequently to the initial recognition, instruments in this group are measured according to fair value. Profit or loss as a result of fair value adjustments, other than interest, rate differentials and impairment, are recognized in other comprehensive income.

##### **Equity instruments:**

Financial instruments that constitute investments in equity instruments do not meet the aforesaid criteria and are therefore measured at fair value through profit or loss.

In relation to equity instruments that are not held for trade, on the date of first-time recognition, the Partnership may make an irrevocable choice, to present in other comprehensive income subsequent changes to the fair value that would have otherwise been recognized through profit or loss. Such fair value changes will not be carried to profit or loss in the future even upon write-off of the investment.

##### **2) Impairment of financial assets:**

On each report date the Partnership examines the provision for loss due to financial debt instruments that are not measured at fair value through profit or loss.



## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 2 – Significant Accounting Policies (Cont.):**

##### **B. Financial instruments (Cont.):**

##### **2) Impairment of financial assets (Cont.):**

The Partnership distinguishes between two situations of recognition of a provision for loss;

- a) Debt instruments whose credit quality did not significantly deteriorate since the date of first-time recognition or cases in which the credit risk is low – the provision to loss that will be recognized with respect to such debt instrument will take into account anticipated credit loss in the 12 month period after the report date, or;
- b) Debt instruments whose credit quality did significantly deteriorate since the date of first-time recognition and with respect to which the credit risk is not low, the provision to loss that will be recognized will take into account anticipated credit loss – for the remainder of the instrument's life. The Partnership applies the relief set forth in IFRS 9 according to which it assumes that the credit risk of a debt instrument did not significantly increase since the date of first-time recognition if it was determined on the report date that the instrument has low credit risk, for example when the instrument has an external "investment grade" rating.

The decrease in value with respect to debt instruments measured according to a depreciated cost shall be carried to profit or loss against a provision while the decrease in value with respect to debt instruments measured at fair value through other comprehensive income will be attributed against a capital reserve and will not reduce the book value of the financial asset in the statement of financial position.

##### **3) Write-off of financial assets:**

The Partnership writes-off a financial asset when, and only when:

- (a) The contractual rights to the cash flows from the financial asset expired, or
- (b) The Partnership materially transfers all of the risks and benefits that derive from the contractual rights to receive the cash flows from the financial asset or when part of the risks and benefits upon transfer of the financial asset remain in the hands of the entity but it can be said that it transferred control over the asset.
- (c) The Partnership retains the contractual rights to receive the cash flows that derive from the financial asset, but assumes a contractual obligation to pay such cash flows in full to a third party, without substantial delay.

##### **4) Financial liabilities:**

On the date of first-time recognition, the Partnership measures the financial liabilities that are subject to IFRS 9 at fair value, less transaction costs that can be directly attributed to the issuance of the financial liability.

Subsequently to the date of first-time recognition, the Partnership measures all of the financial liabilities according to the amortized cost method.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 2 – Significant Accounting Policies (Cont.):**

##### **B. Financial instruments (Cont.):**

###### **5) Write-off of financial liabilities:**

The Partnership writes-off a financial liability when, and only when it is retired – i.e., when the liability that was defined in the contract is paid or cancelled or expires.

A financial liability is retired when the debtor pays the liability by payment in cash, with other financial assets or is legally released from the liability.

In the event of a change of conditions with respect to an existing financial liability, the Partnership examines whether the terms and conditions of the liability are materially different than the existing conditions.

When a material change is made in the conditions of an existing financial liability, the change is treated as a write-off of the original liability and a recognition of a new liability. The difference between the balance of the two aforesaid liabilities in the financial statements is carried to profit or loss.

If the change is immaterial, the Partnership is required to update the liability amount, i.e., capitalize the new cash flows at the original effective interest rate, with the differences carried to profit or loss.

Upon examining whether the change to the conditions of an existing liability is material, the Partnership takes qualitative and quantitative considerations into account.

###### **6) Setoff of financial instruments:**

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position if there is a legally enforceable right to offset the amounts recognized, and there is an intention to retire the asset and the liability on a net basis or to dispose of the asset and settle the liability simultaneously. The setoff right must be legally enforceable, not only in the ordinary course of business of the parties to the contract but also in the event of bankruptcy or insolvency of one of the parties. For the setoff right to be available immediately, it cannot be contingent on a future event or, occasionally inapplicable or, expire pursuant to certain events.

###### **7) Embedded derivatives:**

Pursuant to the provisions of IFRS 9, derivatives embedded in financial assets shall not be separated from a host contract. Such hybrid contracts shall be measured in their entirety at a depreciated cost or at fair value, according to the criteria of the business model and contractual cash flows.

When a host contract does not fulfill the definition of a financial asset, an embedded derivative is separated from the host contract and treated as a derivative when the economic risks and characteristics of the embedded derivative are not tightly connected to the economic risks and characteristics of the host contract, the embedded derivative fulfills the definition of a derivative and the hybrid instrument is not measured at fair value when the differences are carried to profit or loss.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 2 – Significant Accounting Policies (Cont.):**

##### **B. Financial instruments (Cont.):**

###### **7) Embedded derivatives (Cont.):**

The need to separate an embedded derivative is reassessed only when there is a change in the engagement which significantly affects the cash flows from the engagement.

###### **8) Derivative financial instruments for hedging (protection) purposes:**

The Partnership occasionally performs engagements in derivative financial instruments such as foreign currency forward contracts and interest rate swap (IRS) transactions in order to protect itself against the risks entailed by interest rate and foreign currency exchange rate fluctuations.

Profits or losses deriving from changes in the fair value of derivatives that are not used for hedging purposes are immediately carried to profit or loss.

Hedging transactions qualify for hedging accounting, *inter alia*, when on the hedging creation date there is formal documentation and designation of the hedging relations and of the purpose of the risk management and the Partnership's strategy to perform hedging. The hedging is examined on an ongoing basis and it is determined in practice to be highly effective in the financial reporting period for which the hedging is designated. Hedging (protection) transactions are treated as follows:

##### **Cash flow hedging:**

The effective part of the changes in the fair value of the hedging instrument is recognized in other comprehensive profit (loss) while the ineffective part is immediately carried to profit or loss.

Other comprehensive profit (loss) is carried to profit or loss when the hedging transaction results are carried to profit or loss. For example, in periods when interest revenues or expenses are recognized or when an anticipated sale occurs.

When the hedged item is a non-financial asset or liability, their cost also includes the amount of profit (loss) from the hedging instrument.

The Partnership is stopping to apply hedge accounting henceforth only when all or part of the hedge ratios cease to fulfill the entitling criteria (after taking into account a rebalance of the hedge ratios, if applicable), including cases where the hedging instrument expires, is sold, cancelled or settled. When the Partnership discontinues the application of hedge accounting, the amount that accrued in the hedge fund remains in the hedge fund until the cash flow materializes or is carried to profit or loss if the hedged future cash flows are no longer expected to materialize.

**Delek Drilling – Limited Partnership****Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)****Note 2 – Significant Accounting Policies (Cont.):****C. First-time application of IFRS 9 – Financial Instruments:**

The Partnership chose to apply the provisions of New IFRS 9 retroactively without restatement of comparison figures.

The Partnership recognizes any difference between the previous book value and the book value on the date of first-time application in the surplus opening balance. Below is the effect of the first-time application of IFRS 9:

	<u>As reported in the past</u>	<u>The change</u>	<u>In accordance with IFRS 9</u>
<u>As of January 1, 2018</u>			
Retained earnings	439,692	2,114	441,806
Capital reserve for financial assets available for sale and cash flow hedging transactions	9,198	<sup>5</sup> (2,100)	7,098
Short term investments	278,826	(112)	278,714
Trade and other payables	(122,355)	126	(122,229)
Total equity	618,478	14	618,492

**Note 3 – Investments in Petroleum and Gas Assets:****A. Composition:**

	<u>31.3.2018 Unaudited</u>	<u>31.3.2017 Unaudited</u>	<u>31.12.2017 Audited</u>
Appraisal and exploration assets	114,321	138,642	114,186
Petroleum and gas assets	2,077,804	1,913,781	1,909,485
Total	2,192,125	2,052,423	2,023,671

<sup>5</sup> In the context of the New IFRS 9 the right to receive royalties in relation to the sale of Karish and Tanin leases (see Note 4E below) is now stated according to fair value to profit and loss.

**Note 3 – Investments in Petroleum and Gas Assets (Cont.):**

**B. Developments in Investments in Petroleum and Gas Assets:**

**1. Michal-Matan Joint Venture (Tamar and Dalit Leases):**

**a) Appraisal of the natural gas and condensate reserves in the Tamar gas field:**

According to a report prepared in February 2018 by Netherland Sewell & Associates Inc. (“NSAI”), which is a certified, expert and independent reserve evaluator), according to the SPE-PRMS rules, the natural gas reserves in the Tamar project (consisting of the Tamar and Tamar SW reservoirs), which are classified as reserves under production, as of December 31, 2017, and which are classified as proved reserves, are approx. 221.9 BCM and the quantity of reserves classified as proved + probable reserves is approx. 313.2 BCM.

According to the said report, the condensate reserves in the Tamar and Tamar SW reservoirs classified as reserves under production as of December 31, 2017, which are classified as proved reserves, are approx. 10.2 million barrels and the quantity of reserves classified as proved + probable reserves is approx. 14.4 million barrels. Such reserves do not include the reserves that overflow into the Eran license. See Section 4 below regarding uncertainty in the evaluation of reserves.

**b) Appraisal of contingent resources in the Dalit lease:**

According to a report prepared in March 2018 by NSAI, according to PRE-PRMS rules, the amount of the contingent resources in the Dalit lease, classified at the Development Pending justification stage, as of December 31, 2017, ranges between approx. 6.1 BCM (low estimate) and approx. 9.5 BCM (high estimate). In the resource report, it is indicated that the contingent resources are contingent upon the approval of a project which includes an approved development plan and a reasonable projection for sales of natural gas. See Section 4 below regarding uncertainty in the appraisal of the contingent resources.

**2. Ratio-Yam Joint Venture:**

**a) Appraisal of reserves and contingent resources in the Leviathan leases:**

According to a report that was prepared in March 2018 by NSAI, according to SPE-PRMS rules, according to a reserves and contingent and prospective resources in the leases report, updated as of February 28, 2018, the overall quantity of resources is estimated at approx. 605 BCM and is divided into categories of resources classified as reserves and resources classified as contingent. The quantity of reserves Approved for Development, classified as Proved Undeveloped is approx. 266.5 BCM and the quantity of reserves classified as Proved + Probable Reserves is approx. 358.3 BCM.

Additionally, there are approx. 16.9 million barrels of condensate reserves in the leases, in the sub-class of Approved for Development, in the sub-category of Proved Undeveloped, and there are approx. 22.7 million barrels of reserves classified as Proved + Probable Reserves.

In the contingent resources report, the contingent resources were divided into two categories, which relate to each of the development stages of the reservoir, as follows:

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 3 – Investments in Petroleum and Gas Assets (Cont.):**

##### **B. Developments in Investments in Petroleum and Gas Assets (Cont.):**

##### **2. Ratio-Yam Joint Venture (Cont.):**

##### **a) Appraisal of reserves and contingent resources in the Leviathan leases (Cont.):**

Phase 1- First Stage - contingent resources which are classified at the Development Pending stage, these resources are contingent on the decisions to perform additional drillings and on the execution of additional agreements for the sale of natural gas. Future Development – resources contingent on the adoption of another investment decision, in accordance with Phase 1 - Second Stage in the development plan and with an additional stage (insofar as the development plan is updated) and on the execution of additional agreements for the sale of natural gas range between approx. 339.2 BCM (the high estimate) and approx. 207.3 BCM (the low estimate) and condensate contingent resources range between approx. 21.5 million barrels (the high estimate) and approx. 13.1 million barrels (the low estimate). See Section 4 below regarding uncertainty in the appraisal of reserves.

##### **b) Development drillings in the context of the development plan:**

Pursuant to the provisions of Note 7C2 to the Annual Financial Statements, as of the date of approval of the Condensed Interim Financial Statements, the Ensco DS-7 drilling rig finished drilling the bottom part of the Leviathan 3 well to its final depth and began to drill the bottom part of the Leviathan 7 well to its final depth. Subsequently to finishing the Leviathan 7 well, the drilling rig shall perform completion of the production drillings in the Leviathan project.

##### **3. Additional details regarding the Partnership's licenses:**

- a) Pursuant to the provisions of Note 7C8 to the Annual Financial Statements, to date, the mediation proceeding in relation to Eran/353 license has not yet been exhausted, and on May 6, 2018, the parties moved the court to allow them to update on its results by July 6, 2018. As of the date of approval of the Condensed Interim Financial Statements, a decision in the motion has not yet been issued.
- b) Pursuant to the provisions of Note 7C5 to the Annual Financial Statements, on January 16, 2018, the Operator forwarded to the Petroleum Commissioner at the Ministry of Energy (the “**Commissioner**”) an updated work plan for the Alon D license.
- c) Pursuant to the provisions of Note 7C7 to the Annual Financial Statements, on April 15, 2018 Ratio Oil Exploration (1992), Limited Partnership (“**Ratio**”) notified that the Commissioner notified that he is extending the Roi license until July 14, 2018, subject to the change of the work plan in the license.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 3 – Investments in Petroleum and Gas Assets (Cont.):**

##### **B. Developments in Investments in Petroleum and Gas Assets (Cont.):**

#### **4. Appraisals of reserves of natural gas, condensate and contingent resources:**

The above estimates regarding the reserves of natural gas, condensate and contingent resources in the Partnership's rights in the leases and in the licenses for oil and gas exploration are based, *inter alia*, on geological, geophysical, engineering and other information which has been received from the wells and from the Operator of the said rights. The aforesaid estimates constitute professional conjectures and estimates by NSAI, with respect to which there is no certainty. The actual quantities of natural gas and/or condensate to be produced may differ from the aforesaid conjectures and assessments, as a result, *inter alia*, of operational and technical conditions and/or regulatory changes and/or conditions of supply and demand in the natural gas and/or condensate market and/or commercial conditions and/or as a result of the actual performance of the reservoirs. The aforesaid conjectures and assessments may be updated insofar as additional information accumulates and/or as a result of a gamut of factors related to oil and natural gas exploration and production projects.

#### **Note 4 – Additional Information:**

##### **A. Engagement for the export of natural gas from the Tamar project:**

In February 2018, an agreement for the export of natural gas from Tamar Project to Egypt was signed between the Partnership and Noble (jointly below in this Section, the “**Sellers**”) and Dolphinus Holdings Limited<sup>6</sup> (“**Dolphinus**”) (below in this section, the “**Export from Tamar Agreement**”), the scope of which is significantly larger than the agreement for supply of natural gas that was signed between the Tamar partners and Dolphinus on March 17, 2015 and which was executed with the intention of replacing it.

The Sellers approached the other partners in the Tamar Project aiming to assign the Export from Tamar Agreement to the other Tamar Partners or to engage with them in agreements for the purchase of the natural gas from Tamar project, according to the terms of the Export from Tamar Agreement for the sale thereof to Dolphinus. As of the date of approval of the financial statements, the Export from Tamar Agreement has not been assigned yet and the engagement with the other Tamar partners in such agreements has not been carried out yet.

In the Export from Tamar Agreement it was provided that the gas supply to Dolphinus would be first on an interruptible basis. Within the Export from Tamar Agreement the Sellers were granted an option to notify Dolphinus that the basis of the gas supply (in whole or in part) would become a firm basis (hereinafter in this Section: the “**Option**”). Exercise of the Option may be done by the Sellers, in whole or in part, during the period commencing in July 2020 and ending in the end of December 2021, or during another period, as shall be agreed between the Sellers and Dolphinus. From the Option Exercise date, as aforesaid, the Sellers will be obligated to supply Dolphinus with an annual quantity of up to approx. 3.5 BCM (according to the scope of quantities with respect of which the Option will be exercised) and Dolphinus will be obligated to purchase or pay for a minimal annual amount of natural gas according to a mechanism determined in the Export from Tamar Agreement. The total contractual gas quantity stated in the Export from Tamar Agreement is approx. 32 BCM.

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<sup>6</sup> To the Partnership's best knowledge, the buyer is a company which engages in natural gas trade and intends to supply gas to large industrial and commercial consumers in Egypt.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 4 – Additional Information (Cont.):**

##### **A. Engagement for the export of natural gas from the Tamar project (Cont.):**

The price of the gas to be supplied to Dolphinus under the Export from Tamar Agreement, will be determined according to a formula based on the price of a Brent oil barrel.

The supply according to the Export from Tamar Agreement is expected to begin upon the regulation of the use of the infrastructures necessary for the transmission of natural gas to Egypt. The supply will continue up to the supply of the total contractual quantity set forth in the Export from Tamar Agreement or up to December 2030, whichever is earlier.

The Export from Tamar Agreement includes several conditions precedent, mainly regarding the receipt of regulatory approvals in Israel and Egypt (including the receipt of approvals for the gas export and import as aforesaid), entering agreements which will allow use of the transmission infrastructure, including execution of transmission agreements between the Sellers and INGL (if necessary) receipt of guarantees in favor of the Sellers as required in the Export from Tamar Agreement, as well as receipt of approvals from the tax authorities in Israel regarding transactions contemplated in the Export from Tamar Agreement. It is clarified that there is no certainty that the sale of gas to Dolphinus under the Export from Tamar Agreement will materialize, due to the non-fulfillment of the conditions precedent in the Export from Tamar Agreement, in whole or in part, etc.

Note that as of the date of approval of the Condensed Interim Financial Statements, the Partnership is examining, together with its partners, various options for piping natural gas from Israel to Egypt, including through Jordan (using the Pan-Arab pipe), the construction of a new offshore pipe to Egypt and the construction of a new onshore connection between the Israeli transmission system and Egypt (in the Nizana or Kerem Shalom area). At the same time, the Partnership is conducting, together with Noble and Egyptian entities, negotiations with the various rights holders in EMG for examining the purchase of rights in EMG in order to use the gas pipe owned by EMG for piping natural gas from Israel to Egypt. It is emphasized that these negotiations do not obligate the parties up to the execution of binding agreements and there is no certainty that such binding agreements will be executed.

Note further that the taking effect of binding agreements (if and insofar as any will be signed) will be subject to the fulfillment of various conditions precedent, *inter alia*, obtaining all of the regulatory approvals that are required pursuant to any and all laws, conducting of technical tests in order to examine and confirm the possibility of using the EMG pipe and resolution of the open arbitrations of EMG and its shareholders.



## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 4 – Additional Information (Cont.):**

**B.** On February 21, 2018 an agreement on an interruptible basis was signed between the Tamar partners and Israel Chemicals Ltd. (“**ICL**”) for the supply of natural gas (the “**ICL from Tamar Agreement**”). The supply period under the ICL from Tamar Agreement shall begin on February 1, 2018 and expire on September 1, 2020. Pursuant to the ICL from Tamar Agreement, in the event of a delay in the date of commencement of commercial production from the Tanin and Karish reservoirs, the period of the ICL from Tamar Agreement shall be automatically extended by additional periods of six months each, until the date of commencement of commercial production from the Tanin and Karish reservoirs or until December 31, 2025, whichever is earlier. It was further determined that ICL shall be entitled to notify the Tamar partners of the termination of the supply agreement upon the expiration of each of the aforesaid extension periods. If the agreement for the supply of gas to ICL from the Tanin and Karish reservoirs will be terminated, the period of the ICL from Tamar Agreement shall be automatically extended until December 31, 2025.

#### **C. Engagements for the supply of natural gas from the Leviathan project:**

- 1.a. Pursuant to the provisions of Note 12C2B to the Annual Financial Statements pertaining to an agreement for the export of natural gas from the Leviathan project to Jordanian National Electric Power Company (the “**Export Agreement**”), on March 7, 2018 the Partnership notified that all of the conditions precedent that were set forth in the aforesaid Export Agreement have been met.
- b. Pursuant to the provisions of Note 12C2 to the Annual Financial Statements pertaining to agreements for the sale of natural gas from the Leviathan project, on May 9, 2018 (after the date of the statements of financial position), the Partnership notified that all of the conditions precedent in the agreement for the supply of natural gas from the Leviathan project to I.P.M. Beer Tuvia Ltd. have been met.
2. **Agreement for natural gas export from the Leviathan project to Dolphinus:**

In February 2018, an agreement was signed between the Partnership and Noble (jointly below in this section, the “**Sellers**”) and Dolphinus (below in this section, the “**Purchaser**”) for the export of natural gas from the Leviathan Project to Egypt (below in this section, the “**Export from Leviathan Agreement**”), which was signed pursuant to the non-binding LOI that was signed in November 2015.

The Sellers contacted the other partner in the Leviathan project (the “**Other Partner**”), aiming to assign the Export from Leviathan Agreement to the Other Partner or to enter into agreements therewith for the purchase of the natural gas from the Leviathan Project, in accordance with the terms and conditions of the Export from Leviathan Agreement, for the purpose of sale thereof to Dolphinus. As of the date of approval of the Condensed Interim Financial Statements, the Export from Leviathan Agreement has not yet been assigned and agreements as aforesaid with the Other Partner are yet to be entered into.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 4 – Additional Information (Cont.):**

##### **C. Engagements for the supply of natural gas from the Leviathan project (Cont.):**

###### **2. Agreement for natural gas export from the Leviathan project to Dolphinus (Cont.):**

In the Export from Leviathan Agreement it was determined that the supply of gas to the Purchaser will be on a firm basis. The Sellers undertook to supply the Purchaser with an annual quantity of approx. 3.5 BCM and the Purchaser undertook to take or pay for a minimal quantity according to the mechanism set forth in the agreement. The total contractual gas quantity stated in the Export from Leviathan Agreement is approx. 32 BCM.

The price of gas to be supplied to the Purchaser pursuant to the Export from Leviathan Agreement will be determined according to a formula based on the price of a Brent oil barrel. The supply pursuant to the Export from Leviathan Agreement is expected to begin with the commencement of production from the Leviathan reservoir. The supply will last until the supply of the total contractual quantity set forth in the Export from Leviathan Agreement or until December 2030, whichever is earlier.

The Export from Leviathan Agreement includes several conditions precedent, mainly the receipt of regulatory approvals in Israel and Egypt (including receipt of approvals for the export and import of the gas as stated), entering agreements that will enable the use in transmission infrastructure, including the signing of transmission agreements between the Sellers and INGL (if required), the receipt of guarantees in favor of the Sellers as required pursuant to the Export from Leviathan Agreement, and receipt of approvals from the Israeli Tax Authorities in respect of the transactions that are the subject of the Export from Leviathan Agreement.

It is clarified that there is no certainty that the sale of the gas to the Purchaser under the Export from Leviathan Agreement will be realized, due to the non-fulfillment of the conditions precedent in the Export from Leviathan Agreement, in whole or in part, etc.

Note that as of the date of approval of the Condensed Interim Financial Statements, the Partnership is continuing to examine, together with its partners, various options for piping natural gas from Israel to Egypt, including through Jordan (using the Pan-Arabian pipe), through the northern pipe to Jordan and/or the construction of a new offshore pipe to Egypt and the construction of a new onshore connection between the Israeli transmission system and Egypt (in the Nizana or Kerem Shalom area). At the same time, the Partnership is conducting, together with Noble and Egyptian entities, negotiations with the various right holders in EMG for examining the purchase of rights in EMG in order to use the gas pipe owned by EMG for piping natural gas from Israel to Egypt. It is emphasized that these negotiations do not obligate the parties up to the execution of binding agreements and there is no certainty that such binding agreements will be executed.

It is also noted, that the taking effect of binding agreements (if and to the extent signed) will be subject to the fulfillment of various conditions precedent, inter alia, the receipt of all of the regulatory approvals required under any law, the performance of technical tests in order to examine and approve the possibility of using EMG's pipe and the settlement of the open arbitrations of EMG and its shareholders.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 4 – Additional Information (Cont.):**

##### **C. Engagements for the supply of natural gas from the Leviathan project (Cont.):**

3. On February 21, 2018 an agreement was signed between the Leviathan project partners and ICL for the supply of natural gas (the “**ICL from Leviathan Agreement**”). The period of the supply agreement shall begin on the date of piping of the gas in commercial quantities from the Leviathan project and expire on September 1, 2020.

As the Leviathan partners were informed by ICL, ICL engaged in an agreement for the purchase of natural gas from the Tanin and Karish leases (the “**Tanin Karish Agreement**” and “**Tanin and Karish Reservoirs**”, respectively). Therefore, pursuant to the provisions of the Gas Framework and the orders of the Antitrust Authority, the Leviathan partners and ICL agreed that in the event of a delay in the date of the commencement of commercial production from the Tanin and Karish Reservoirs, the term of the agreement shall be automatically extended by additional periods of six months each, until the date of the commencement of commercial production from the Tanin and Karish Reservoirs or until December 31, 2025, whichever is earlier. It was further determined that ICL shall be entitled to notify the Leviathan partners of the termination of the supply agreement upon the expiration of each of the aforesaid extension periods. The supply agreement further determined that if the Tanin Karish Agreement will be terminated, the period of the supply agreement shall be automatically extended until December 31, 2025.

The Leviathan partners undertook to supply ICL with an annual quantity of natural gas in the scope of approx. 0.38 BCM, pursuant to the terms and conditions set forth in the supply agreement. ICL undertook to take or pay. The supply agreement further determined a mechanism for increasing the gas quantity that will be supplied to the buyer, up to an annual amount in the scope of approx. 0.76 BCM.

The supply agreement set forth that the gas price shall be linked in part to the Brent oil barrel price and in part to the electricity production tariff, as the same will be determined from time to time by the PUA-E, including a “floor price”.

##### **D. Investment in a company accounted for at equity:**

1. Pursuant to the provisions of Note 6 to the Annual Financial Statements, in March 2018 the company accounted for at equity Tamar Petroleum purchased from Noble 7.5% (out of 100%) of the rights in the Tamar and Dalit leases, *inter alia*, in consideration for a private allotment of 43.5% of the Tamar Petroleum shares (post allotment). Pursuant to the aforesaid, the Partnership’s rate of holding in Tamar Petroleum dropped to approx. 22.6% of the equity rights<sup>7</sup>. The Partnership’s share in the results of Tamar Petroleum in the report period, and the effect of the decrease in the holding rate were included in the Partnership’s share of earnings (losses) of company accounted for at equity, net item.
2. On March 20, 2018 the board of directors of Tamar Petroleum decided on a dividend distribution in the amount of approx. \$32 million (approx. \$0.36 per share), of which the Partnership’s share is approx. \$7.2 million. The aforesaid dividend was received in April 2018.

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<sup>7</sup> It is clarified that no change occurred in the voting rights of the Partnership in the company accounted for at equity (16.67%) following the closing of the said transaction with Noble, due to the waiver by Noble of all of the voting rights attached to the Tamar Petroleum shares that were allotted thereto.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 4 – Additional Information (Cont.):**

- E.** Pursuant to the provisions of Note 8B to the Annual Financial Statements regarding an agreement for the sale of rights in I/17 Karish and I/16 Tanin leases (jointly below, the “**Leases**”), on March 27, 2018 the Partnership received a notice from Energean according to which, on March 22, 2018 Energean adopted a final investment decision in relation to the development of the Leases. Pursuant to the terms of the agreement, the Partnership is entitled to receive, starting from the date of adoption of the investment decision as aforesaid, the amount of \$108.5 million, in ten equal annual installments plus interest according to the mechanism and rate set forth in the agreement, and to royalties in relation to natural gas and condensate that will be produced from the Leases. Note that in March 2018, the Partnership received the first installment.

The finance income item in the report period includes a sum of approx. \$45 million deriving from an update of receivables in respect of the component of future-production-based royalties (the “**Royalties**”) and receivables in relation to a final investment decision (the “**Receivables**”) that derived from the sale of all of the Partnership’s rights in the Leases. Such update derives mainly from changes in the cap rates, bringing forward of the date of the investment decision on the development of the Leases, updating of the contingent resources and hydrocarbon liquids (condensate and natural gas liquids) and a production rate forecast.

Below are main parameters out of the valuations that were used to measure the Royalties and the Receivables: cap rate for the Receivables is estimated at 7.5%; the cap rate estimated for the Royalties component is estimated at 11%; the sum total of the contingent resources of natural gas and hydrocarbon liquids that were used for the valuation to measure the Royalties were estimated at approx. 67 BCM and approx. 33 MMBBL, respectively.

- F.** In March 2018, the Partnership released a shelf offering report, under which Delek Group offered, *inter alia*, participation units of the Partnership, within a full exchange tender offer that Delek Group wishes to carry out with the shares of Delek Energy. In April 2018, Delek Group and the Partnership notified that the condition to the taking effect of the aforesaid tender offer was not fulfilled.
- G.** In April 2018 (after the date of the statements of financial position), the Israeli partners in the Leviathan project provided an additional guaranty in favor of the Israel Tax Authority (Customs) in relation to equipment which is imported by the Operator for the purpose of development of the Leviathan project. The Partnership’s share in the aforesaid guaranty is in the amount of approx. ILS 188 million. As of the date of approval of the Condensed Interim Financial Statements, the Partnership’s share in the guaranties that were provided for the benefit of Customs in relation to the Tamar and Leviathan projects amounts to approx. ILS 375 million.
- H.** Pursuant to the provisions of Note 21C1 to the Annual Financial Statements, On February 19, 2018 the Partnership announced that the CEO of the General Partner, Mr. Abu notified the Partnership that the board of directors of Delek Energy approved his appointment as the CEO of Delek Energy, subject to the receipt of all of the approvals required pursuant to law, in addition to his position as the CEO of the General Partner, and such that his main engagement will continue to be the CEO of the General Partner.

## **Delek Drilling – Limited Partnership**

### **Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)**

#### **Note 4 – Additional Information (Cont.):**

##### **H. (Cont.):**

Following the aforesaid, Mr. Abu reached an agreement with the General Partner and Delek Energy, under which he will continue to serve in his current office as the CEO of the General Partner in an approx. 80% position (instead of 100%), and he will also concurrently serve as the CEO of Delek Energy in a 20% position, subject to the receipt of all of the approvals required therefor in the Partnership and in Delek Energy (including approval from the general meeting of the Partnership (see Section I2 below). Mr. Abu will update the audit committee and the board of directors on any matter where a concern shall arise for the creation of a conflict of interests between his office as the CEO of the General Partner and his office as the CEO of Delek Energy, and he will act pursuant to their instructions on such matter. The parties agreed that the General Partner will continue to bear the entire compensation of Mr. Abu (100% position) and a settlement of accounts will be held between the General Partner and Delek Energy for bearing the share of Delek Energy (20%) of the total cost of Mr. Abu's compensation, including all of the compensation components to which he is entitled under the current employment terms pursuant to the Second Employment Agreement. Furthermore, for his service as a director in companies held by the Partnership or Delek Energy, Mr. Abu will be entitled to customary compensation.

- I.** The Partnership notified of the convening of a special annual general meeting that shall be held on May 17, 2018 that shall have, *inter alia*, the following issues on its agenda:
1. To authorize the General Partner to perform an issue of participation units and/or securities convertible into participation units during the period from the date of the meeting's approval until May 6, 2021, in such scope and under such terms and conditions as will be determined pursuant to the General Partner's decision and subject to the entire proceeds of the issue (or issues) in the aforesaid period shall not exceed the amount in ILS that is equal to U.S. \$300 million.
  2. To approve the changes to the terms of office and employment of Mr. Yossi Abu, CEO of the General Partner, as specified in paragraph H above.
- J.** Pursuant to the provisions of Note 12I1 to the Annual Financial Statements pertaining to a claim to return royalties, the court decided, *inter alia*, to reschedule the concluding pre-trial to July 18, 2018.
- K.** Pursuant to the provisions of Note 20C6 to the Annual Financial Statements pertaining to the provisions of Section 19 of the Taxation of Profits and Natural Resources Law, on April 17, 2018 the Supreme Court ruled that the appeal that was filed by the General Partner in the Partnership with the Supreme Court from the judgment of the District Court in the motion and the appeal that was filed with the Supreme Court in the matter of Isramco Negev 2 Limited Partnership, shall be scheduled to be heard on the same date and before the same panel. On May 2, 2018 the court scheduled a trial date for the purpose of completing the hearing to March 18, 2019.

**Delek Drilling – Limited Partnership****Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)****Note 4 – Additional Information (Cont.):**

L. Pursuant to the provisions of Note 12I2 to the Annual Financial Statements pertaining to the motion for class certification by an IEC consumer, in April 2018 counsel for the late petitioner filed an agreed motion to replace him with his widow, subject to the filing of a supplemental affidavit on her behalf, and on the same day the motion was granted by the court. The cross-examinations of the affiants on behalf of the State were conducted on May 6, 2018. The cross-examinations of the other affiants in the proceeding were scheduled for May 22, 2018 and June 26, 2018. The Partnership estimates, based on the opinion of the legal counsel, that the chances of the class certification motion being granted are less than 50%.

**Note 5 – Financial Instruments:****Fair value of financial instruments:**

- A. The fair value of the financial instruments presented in the financial statements is at or around their book value, with the exception of issued bonds whose fair value, as of March 31, 2018, is approx. \$1,696.6 million (as of December 31, 2017: approx. \$1,695 million, as of March 31, 2017: approx. \$2,107.5 million), and whose book value is approx. \$1,674.1 million (as of December 31, 2017: approx. \$1,664 million, as of March 31, 2017: approx. \$1,989.3 million).
- B. Set forth below are figures regarding the fair value hierarchy of the financial instruments measured at fair value which were recognized in the Condensed Statements of Financial Position:

	31.3.2018			
	Unaudited			
	Level 1	Level 2	Level 3	Total
<b>Financial assets at fair value through profit or loss:</b>				
- Bonds	83,896	-	-	83,896
- Structured deposits <sup>8</sup>	-	-	49,859	49,859
- Contingent proceeds from the sale of the Karish and Tanin leases in respect of future-production-based royalties (See Note 4E above) <sup>9</sup>	-	-	114,600	114,600
- Receivables from the sale of the Karish and Tanin leases in respect of a final investment decision for the development of the Karish Tanin leases (See Note 4E above) <sup>10</sup>	-	86,700	-	86,700
- ETFs	14,181	-	-	14,181
	<u>98,077</u>	<u>86,700</u>	<u>164,459</u>	<u>349,236</u>

<sup>8</sup> In the report period structured deposits in the amount of approx. \$10 million were repaid, structured deposits in the amount of approx. \$15 million were purchased and the balance of the deposits was revaluated at the amount of approx. \$42 thousand (an expense).

<sup>9</sup> In the report period the balance was revaluated at the amount of approx. \$26 million (revenue).

<sup>10</sup> In the report period approx. \$10.8 million were received. The balance was revaluated at approx. \$19 million (revenue) and classified from Level 3 to Level 2.

**Delek Drilling – Limited Partnership****Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)****Note 5 – Financial Instruments (Cont.):****Fair value of financial instruments (Cont.):****B. (Cont.):**

	<b>31.3.2017</b>			
	<b>Unaudited</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Financial assets at fair value through profit or loss:</b>				
- Bonds	83,280	-	-	83,280
- Financial derivatives	-	-	462	462
- Contingent proceeds from the sale of the Karish and Tanin leases in respect of future-production-based royalties	-	-	76,700	76,700
<b>Financial assets available for sale:</b>				
- Contingent proceeds from the sale of the Karish and Tanin leases in respect of a final investment decision for the development of the Karish Tanin leases	-	-	68,200	68,200
- ETF	4,605	-	-	4,605
	<u>87,885</u>	<u>-</u>	<u>145,362</u>	<u>233,247</u>

**Delek Drilling – Limited Partnership****Notes to the Condensed Interim Financial Statements as of March 31, 2018 (Dollars in thousands)****Note 5 – Financial Instruments (Cont.):****Fair value of financial instruments (Cont.):****B. (Cont.):**

	31.12.2017			
	Level 1	Level 2	Level 3	Total
<b>Financial assets at fair value through profit or loss:</b>				
- Bonds	95,070	-	-	95,070
- Contingent proceeds from the sale of the Karish and Tanin leases in respect of future-production-based royalties <sup>11</sup>	-	-	88,600	88,600
- ETFs	14,093	-	-	14,093
<b>Financial assets available for sale:</b>				
- Contingent proceeds from the sale of the Karish and Tanin leases in respect of a final investment decision for the development of the Karish Tanin leases <sup>12</sup>	-	-	78,500	78,500
	109,163	-	167,100	276,263
<b>Financial liabilities at fair value through profit or loss:</b>				
- Financial derivatives <sup>13</sup>	-	-	126	126

**Note 6 – Events Subsequent to the Date of the Statements of Financial Position:**

- A.** For details on development drillings, see Note 3B2(b) above.
- B.** For details on the fulfillment of the conditions precedent in the engagement for supply of natural gas from the Leviathan project agreement, see Note 4C1(b) above.
- C.** For details on the provision of a guaranty for the benefit of the Israel Tax Authority (Customs) in relation to equipment imported for the Leviathan project, see Note 4G above.
- D.** For details on legal proceedings, see Notes 4K and 4L above.

<sup>11</sup> In 2017, the balance was revaluated at approx. \$14,900 thousand that was recognized in profit or loss in the financing revenues item.

<sup>12</sup> In 2017, the balance was revaluated at approx. \$11,900 thousand of which approx. \$2,100 thousand was recognized in other comprehensive income and approx. \$9,800 thousand was recognized in profit or loss in the financing revenues item.

<sup>13</sup> In 2017, the balance was revaluated at approx. \$558 thousand that was recognized in profit or loss in the financing expenses item.



An aerial photograph of an offshore oil rig and a support vessel on the ocean. The rig is a large, complex structure with a tall derrick and various platforms. A smaller support vessel is visible to the left of the rig. The ocean is a deep blue color.

# 2018

**Proforma Financial Statements**  
**31.3.2017**

**Delek Drilling - Limited Partnership**  
**Proforma Condensed Interim Financial Statements for the Three-Month Period Ended**  
**March 31, 2017**  
**Unaudited**  
**in U.S. Dollars in Thousands**

*This report is a translation of Delek Drilling - Limited Partnership's Hebrew-language proforma condensed interim financial statements. It is prepared solely for convenience purposes. Please note that the Hebrew version constitutes the binding version, and in the event of any discrepancy, the Hebrew version shall prevail.*

**Delek Drilling – Limited Partnership**  
**Proforma Condensed Interim Financial Statements for the Three-Month Period Ended**  
**March 31, 2017**  
**Unaudited**  
**in U.S. Dollars in Thousands**

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## **Auditors' report to the partners of Delek Drilling - Limited Partnership**

### **Introduction**

We have reviewed the accompanying proforma financial information of Delek Drilling - Limited Partnership (the “**Partnership**”), which includes the Condensed Proforma Statement of Comprehensive Income for the three-month period ended March 31, 2017. The board of directors and management of the Partnership's general partner are responsible for the preparation and presentation of proforma financial information for such interim period in accordance with the accounting policy specified in Note 2 and the assumptions specified in Note 3 to the proforma financial information, and they are also responsible for the preparation of proforma financial information for such interim period according to Regulation 38B of the Securities Regulations (Periodic and Immediate Reports), 5730-1970. Our responsibility is to express a conclusion on the proforma financial information for such interim period, based on our review.

### **Scope of Review**

We conducted our review in accordance with Review Standard 1 of the Institute of Certified Public Accountants in Israel “Review of Interim Financial Information Performed by the Auditor of the Entity”. A review of interim financial information consists of making inquiries, primarily with persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Generally Accepted Auditing Standards in Israel, and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the aforesaid proforma financial information is not prepared, in all material respects, in accordance with the accounting policy specified in Note 2 and the assumptions specified in Note 3 to the proforma financial information.

In addition to the previous paragraph, based on our review, nothing has come to our attention which causes us to believe that the aforesaid proforma financial information does not comply, in all material respects, with the provisions of Regulation 38B of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

**Kost, Forrer, Gabbay & Kasierer**  
**Certified Public Accountants**

**Ziv Haft**  
**Certified Public Accountants**

Tel Aviv, May 15, 2018

## **Delek Drilling - Limited Partnership**

### **Proforma Condensed Interim Financial Statements of Comprehensive Income (Dollars in thousands)**

	For the three-month period ended March 31, 2017		
	Actual Figures	Proforma Adjustments Unaudited	Proforma Figures
<b>Revenues:</b>			
From natural gas and condensate sales	145,047	(42,329)	102,718
Net of royalties	22,697	(6,559)	16,138
	122,350	(35,770)	86,580
<b>Expenses and costs:</b>			
Cost of production of natural gas and condensate	10,379	(3,100)	7,279
Depreciation, depletion and amortization expenses	15,078	(4,323)	10,755
Oil and gas exploration and other direct expenses	1,989	-	1,989
G&A expenses	2,633	(300)	2,333
<b>Total expenses and costs</b>	30,079	(7,723)	22,356
Partnership's share of earnings of company accounted for at equity, net	-	8,796	8,796
<b>Operating profit</b>	92,271	(19,251)	73,020
Finance costs	(18,681)	3,969	(14,712)
Finance income	9,071	(5)	9,066
Finance costs, net	(9,610)	3,964	(5,646)
<b>Income before levy</b>	82,661	(15,287)	67,374
Petroleum and gas profit levy	(3,796)	-	(3,796)
<b>Net profit</b>	78,865	(15,287)	63,578
<b>Other comprehensive income for items which may subsequently be reclassified to profit or loss:</b>			
Income from financial assets available for sale	137	-	137
<b>Total other comprehensive income (loss)</b>	137	-	137
<b>Total comprehensive income</b>	79,002	(15,287)	63,715
Basic and diluted profit per participation unit (in dollars)	0.067	(0.013)	0.054
Weighted number of participation units for the purpose of the said calculation (in thousands)	1,173,815	1,173,815	1,173,815

**The attached notes constitute an integral part of the Proforma Condensed Interim Financial Statements.**

May 15, 2018			
Date of approval of the proforma financial statements	Gabi Last Stand-in Chairman of the Board	Yossi Abu CEO	Yossi Gvura Deputy CEO
	Delek Drilling Management (1993) Ltd. General Partner	Delek Drilling Management (1993) Ltd. General Partner	Delek Drilling Management (1993) Ltd. General Partner

## **Delek Drilling - Limited Partnership**

### **Notes to the Proforma Condensed Interim Financial Statements for the Period Ended March 31, 2017 (Dollars in thousands)**

#### **Note 1 - General:**

- A. The proforma event – the sale of participation rights at a rate of 9.25% of the Partnership’s holdings in interests in the Tamar and Dalit reservoirs:

On July 2, 2017, Delek Drilling - Limited Partnership (“**Delek Drilling**” or the “**Partnership**”) signed a sale agreement (the “**Sale Agreement**” or the “**Agreement**”) with Tamar Petroleum Ltd. (“**Tamar Petroleum**” or the “**Company**”) for the sale of 9.25% of its interests in the Tamar and Dalit leases.

For further details with respect to the Sale Agreement, see Note 7C1B to the Partnership’s Financial Statements as of December 31, 2017.

#### **Note 2 - Significant Accounting Policies:**

- A. The Partnership’s Proforma Condensed Interim Financial Statements (the “**Proforma Financial Statements**”) should be read in conjunction with the Partnership’s Financial Statements for December 31, 2017.

The significant accounting policies, subject to the proforma assumptions specified in Note 3 below, which were applied in the Proforma Financial Statements, are consistent with the policies applied in the preparation of the Partnership’s Financial Statements as of December 31, 2017 and according to the provisions of Regulation 9A of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

- B. The Proforma Statements include Statements of Comprehensive Income for the period ended March 31, 2017.

#### **Note 3 - Proforma Assumptions:**

- A. In view of Note 1 above regarding the sale of participation rights at a rate of 9.25% of the interests in the Tamar and Dalit reservoirs, these Proforma Statements were presented so as to reflect the Partnership’s results of operations, subject to the following proforma assumptions.

- B. Below are the proforma assumptions for the Proforma Financial Statements of Comprehensive Income:

1. The Partnership prepared the Proforma Financial Statements of Comprehensive Income to reflect the transferred rights as if transferred on January 1, 2015.
2. Proforma G&A expenses were presented net of the share attributed to the object of sale as estimated by the Partnership’s management out of the total G&A expenses of the Partnership.
3. Proforma finance costs were presented net of 20% of the finance costs deriving from the bonds of Tamar Bond repaid following the closing of the transaction.
4. The Partnership accounts for its investment in Tamar Petroleum by the equity method, the application includes depreciation of excess of fair value over the book value which was created upon the closing of the Sale Agreement, had it been closed on January 1, 2015.



Delek Drilling



# 2018

**Report on the Effectiveness of  
Internal Controls for Financial  
Reporting and Disclosure**



*This report is a translation of Delek Drilling - Limited Partnership's Hebrew-language Quarterly Report on the Effectiveness of Internal Control over Financial Reporting and Disclosure pursuant to Regulation 38C(a) of the Securities Regulations (Immediate and Periodic Reports), 5730-1970. It is prepared solely for convenience purposes. Please note that the Hebrew version constitutes the binding version, and in the event of any discrepancy, the Hebrew version shall prevail.*

**Quarterly Report on the Effectiveness of Internal Control over Financial Reporting and Disclosure pursuant to Regulation 38C(a) of the Securities Regulations (Immediate and Periodic Reports), 5730-1970:**

The management, under the supervision of the board of the general partner in Delek Drilling – Limited Partnership (the “**General Partner**” and “**Partnership**”, respectively), is responsible for setting and maintaining proper internal control over financial reporting and disclosure at the Partnership.

For this purpose, the members of management are:

1. Asi Bartfeld, Chairman of the Board of the General Partner;
2. Yossi Abu, CEO of the General Partner;
3. Yossi Gvura, Deputy CEO and Market Risk Manager;
4. Yaniv Friedman, Deputy CEO.

Internal control over financial reporting and disclosure consists of controls and procedures existing at the Partnership, designed by, or under the supervision of, the CEO and the most senior financial officer, or by anyone actually performing such functions, under the supervision of the board of directors of the General Partner, and which are designed to provide reasonable assurance regarding the reliability of the financial reporting and the preparation of the reports according to the provisions of the law, and to ensure that information which the Partnership is required to disclose in reports released thereby according to the law is gathered, processed, summarized and reported within the time frames and in the format set forth by the law.

Internal control includes, *inter alia*, controls and procedures designed to ensure that information which the Partnership is thus required to disclose, is gathered and transferred to the management of the General Partner, including the CEO and the most senior financial officer, or anyone actually performing such functions, in order to enable the timely decision making in reference to the disclosure requirements.

Due to its inherent limitations, internal control over financial reporting and disclosure is not designed to provide absolute assurance that misrepresentation or omission of information in the reports will be avoided or discovered.

In the annual report regarding the effectiveness of internal control over financial reporting and disclosure, which was attached to the periodic report for the period ended on December 31, 2017 (the “**Most Recent Annual Report on Internal Control**”), the board and management of the General Partner evaluated the internal control in the Partnership; based on this evaluation, the board and management of the General Partner came to the conclusion that such internal control, as of March 31, 2018, is effective.



Until the date of the report, no occurrence or issue were brought to the knowledge of the board or management of the General Partner, which may change the evaluation of the effectiveness of the internal control, as presented in the Most Recent Annual Report on Internal Control;

As of the date of the report, based on the evaluation of the effectiveness of the internal control in the Most Recent Annual Report on Internal Control, and based on information which was brought to the knowledge of the management and board of the General Partner as aforesaid, the internal control is effective.

Statement of CEO pursuant to Regulation 38C(d)(1):

**Statement of Managers**

**Statement of CEO**

I, Yossi Abu, CEO of the General Partner, represent that:

- (1) I have reviewed the quarterly report of Delek Drilling – Limited Partnership (the “**Partnership**”) for Q1/2018 (the “**Reports**”);
- (2) To my knowledge, the Reports do not contain any misrepresentation nor an omission of a material fact required for the representations included therein, given the circumstances under which such representations were included, not to be misleading with regard to the period of the Reports;
- (3) To my knowledge, the financial statements and other financial information included in the Reports adequately reflect, in all material respects, the financial position, operating results and cash flows of the Partnership for the periods and as of the dates covered by the Reports;
- (4) I have disclosed to the Partnership’s auditor, the board of directors and to the audit and financial statements review committees of the General Partner in the Partnership, based on my most current evaluation of internal control over financial reporting and disclosure:
  - (a) Any and all significant flaws and material weaknesses in the setting or maintaining internal control over financial reporting and disclosure which may reasonably adversely affect the Partnership’s ability to gather, process, summarize or report financial information in a manner which casts a doubt on the reliability of the financial reporting and preparation of the financial statements in conformity with the provisions of the law; and –
  - (b) Any fraud, either material or immaterial, which involves the CEO or anyone reporting to him directly or which involves other employees who play a significant role in internal control over financial reporting and disclosure;
- (5) I, myself or jointly with others in the Partnership:
  - (a) Have set controls and procedures, or confirmed, under my supervision, the setting and maintaining of controls and procedures, which are designed to ensure that material information in reference to the Partnership is brought to my knowledge by others in the Partnership, particularly during the preparation of the Reports; and –
  - (b) Have set controls and procedures, or confirmed, under my supervision, the setting and maintaining of controls and procedures, which are designed to reasonably ensure reliability of financial reporting and preparation of the financial statements in conformity with the provisions of the law, including in conformity with GAAP;

- (c) No occurrence or issue have been brought to my attention that occurred during the period between the date of the most recent report (the periodic report as of December 31, 2017) and the date hereof, which can change the conclusion of the board of directors and the management of the Partnership's General Partner with regard to the effectiveness of internal control over Partnership's financial reporting and disclosure.

The aforesaid does not derogate from my responsibility or from the responsibility of any other person, pursuant to any law.

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May 15, 2018

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Yossi Abu, CEO

Statement of the most senior financial officer pursuant to Regulation 38C(d)(2):

**Statement of Managers**

**Statement of the most senior financial officer**

I, Yossi Gvura, Deputy CEO, represent that:

- (1) I have reviewed the interim financial statements and the other financial information included in the interim reports of Delek Drilling – Limited Partnership (the “**Partnership**”) for Q1/2018 (the “**Reports**” or the “**Interim Reports**”);
- (2) To my knowledge, the interim financial statements and the other financial information included in the Interim Reports do not contain any misrepresentation nor omission of a material fact required for the representations included therein, given the circumstances under which such representations were included, not to be misleading with regard to the period of the Reports;
- (3) To my knowledge, the interim financial statements and the other financial information included in the Interim Reports adequately reflect, in all material respects, the financial position, operating results of operations and cash flows of the Partnership for the periods and as of the dates covered by the Reports;
- (4) I have disclosed to the Partnership’s auditor and to the board of directors and the audit and financial statement review committees of the General Partner in the Partnership, based on my most current evaluation of internal control over financial reporting and disclosure:
  - (a) Any and all significant flaws and material weaknesses in the setting or maintaining internal control over financial reporting and disclosure, insofar as it relates to the interim financial statements and the other financial information included in the Interim Reports, which may reasonably adversely affect the Partnership’s ability to gather, process, summarize or report financial information in a manner which casts doubt on the reliability of financial reporting and preparation of the financial statements in conformity with the provisions of the law; and –
  - (b) Any fraud, either material or immaterial, which involves the CEO or anyone reporting to him directly or which involves other employees who play a significant role in internal control over financial reporting and disclosure;

- (5) I, myself or jointly with others in the Partnership:
- (a) Have set controls and procedures, or confirmed, under my supervision, the setting and maintaining of controls and procedures, which are designed to ensure that material information in reference to the Partnership is brought to my knowledge by others at the Partnership, particularly during the preparation of the Reports; and
  - (b) Have set controls and procedures, or confirmed, under my supervision, the setting and maintaining of controls and procedures, which are designed to reasonably ensure reliability of financial reporting and preparation of the financial statements in conformity with the provisions of the law, including in conformity with GAAP;
  - (c) No occurrence or issue have been brought to my attention, that occurred during of the period between the date of the most recent report (the periodic report as of December 31, 2017) and the date hereof, pertaining to the interim financial statements and any other financial information included in the Interim Reports, which could, in my opinion, change the conclusion of the board of directors and the management of the Partnership's General Partner with regard to the effectiveness of internal control over the Partnership's financial reporting and disclosure.

The aforesaid does not derogate from my responsibility or from the responsibility of any other person, pursuant to any law.

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May 15, 2018

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Yossi Gvura, CPA  
Deputy CEO



## Valuations



GIZA SINGER EVEN

## **Delek Drilling – Limited Partnership**

### **Valuations of Royalties and the Debt Component From the sale of I/16 “Tanin” and I/17 “Karish” Leases**

\*\*\*\*

**May 2018**

*This document is a translation of the original Hebrew-language document of Giza Singer Even Ltd. of May 2018. It is prepared solely for convenience purposes. Please note that the Hebrew version constitutes the binding version, and in any event of discrepancy, the Hebrew version shall prevail.*

**Giza Singer Even Ltd.**

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GIZA SINGER EVEN

## 1. Introduction and Limitation of Liability

### 1.1 General

This work (the “**Work**” and/or the “**Opinion**”) was prepared by GSE Financial Advisory Ltd. (“**GSE**”) for the purpose of valuation of the royalties to which the limited partnership Delek Drilling<sup>1</sup> (“**Delek Drilling**” and/or the “**Partnership**”) is entitled for the sale of its rights in the I/16 “Tanin” and I/17 “Karish” Leases (the “**Leases**”) as of March 31, 2018 (the “**Valuation Date**”) according to the management’s requirement. We are aware that the Work is intended to be used by Delek Drilling, *inter alia*, for quarterly and periodic financial statements, and therefore we agree that the Work will be referred to and/or included in any report released by the Partnership and the interested parties therein, according to the Securities Law, 5728-1968 and the regulations thereunder, all as specified in the engagement letter of November 3, 2016.

For the preparation of the Work we relied, *inter alia*, on representations, forecasts and explanations (the “**Information**”) which we received from the Partnership and/or anyone on its behalf. GSE assumes that this Information is reliable and it does not carry out an independent examination of the Information, nor have we become aware of anything which could indicate it being unreasonable. The Information was not examined independently, and therefore the Work furnished to you does not constitute a verification to the correctness, integrity and accuracy of this Information. An economic valuation is supposed to reflect in a reasonable and fair manner a given situation at a certain time, based on known data and while referring to basic assumptions and forecasts which were evaluated.

This Opinion includes a description of the methodology and the main assumptions and analyses which were used for the determination of the fair value of the consideration to which the Partnership is entitled. However, the description does not purport to be a full and detailed description of all of the procedures which we implemented upon the formulation of the Opinion.

This Work does not constitute a due diligence inspection and does not replace it. Furthermore, the Work is also not intended to determine the value of the consideration for the specific investor and it does not constitute legal advice or opinion.

The Work does not include accounting auditing regarding the compliance with the accounting principles. GSE Financial Advisory is not responsible for the manner of accounting presentation of the financial statements of the Partnership regarding the accuracy and integrity of the data and the implications of such accounting presentation, if any.

Should the Information and data on which GSE relied, be incomplete, inaccurate or unreliable, the results of this Work may change. We reserve the right for ourselves, to re-update the Work in view of new data which were not presented to us. For the avoidance of doubt, this Work is valid as of the date of signing hereof only.

**It is emphasized that the Information specified in this Work, including with respect to forecasts and the primary commercial terms in the agreement for the sale of the reservoirs, its total financial scope, the rights transferred thereunder, the royalties agreed**

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<sup>1</sup> On May 17, 2017, Delek Drilling merged with the partnership Avner Oil Exploration – Limited Partnership (“**Avner**”, hereinafter jointly: the “**Partnerships**”) and as a result, Avner partnership was stricken off with no dissolution.



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therein, and the fulfilment of the conditions precedent therein, constitutes forward-looking information in the meaning thereof in the Securities Law, 5728-1968, of which there is no certainty that it will materialize, in whole or in part, in the said manner or otherwise. The actual performance of the said information may differ materially due to various factors such as delays in the timetables, the development of the reservoirs etc.

We shall further note that upon our valuation of the consideration, we relied on the assumption that the transaction for the sale of rights in the Karish and Tanin Leases was made at market conditions between a willing buyer and seller, and we were not presented with any information which might contradict this assumption.

We hereby confirm that we have no personal interest and/or dependence on the Partnership and/or on the general partner in the Partnership, apart from the fact that we are receiving a fee for this work. Furthermore, we confirm that our fee is not dependent on the results of the Work.

Neither GSE nor any company controlled thereby directly and/or indirectly as well as any controlling shareholder, officer and employee therein, are responsible for any damage, loss or expense whatsoever, including direct and/or indirect, which will be incurred by anyone relying on the contents of this Work in whole or in part.

## 1.2 Sources of Information

The main sources of information used in the preparation of the Opinion are specified below:

- Periodic report of the Partnership for 2017
- Information regarding the terms of the transaction and forecasts received from the Partnership
- Prospectus released by Energean Oil & Gas plc (the parent company of Energean Israel Limited) of March 16, 2018 (the “**Prospectus**”) including the resource report prepared by Netherland Sewell and Associate Inc. (“**NASI**”)
- Agreement for the sale of the rights in the Karish and Tanin Leases
- Immediate reports of publicly traded companies and overt information released on websites, journalistic articles or other public sources
- Internal sources and databases of Giza Singer Even
- Meetings and/or phone calls with office holders at the Partnership



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### **1.3 Details of the valuating company**

GSE Financial Advisory Ltd. Is a subsidiary of Giza Singer Even Ltd., which is a leading financial advisory and investment banking firm in Israel. The firm has extensive experience in the advising of the large companies, the prominent privatizations and the important transactions in the Israeli market, which it accrued over its thirty years of operation. Giza Singer Even operates in three fields, through independent business divisions: financial advisory; investment banking; analytical research and corporate governance.

The Work was carried out by a team headed by CPA Eitan Cohen, a partner and head of the economic department at Giza Singer Even with experience of over ten years in the fields of economic and business advisory, company valuations and financial instruments. In the past he served as the head of the economic department in an entrepreneurial company in the field of infrastructures and as a manager at the economic department of KPMG (Somekh Chaikin). Eitan is an accountant, holds a BA in economics and business administration from the Ben Gurion University and an MSc in Financial Mathematics from Bar Ilan University.

Sincerely,

GSE Financial Advisory

May 15, 2018



## 2. Executive Summary

### 2.1 Background

Delek Drilling is a public limited partnership (in the meaning thereof in the Partnerships Ordinance) listed for trade on the Tel Aviv Stock Exchange (TASE). The Partnership engages in the exploration, development and production of petroleum, natural gas and condensate.

During the years 2012 and 2013 the Partnership reported to TASE that the Tanin and Karish gas reservoirs constitute natural gas discoveries. Following are the quantities of natural gas and hydrocarbon liquids (condensate and natural gas liquids) at the Karish and Tanin reservoirs (100%) as released in the Prospectus of Energean Oil & Gas plc, the parent company of Energean Israel Limited<sup>2</sup> (“**Energean**” and/or the “**Purchaser**”) of March 16, 2018<sup>3</sup>:

Lease	Contingent Resources	
	Natural Gas (BCM)	Hydrocarbon liquids (MMBBL)
Karish	45.0	28.7
Tanin	21.7	4.1
<b>Total</b>	<b>66.7</b>	<b>32.8</b>

Following the decision of the Israeli government on a framework for the increasing of the amount of natural gas produced from the Tamar natural gas field and the quick development of the Leviathan, Karish and Tanin natural gas fields and other natural gas fields (the “**Gas Framework**”), the Partnerships and Noble Energy Mediterranean (“**Noble**”) were required, *inter alia*, to sell their holdings in the Karish and Tanin reservoirs in order to comply with the conditions which would entitle them to an exemption from several provisions of the Antitrust Law, 5748-1988 (the “**Antitrust Law**”).

On August 16, 2016, an agreement was executed for the sale of all of the rights in Karish and Tanin between Delek Drilling and Avner and Energean, within which the Partnerships are entitled to consideration in the amount of \$148.5 million, comprising cash payment of \$40 million (paid on the date of the transaction closing) and \$108.5 million which will be paid spread into 10 annual equal payments plus interest, with this amount depending on the Purchaser’s decision to develop the reservoir<sup>4</sup> (the “**Debt Component**”). Furthermore, the Partnerships will be entitled to royalties from the revenues generated for the Purchaser from the sale of natural gas and condensate produced from the Leases, at the rates of 7.5% (before the payment of petroleum profit levy) and 8.25% (after payment of petroleum profit levy), net of the rate of the existing royalties<sup>5</sup>, by which the Partnership is charged regarding the original share of Delek Drilling and Avner in the Leases (the “**Royalties**”). On December 27, 2016, the Partnerships announced that the conditions precedent for the closing of the transaction were fulfilled. On March 27, 2018, Energean notified the Partnership of the adoption of a decision of investment for the development of Karish reservoir.

<sup>2</sup> Formerly Ocean Energean Oil and Gas Ltd.

<sup>3</sup> According to the NSAI resource report attached to Energean Prospectus, Net Resources

<sup>4</sup> Making of a Final Investment Decision (FID) regarding the development of the Leases or on the date which the total expenses of the Purchaser regarding the development of the leases cost \$150 million (whichever is earlier).

<sup>5</sup> As defined in the reports of Delek Drilling and Avner to the Tel Aviv Stock Exchange on December 25, 2016.



## 2.2 Results of the Valuation

The valuation of the consideration was performed in the Discounted Cash Flow (DCF) method. According to the assumptions specified in the Work itself, the value of the Royalties in the transaction as of the valuation date is estimated at approx. \$114.6 million. For specification regarding the valuation of the Debt Component see Annex B.

Below is the sensitivity analysis for the value of the Royalties in relation to the discounting rate and the changes in the natural gas prices (US Dollars in millions):

		Change in the natural gas vector (US Dollar per mmbtu)						
		(1.50)	(1.00)	(0.50)	-	0.50	1.00	1.50
Change in the discounting rate (in base points)	+250bp	79.3	83.7	89.6	94.5	98.6	103.2	109.8
	+150bp	85.6	90.2	96.6	101.9	106.3	111.3	118.4
	+50bp	92.6	97.5	104.4	110.2	114.9	120.3	128.0
	-	96.3	101.5	108.7	<b>114.6</b>	119.5	125.2	133.2
	-50bp	100.3	105.7	113.1	119.4	124.5	130.4	138.7
	-150bp	109.0	114.8	122.8	129.6	135.1	141.7	150.7
	-250bp	118.7	124.9	133.7	141.1	147.1	154.4	164.2



### 3. Description of the Partnership's Business

#### 3.1 Description of the Partnership

Delek Drilling is a limited partnership (within the meaning thereof in the Partnerships Ordinance) listed for trade on the Tel Aviv Stock Exchange. The Partnership engages in the exploration, development and production of petroleum, natural gas and condensate. Following is a description of the overriding royalties applicable to the Partnership as of the date of this Work:

Overriding Royalties	For 50% of the revenues from Karish and Tanin Leases	For 50% of the revenues from Karish and Tanin Leases
Offshore petroleum assets	3% before the date of return on investment <sup>6</sup> 13% after the date of return on investment	6%
Onshore petroleum assets	5% before the date of return on investment 15% after the date of return on investment	

#### 3.2 Description of the Business Field

##### 3.2.1 General

As aforesaid, the main field of business of the Partnership, is the exploration, development and production of petroleum, natural gas and condensate, in Israel and in Cyprus and the review of various infrastructure alternatives for natural gas flow to other target markets. The nature resources exploration, development and production activity in Israel is subject to the provision of approvals under the Petroleum Law, 5712-1952 (the "**Petroleum Law**") which controls the regulation in the field and defines the type of approvals given to defined field blocks and subject to the approval of a work plan for the performance of exploration and production work as specified below:

- "Preliminary Permit" is intended to allow the permit holders a sufficient time margin to carry out inspections in order to estimate the chances of discovering hydrocarbons (except for exploration wells) and it is granted for a period of up to 18 months.

<sup>6</sup> The term "**Date of Return on Investment**" means – the date after the execution of the agreement for the transfer of rights between the Partnership and Delek Energy Systems and Delek Israel (now Delek Group) which was executed in 1993 (as amended from time to time) according to which the Proceeds Value (net) which the Partnership received or is entitled to receive for petroleum and/or gas and/or other valuable materials which were produced and used from the petroleum asset (i.e. – license or lease) where the finding is located, calculated in Dollars shall reach an amount which is equal to the full Value of All of the Partnership's Expenses in such petroleum asset calculated in Dollars.

The term "**Proceeds Value (net)**" means – the value of all of the proceeds as shall be approved by the accountants of the partnership for petroleum and/or gas and/or other valuables which were produced and used from the petroleum asset (i.e. – license or lease) (the "**Proceeds Value (gross)**" after the deduction of all of the production costs thereof and royalties paid in respect thereof).

The term the "**Value of All of the Partnership's Expenses**" means – all of the expenses incurred by the Partnership in the petroleum asset (i.e. – license or lease) where the petroleum and/or the gas and/or the other valuables are produced but excluding expenses (up to the Proceeds Value (net)) which were deducted from the Proceeds Value (gross) for the determination of the amount of the all of the Proceeds Value (net) and as they shall be approved by the Partnership's accountants.

For details and elaboration regarding agreements pertaining to the payment of royalties to the State and to interested parties in the Partnership, see Section 7.25.12 of the periodic report for 2017 of Delek Drilling.



- “License” grants the license holder a right to explore natural gas and petroleum in the license area and to drill exploration wells. The license is granted for a period of up to 7 years.
- “Lease” grants the receiver of the lease the right to explore and produce natural gas and petroleum and is valid for a period of 30 years with an option for an extension of 20 additional years.

In addition, the Natural Gas Sector Law, 5760-2000 regulates mainly the issue of transmission, distribution and marketing of natural gas in Israel.

The natural gas sector in Israel began developing upon the discoveries of the natural gas reservoirs Noa and Mari B in the years 1999-2000, these discoveries allowed companies in the market, headed by the Israel Electric Corporation, to transition to more extensive use of natural gas instead of the use of more expensive contaminating fuels such as coal, diesel oil and fuel oil. The development of the sector was accelerated upon the discovery of the Tamar and Leviathan reservoirs in the years 2009 and 2010 respectively. These discoveries materially affect the energetic independence of Israel and the development and expansion of uses of natural gas in the Israeli market.

### **3.2.2 Exploration and Development of Natural Gas Reservoirs**

Exploration and development of natural gas reservoirs is a long and complex process, characterized by extensive uncertainty and significant capital investments throughout the entire stages of the process. There are material differences between the exploration and development of natural gas reservoirs onshore which are considered relatively simple and exploration and development offshore, which require larger money inputs and unique technologies, under more complex and dangerous conditions.

A typical process of exploration, development and production of natural gas in any area may include, *inter alia*, the following stages: Initial analysis of existing geological and geophysical data, for the selection of areas presenting exploration potential; Performance of geophysical surveys; the drilling of an exploration well and other tests (at this stage there is a possibility of discovering a dry well and cessation of the process); final analysis of the results of the drilling and, in the event of a natural gas finding, performance of an analysis of financial data and initial evaluation of the format and cost of development; formulation of a development plan and preparation of a financial plan for the project; final analysis of the data and making a decision whether the finding (the discovery) is commercial (at this stage too it is possible that the survey results will indicate that the finding is not commercial and the development of the reservoir will be ceased); performance of the reservoir's development work, including the drilling of production wells, laying pipelines, building treatment facilities etc.; regular operation and maintenance.

The natural gas market in Israel is young relative to other gas markets in the world, and for the purpose of developing it in the best effective manner, cooperation is required with multi-national companies which will provide the local players resources, knowledge and experience. In this context we shall emphasize that multi-national companies can invest and operate throughout the world, and they naturally weight, within the calculation of their cost-effectiveness, the potential profitability and the actual profitability in different locations around the world compared with the restrictions, costs and risks derived from the geopolitical condition and the regulatory environment in each area.



### 3.2.3 Benefits

The use of natural gas has a lot of benefits for the Israeli market, including:

- **Saving energy costs in industry and in electricity production** – the low price of natural gas compared with currently common alternative fuels such as diesel oil and fuel oil, leads to significant saving in the production costs, and thereby also to a decrease in prices of final products whose main production costs are the costs of electricity. Most of the power plants constructed in recent years in Israel operate by natural gas turbines and are characterized by low construction costs<sup>7</sup>, shorter construction time, saving in land areas<sup>8</sup> and many operational advantages. In addition to the relatively low price, natural gas is a more efficient energetic source than other fuels and it allows power plants and enterprises to reach a high energetic efficiency level which is also ultimately reflected in savings of costs<sup>9</sup>. according to the estimates of the Gas Authority<sup>10</sup>, the total saving in the Israeli market from the transfer to natural gas in the years 2004-2016<sup>11</sup> is estimated at approx. ILS 48.4 billion. Most of the saving derives from the electricity sector and amounts, in the years 2004-2016 to approx. ILS 36.3 billion. The balance of the comprehensive saving from the transfer to use of natural gas is attributed to the Israeli industry.
- **Clean Energy** – the main substances emitted from the burning of natural gas are carbon dioxide and water vapor. Since coal and petroleum are more complex fuels, with a higher ratio of Carbon and Nitrogen and Sulphur components, then upon their combustion contaminants at higher contamination levels are released, including ash particles of materials which are not burned but are present in the atmosphere and add to the air pollution. The natural gas combustion on the other hand, releases a small quantity of contaminants while reducing air pollution and maintaining a cleaner and healthier environment.
- **Energetic Independence** – the geopolitical characteristics of Israel make it an energetic island which cannot import fuels from neighbouring countries and forced it to rely for many years on costly fuels import from Europe. Israel's energetic isolation was somewhat reduced between the years 2008 and 2012 upon the commencement of supply of natural gas from Egypt, however, the sudden cut of supply illustrated the importance of the development of local energy sources. The development of the natural gas market in Israel will provide the Israeli industry energetic security in the long term and will reduce its dependence on international energy prices.
- **Natural gas as a governmental source of income through taxation** - the Israeli natural gas market is expected to benefit the local economy also directly through governmental revenues from the taxation of the companies and from the VAT from sales to the ultimate consumer. Moreover, the Israeli market has a few unique taxation systems which apply to the natural gas sector and similarly to all of the other fuel products, the natural gas is also

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<sup>7</sup> About half of the cost of a coal power plant, about a third of the cost of a nuclear power plant and about 15% of a wind energy operated plant.

<sup>8</sup> The natural gas is transported by an underground pipe and unlike other fuels, requires no storage areas.

<sup>9</sup> Power plants operated with coal or fuel oil only utilize approx. 40% of the initial energy directed to the production of electricity. A combined cycle power plant combining a gas turbine and a steam turbine is more efficient and uses 55% of the energy. Cogeneration stations utilizing the thermal energy produced in the production process reach an efficiency level of approx. 80%.

<sup>10</sup> Source: The Ministry for National Infrastructures, Energy and Water, the Natural Gas Authority – Review of the Developments in the natural gas market during 2015.

<sup>11</sup> <http://archive.energy.gov.il/Subjects/NG/Documents/Publication/NGPublication2016.pdf>



subject to excise tax. Furthermore, according to the Petroleum Law, the State is entitled to charge royalties at a rate of approx. 12.5% of the total sales of natural gas at the wellhead. Moreover, following the conclusions of the Sheshinski Committee the State is entitled to proceeds of petroleum and gas profits levy at a rate of approx. 20%-50% (depending, *inter alia*, on the corporate tax rate) of the revenues of the holders of the petroleum rights, net of royalties, operation costs and development costs.

### 3.2.4 Customers

The natural gas market in Israel comprises several layers of consumers differentiated from each other in the nature of their activity and the characteristics of the natural gas consumption:

- **Israel Electric Corporation (IEC)** – IEC constitutes for the Tamar Project partners a very important anchor customer, *inter alia*, for the obtaining of financing for the construction of infrastructure for production of natural gas and development of the reservoirs. In fact, without the existence of the transaction for the sale of natural gas to the IEC, it might not have been possible to secure the financing required for the development of the Tamar Project. The IEC is a governmental company supervised by the Electricity Authority (“PUA-E”), *inter alia*, regarding the costs of inputs for electricity production, particularly, the costs of natural gas.

In 2016, consumption of natural gas for electricity production constituted approx. 83%<sup>12</sup> of the total natural gas consumption in the market, compared with approx. 80% of the total consumption in 2015. The share of IEC constituted close to 61% of the natural gas consumption for electricity production in 2016 compared with approx. 66% in 2015 and 75% in 2014. The remaining demand is of the private electricity producers and this trend is expected to continue in the coming years.

- **Private Electricity Producers** – the layer of the private electricity producers (“PEPs”) is second in importance in terms of scope of natural gas consumption, after the IEC. In 2016, the share of the PEPs in the production of electricity with natural gas grew by approx. 36% and consumption amounted to approx. 3.1BCM<sup>13</sup>.

Private Electricity Producers are divided into several types, according to the production technology which they use: conventional PEP, cogeneration facilities, pumped energy, renewable energies PEPs and large enterprises which constructed for themselves power plants for which they received a self-production license. As to the status of the PEPs in the natural gas sector, Section 93 of the Natural Gas Sector Law defines that natural gas sold to a PEP is a product subject to control under the Control of Prices of Commodities and Services Law, 5756-1996.

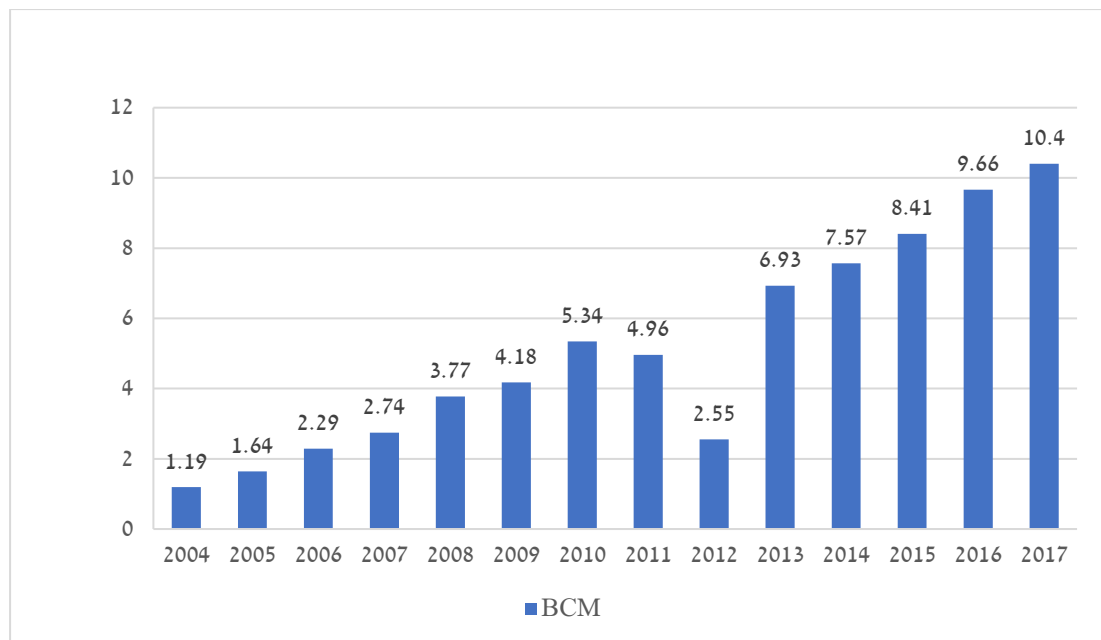
- **Large Industry Consumers** – this layer of consumers comprises several significant consumers, which are essential to the development of the Israeli gas sector. Consumers with significant power and reputation in the Israeli market, having extensive experience and knowledge pertaining to the operations of Israeli industry in general and the operations of the natural gas sector in Israel in particular. Most of the large industrial enterprises in the market executed agreements for the purchase of natural gas within the construction of private power plants at the enterprise’s premises, for the supply of the enterprise’s

<sup>12</sup> <http://archive.energy.gov.il/Subjects/NG/Documents/Publication/NGPublication2016.pdf>

<sup>13</sup> Including gas consumption in industrial plants for electricity production.

electricity needs, constituting only part of the production capacity of the power plant, and the sale of the produced electricity to external consumers or to the IEC. Accordingly, also the natural gas purchase agreement executed by most of the large industrial enterprises up to now have the characteristics of agreements with private power plants. The total natural gas consumption in the industrial sector in 2016 amounted to approx. 1.62BCM<sup>14</sup>.

- **Medium and small consumers** – the distribution networks consumers sector which includes mainly medium and small enterprises and businesses such as laundries and bakeries is a relatively new sector in the natural gas sector which began executing agreements for purchase and infrastructure conversion performance only in recent years. These consumers typically consume low gas pressure, at a relatively small amount, noncontinuous over a whole day (24 hours), some of which not yet connected to the onshore transmission systems, or the distribution, and therefore consuming Condensed Natural Gas (CNG) – a temporary and not optimal solution, as the cost of consumption can reach twice the cost of the liquidated natural gas.
- **Chart 1 – natural gas consumption in the years 2004-2017 (Source: the Natural Gas Authority<sup>15</sup>)**



### 3.2.5 Demand Forecast

Below are the main factors expected to motivate growth in natural gas demand:

- **Transition to the use of natural gas by Private Electricity Producers and industrial enterprises** – in 2013, private electricity producers started using natural gas. In addition, the demand in the industrial sector grew and in recent years there is significant conversion of use of petroleum distillates in the industry to natural gas. There is also a trend of connecting additional industrial enterprises to the natural gas distribution network.

<sup>14</sup> Not including gas consumption in industrial plants for electricity production.

<sup>15</sup> Natural gas consumption for 2017 is according to the Partnership's estimate, as released in its financial statements as of December 31, 2017

As of December 31, 2016, 24 consumers were connected to the distribution network consuming together approx. 108 million cubic meters and 4 CNG consumers.

- **Increasing the demands in the electricity sector** - in recent years a trend is apparent for the conversion from using petroleum and coal distillates at the IEC power plants to the use of natural gas (in December 2015, the Minister of Energy, Dr. Yuval Steinitz decided of the reduction of 15% use of coal for electricity production in 2016 compared with 2015). Commencing in 2017 another reduction of 5% occurred and in total, a reduction of 20% compared with the use made in 2015.

In August 2016 the Minister of Energy announced his decision to shut down four coal production units of IEC upon the connection of three gas reservoirs to the shore and the construction of new natural gas operated power plants within up to six years. Following that, in September 2016, emission permits were received by the IEC under the Clean Air Law, 5768-2008 with respect to its coal power plants sites, which included, *inter alia*, an obligation to continue installing emission reduction measures, as well as the shutdown of units 1-4 in the coal power plant at the “Rabin Lights” site, no later than January 1, 2022. On May 28, 2017, the website of the Ministry of Energy released a notice regarding the decision of the Minister of Energy according to which the private sector will construct the natural gas operated power plants instead of the coal units 1-4 at the “Rabin Lights”, *inter alia*, in order to ensure compliance with the timetables that he prescribed for the cessation of coal use at these units.

In November 2017, the Minister of Energy decided of principles of policy on the issue of minimal operation of coal production units, according to which natural gas electricity production shall be granted preference at any time to electricity production with coal, while operating the coal units at a minimal load which allows flexibility and reliability of the supply to the market.

In January 2018 the Minister of Energy announced that he had decided to instruct the IEC to reduce the use of coal for electricity production at a rate of 30% compared with 2015 according to the announcement of the Ministry of Energy and the Ministry of Environmental Protection, this decision will lead to significant reduction of air pollution from the coal power plants and is expected to increase demand for natural gas in the market. According to the announcement of the Ministries, these steps, which were approved by the Minister of Energy, as well as power plants according to the Clean Air Law, 5768-2008 will lead to more than 70% of the electricity production in the market relying on natural gas and renewable energies in the end of 2018.

In March 2018 the Finance Committee of the Knesset and thereafter the Plenum of the Knesset approved the orders, in which it was provided, *inter alia*, that commencing on March 15, 2019 the excise tax on coal will be increased by approx. 125% in view of the government's policy to gross up external costs of fuels and encourage the expansion of use of natural gas.

The aforesaid has several main advantages, including, *inter alia*, the reduction of electricity production costs, since the natural gas is a more efficient energy source compared with the main energy sources currently used by the IEC (coal, diesel oil and fuel oil). Natural gas is also a cleaner source of energy compared with the sources of energy mentioned above, thereby increasing the demand for natural gas on account of more contaminating sources of energy.



- **Improvement of diplomatic relations with the neighboring countries** – recently, an improvement trend is apparent in the relations with several neighboring countries, the business relations with which are strategic for the State of Israel in general, and for the gas companies in particular. In this context we shall note the export agreement executed on September 26, 2016 between the Leviathan Partnership and the Jordanian electric corporation (NEPCO), for the supply of natural gas in a total amount of approx. \$10 billion (we note that the conditions precedent in the agreement have been fulfilled, and that the gas transmission pipeline is currently under construction), and the agreements executed on February 19, 2018 between the Tamar and Leviathan Partnerships and the Egyptian Dolphinus, for the supply of natural gas in a total sum of approx. \$15 billion. This improvement trend has a positive effect on the export capacity of Israeli gas and it can increase the demand for natural gas produced from the gas reservoirs in Israel.

According to the publications of the Natural Gas Authority in May 2016, the amount of natural gas consumed in the market in 2016 amounted to approx. 9.7BCM, an increase of approx. 15% compared with 2015. The total natural gas consumption for electricity production was estimated at approx. 8.0 BCM<sup>16</sup>, constituting approx. 83% of the total natural gas consumption. Natural gas consumption in the industrial sector was estimated at approx. 1.6 BCM. According to the Partnership's estimate, the amount of natural gas consumed in the market in 2017 amounted to approx. 10.4 BCM, an increase of approx. 8% compared with 2016.

Natural gas demand forecast released by the Gas Authority<sup>17</sup> is based, *inter alia*, on continued growth of electricity consumption with a multi-annual average of approx. 3%, with minimal use of diesel oil and fuel oil, reliance on coal plants at a similar scope to the current scope, except for the construction of new plants (assuming that coal units at the Rabin Lights power plant will not be converted to the use of natural gas), transition to natural gas as a primary fuel for electricity production commencing in 2014 and gradual assimilation of renewable energies. Furthermore, the forecast takes into account gradual conversion into use of natural gas in transportation, as well as local production of methanol and ammonia in the petrochemical industry.

According to the forecasts of the Natural Gas Authority from 2016, the amount of demand for natural gas in 2020 and 2025 is expected to be at approx. 12 BCM and 14.7 BCM, respectively. In 2017 forecasts were published by various entities in the market, including forecasts which were included in the Partnership's reports to TASE. According to these plans, the level of demand for natural gas in the years 2020 and 2025 will be approx. 14.6 BCM and 21 BCM, respectively. Note that the forecasts of the Gas Authority assume reliance on coal plants at a similar scope to the current scope, while the forecasts published in the market assume the conversion of some of the coal production units to production by the use of natural gas (according to the government's resolutions and policy). Under these forecasts, conversion of the coal production units will contribute to an increase in the demand by approx. 1.6 BCM and approx. 3.6 BCM in the years 2020 and 2025, respectively.

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<sup>16</sup> Gas supply for electricity production includes the electricity supply to the IEC, Private Electricity Producers and industrial plants with partial electricity production.

<sup>17</sup> Source: <http://energy.gov.il/Subjects/NG/Pages/GxmsMniNGEconomy.aspx>



### 3.2.6 Regulatory Environment

The production of natural gas from reservoirs in the territorial waters of the State of Israel and the sale thereof are subject to regulatory restrictions pertaining to the amount of gas produced and restrictions on exporting the gas outside of Israel and pertaining to the gas prices. In addition, the production and sale of natural gas from the Tamar, Leviathan, Karish and Tanin reservoirs and/or another reservoir, are subject to further regulatory restrictions by virtue of the Gas Framework, as specified below:

- **Antitrust and exemption from the provisions of the Antitrust Law** – in 2012 the Antitrust Commissioner declared the partners in the Tamar Project as holding a monopoly in the supply of natural gas in Israel. Following the declaration, restrictions may be imposed on the activity of the partners in the Tamar Project, by virtue of the Antitrust Law. Furthermore, during the years 2011-2014 the Antitrust Commissioner considered declaring the partners in the Leviathan Project as taking part in restrictive arrangements pertaining to the marketing of natural gas from the Leviathan reservoir.

The Gas Framework grants an exemption to Delek Drilling, Noble and Ratio regarding the restrictive arrangements pertaining to the Leviathan reservoir. The Gas Framework grants an exemption from Delek Drilling and Noble being the holders of a monopoly with respect to the Tamar and Leviathan reservoirs (the “**Exemption**”). The grant of the Exemption as described above is subject to the fulfillment of the following conditions:

- The sale of the rights of Delek Drilling and Noble in the Karish and Tanin reservoirs to a third party, not related to any of them, within 14 months from the date of grant of the Exemption or from the date of release of a new regulation draft by the Petroleum Commissioner pertaining to the qualifying conditions for an operator, whichever is later. The condition defines a minimal price as the lower of \$40 million or the total consideration paid for all of the rights in Karish and Tanin. We shall note that on August 16, 2016, an agreement was executed for the sale of all of the rights in the Karish and Tanin leases between Delek Drilling and Energean.
- The sale of the entire rights of Delek Drilling in Tamar Reservoir to a third party unrelated thereto or to any of the holders of rights in the Leviathan, Karish and Tanin reservoirs as well as restriction of the rights of Noble in the Tamar reservoir to a maximum 25% rate within 72 months. As of the date of the Work, the Partnership holds 22% of the Tamar reservoir. Furthermore, we shall note that in January 2018 Noble sold Tamar Petroleum Ltd. 7.5% of its rights in the Tamar reservoir, and as a result, it went down to a 25% holding rate in the Tamar reservoir.
- The imposition of restrictions on new agreements to be executed for the supply of gas from the Tamar and Leviathan reservoirs, such as a prohibition on limitations on purchase from other suppliers, in certain cases granting the consumers the right to unilaterally set the period of engagement and granting a unilateral option to the consumers to change the scope of supply in the agreement.
- **Stable Regulatory Environment** – in the original framework, the Israeli government undertook to maintain “regulatory stability” in the context of natural gas exploration and production for a period of 10 years. In March 2016, HCJ ruled that the issue of the regulatory stability in the Gas Framework in the existing version was illegal. In May 2016, the government re-adopted its resolution on the Gas Framework while setting an alternative





arrangement pertaining to a “regulatory stable environment” in order to ensure a regulatory environment which encourages investments in the natural gas exploration and production sector.

- **Royalties to the State of Israel** – under the Petroleum Law, a lease holder is charged with a royalty of 12.5% of the amount of natural gas or petroleum produced in the lease and the lease holder will pay the state the market value of the royalty at the wellhead. The manner of calculation of the value at the wellhead for the Tamar reservoir is under discussion between the Petroleum Commissioner and the partners in the Tamar reservoir and the manner of calculation has not been set yet. Currently the Tamar partnerships pay advance payments on account of royalties at the rate of 12% of the Tamar Project revenues. The manner of calculation of the royalties for the Leviathan, Karish and Tanin reservoirs has not been determined yet.
- **Taxation of Profits from Natural Resources Law** - the Resources Taxation Law prescribes a levy on petroleum and gas profits according to a mechanism which relates the rate of the levy and the ratio of the net accrued revenues from the petroleum and gas production project and the total accrued investments for the initial exploration and development of the reservoir (“**Investment Coverage Ratio**”). The minimal levy at a rate of 20% will be charged when the Investment Coverage Ratio will reach 1.5 and will increase gradually to a rate of 50% (depending, *inter alia*, on the Corporate Tax rate) when the Investment Coverage Ratio shall reach 2.3. The levy will be calculated and imposed on each reservoir separately.
- **Price Control** – in the period between the taking effect of the Gas Framework until the fulfilment of the entire conditions of the Exemption, the price control in the natural gas sector by virtue of the Antitrust Law will be limited to the imposition of reporting requirements regarding profitability and the gas price, provided that during this period the holders of rights in Tamar and Leviathan shall offer potential consumers a price based on the weighted average price of the prices in the agreements existing in the reservoirs or prices in export agreements. Following is a summary of the price and linkage alternatives released within Government Resolution 476 of August 16, 2015:
  - **Alternative 1** – a price which will be set and updated according to the formula  $P(T) = R(T-2)/Q(T-2)$ . With  $P(T)$  being the base price;  $R(T-2)$  being the amount of revenues from the total sales of natural gas carried out in the quarter preceding the quarter which preceded the date of execution of the agreement by the holder of a lease; and  $Q(T-2)$  being the aggregate amount of natural gas, supplied to the consumers in the quarter preceding the quarter which preceded the date of execution of the agreement by a holder of a lease. The base price will be updated based on the result obtained from the calculation according to the aforesaid formula.
  - **Alternative 2** – a price which will be set according to the price of a Brent oil barrel, as calculated according to the formula optimal for the consumer prevailing on the date of resolution, in agreements of the lease holders for supply from the “Tamar” field.
  - **Alternative 3** – the holders of rights in the leases will offer the potential consumers who are Private Electricity Producers (PEP) holding a license for installed capacity of 20 Megawatt or more per site, in addition also the alternative which includes linkage to the weighted production tariff published by the PAU-E as specified below:



- **Conventional electricity producers** – simple average of the prices set in the contracts of the three large PEPs, and of the linkage under such contracts;
- **Cogeneration electricity producers** – simple average of the prices set on the date of the government resolution in the cogeneration contracts linked to the weighted production tariff and the linkage under such contracts;

The aforesaid averages will be calculated by the Natural Gas Authority according to data provided thereto by the holders of rights in the leases. Following are the linkage formulas for private electricity producers for Q1/2018:

Conventional Private Electricity Producer

$$CP\$ = 5.71 * (53.3\% * Pt/Pt0 + 46.7\% * Pt/Pt0 * Ns0/Ns)$$

Cogeneration Private Electricity Producer

$$CP\$ = 5.81 * (90\% * Pt/Pt0 + 10\% * Pt/Pt0 * Ns0/Ns)$$

Whereby:

CP\$	-	Indexed monthly price in \$ per MMBTU
Pt	-	Production component tariff known on the last date of the month preceding the month of calculation of the price
Pt0	-	Base production component tariff = ILS 0.3463 per kilowatt per hour
Ns	-	Monthly average of Shekel-Dollar exchange rate as of the month of calculation of the price
Ns0	-	Dollar base rate = ILS 3.65 per Dollar

The lease holders will offer the consumer a floor price according to the offering in the existing agreements according to increments of \$5.2 per MMBTU, \$5 per MMBTU and \$4.7 per MMBTU and the update mechanism will begin according to the last change which occurred in the production component. As of January 2018, the floor price is \$4.7 per MMBTU.

- The option to choose among the price alternatives specified above will be made available to the Purchaser only just before the engagement in a contract. Furthermore, the holders of rights in the leases will be entitled to offer the potential consumers a discount on prices deriving from the alternatives specified above. In addition, the parties to the agreement will be entitled to elect any method of updating the base price, provided that it will be reasonable and accepted in the natural gas agreements in Israel or worldwide. In such case, the base price will be updated according to the linkage method selected.

### **3.2.7 Transactions for the purchase of natural gas from Karish and Tanin gas reservoirs**

In December 2017 an agreement was executed for the sale of natural gas between Energean and 3 companies held by the Israeli Corporation Ltd. (Israel Chemicals (“**ICL**”), Oil Refineries Ltd. (“**ORL**”) and OPC Energy Ltd. (“**OPC**”) which is the second largest natural gas consumer in Israel after IEC, at a total scope of approx. 39 BCM for 15 years.



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**The price mechanism between Energean and ICL and ORL, which are the main purchasers in the transaction (purchased 30 BCM of the total amount) is set as follows:**

When PT is larger than 43.47:

$$CP = 3 + ((P_0 * PT/PT_0) * 0.5)$$

When PT is smaller than 43.47:

$$CP = P_0 * PT/PT_0$$

Whereby:

- |     |   |                                                                                                     |
|-----|---|-----------------------------------------------------------------------------------------------------|
| P0  | - | \$3.975 per MMBTU of natural gas                                                                    |
| PT0 | - | Equal to 28.8                                                                                       |
| PT  | - | The weighted average of the production component tariff as published from time to time by the PAU-E |
| Ns  | - | Monthly average of Shekel-Dollar exchange rate as of the month of calculation of the price          |

In Addition, within the aforesaid agreements, there is a floor price of \$3.975 per MMBTU of natural gas.

**The price mechanism between Energean and OPC is set as follows:**

$$CP = P_0 * PT/PT_0$$

Whereby:

- |     |   |                                                                                                     |
|-----|---|-----------------------------------------------------------------------------------------------------|
| P0  | - | \$3.975 per MMBTU of natural gas                                                                    |
| PT0 | - | Equal to 28.0 when PT is higher than 26.4<br>Equal to 26.4 when PT is lower than or equal to 26.4   |
| PT  | - | The weighted average of the production component tariff as published from time to time by the PAU-E |

Furthermore, within the aforesaid agreements, there is a floor price of \$3.975 per MMBTU of natural gas when PT is larger than or equal to 26.4 and a floor price of \$3.8 per MMBTU of natural gas when PT is smaller than 26.4.

### **3.2.8 Risk and Uncertainty Factors**

The exploration and findings development operations of petroleum and natural gas involves significant monetary expenses in conditions of uncertainty resulting in a very high financial risk level. Following is a specification of risk and uncertainty factors with significant effect on the operations of the Purchaser of the Karish and Tanin reservoirs and the proceeds expected therefrom:

- **Changes in the electricity production tariff, price indices, alternative energy sources prices** – the prices paid by the consumers for the natural gas derive, *inter alia*, from the electricity production tariff, the Shekel/US Dollar exchange rate, the US consumer price index and the prices of fuels alternative to gas such as fuel oil, diesel oil and Brent. Furthermore, a significant change in alternative energy sources could lead to a change in



the use model of the IEC such that priority shall be granted to power plants operated by energy sources alternative to gas. A decline in tariffs can adversely affect also the prices which will be obtained from the Karish and Tanin reservoirs and the economic merit in the development thereof.

- **Competition on gas supply** – in recent years, several significant gas reservoirs were discovered in Israel in amounts which significantly exceed the estimates of the Ministry of Energy regarding the needs of the local market. In addition, in 2015, a material natural gas reservoir was discovered in Egypt (“Zohar”) and in 2018, a natural gas reservoir was discovered in Block 6 in Cyprus, these reservoirs could have a negative effect on the capacity of natural gas export from Israel on the one hand, and they could lead to an increase in competition in the natural gas market in Israel by increasing the supply (through import) on the other hand. Also, further findings may be discovered in the future, both in Israel and in other countries in the eastern Mediterranean Basin, whose development could lead to the entrance of other competitors on the supply of natural gas to the local market and to neighboring countries, and thus increase the scope of competition in the sector.
- **Restrictions on export** – limitation of the amount of gas that can be exported could adversely affect by means of surplus supply in the local market and a decrease in tariffs which could adversely affect also the prices which will be obtained from the Karish and Tanin reservoirs and the economic merit in the development thereof.
- **Dependence on the proper working order of the national transmission system** – the ability to supply gas which will be produced from the reservoirs to the potential consumers is dependent, *inter alia*, on the proper working order of the national transmission system for the supply of gas and of the regional distribution networks.
- **Operational risks and lack of sufficient insurance coverage** – petroleum and gas exploration and production activities are exposed to a variety of risks, such as uncontrolled eruption of liquids and gas from the well, explosion, collapse of the well and other events which could affect the functioning of the production and transmission system, each of which could cause destruction or damage to petroleum or gas wells, the transmission and production facilities, exploration equipment etc. There is also a risk of liability for damage deriving from contamination due to the eruption and/or leakage of liquid and/or a gas leak. Despite the insurance existing in the market, not all of the possible risks are covered or are coverable.
- **Solely estimated costs and timetables and the option of lack of means** – estimated costs for the performance of exploration and development activities and estimated timetables for the performance thereof are based solely on general estimates and could deviate significantly. The exploration plans could significantly change, *inter alia*, following failures and/or findings which will be obtained during the performance of such actions and lead to significant gaps in the timetables and the estimated costs of such activities. In certain cases, the purchaser could also waive the performance of certain activities required according to the work plan of the reservoirs and lose its rights therein as a result.
- **Regulatory Changes** – the field of activity requires many regulatory approvals, mainly by the entities authorized under the Petroleum Law and the Natural Gas Sector Law, as well as related approvals of the State’s authorities (including the Ministry of Defence, the Ministry of Environmental Protection, the tax authorities and the various planning authorities). In recent years several proposals were made for amendments of laws and/or



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regulations and/or directives relevant to the field of activity and several resolutions, laws and directives were released, the implementation of which could have a negative effect on the reservoirs' operations.

- **Further risk factors** – there are other factors which contribute to the uncertainty prevailing in the field of activity including dependence on subcontractors, difficulties in obtaining financing, dependence on weather and sea conditions, cancellation or expiration of rights and petroleum assets and more.

### 3.2.9 Developments in the Market

- **Raising senior debt from a lenders' consortium** - on March 2, 2018 an agreement for the raising of senior debt in the amount of approx. \$1.275 billion<sup>18</sup> was executed between Energean Oil & Gas plc and a consortium of local and international lenders towards the development of the Karish reservoir.
- **The offering of Energean on the London Stock Exchange** – on March 15, the parent company of Energean, Energean Oil & Gas plc completed an initial public offering on the London Stock Exchange, within that offering, it raised approx. \$460 million, designated to be used, *inter alia*, for the development of the Karish reservoir.
- **Adoption of an Investment Decision** – on March 27, 2018, Energean notified the Partnership of the adoption of a decision of investment in the development of the Karish reservoir, and on March 29, it paid the Partnership the first payment in the amount of \$10.85 million.

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<sup>18</sup> See page 289 of the Energean Prospectus of March 22, 2018



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## 4. Description of the transaction of sale of rights in the Karish and Tanin Leases

### 4.1 The Sold Rights

On February 7, 2012 and on May 22, 2013, the Partnerships reported to TASE that the Tanin and Karish gas leases, respectively, constitute natural gas discoveries. The share of each of the Partnerships in each of the leases is 26.4705% (the share of Noble – 47.059%).

On August 16, 2015 a government resolution was made regarding a framework for the regulation of the natural gas market in Israel including with respect to the rights of the Partnership in the natural gas reservoirs Tamar, Leviathan, Karish and Tanin (the “**Gas Framework**” or the “**Framework**”). Within the Framework the gas and petroleum corporations active in the gas market in Israel, including the Partnerships, were granted an exemption from several provisions of the Antitrust Law given compliance with several conditions, including the sale of Karish and Tanin leases within 14 months.

On November 14, 2015, the Partnerships announced that they purchased from Noble the right to sell the share of Noble in the Karish and Tanin leases, in equal parts, in consideration for a total amount of approx. \$67 million. According to the agreement between the Partnerships and Noble, the latter will not be entitled to any further consideration for the sale of the rights to a third party.

On August 16, 2016, an agreement was executed for the sale of all of the rights in the Karish and Tanin leases between Delek Drilling and Avner and Energean Israel Ltd. (formerly Ocean Energean Oil and Gas Ltd.), a company registered in Cyprus which is a subsidiary of Energean E&P Holdings Ltd. (“**Energean**” and/or the “**Purchaser**”)<sup>19</sup>. The main activity of the Purchaser is exploration, development and production of gas and petroleum reservoirs in Greece and other countries in the Balkan and middle east area.

Following is a specification of the amounts of natural gas and hydrocarbon liquids (condensate and natural gas liquids) at the Karish and Tanin reservoirs (100%) which were released in the Energean Prospectus of March 16, 2018<sup>20</sup>:

Lease	Contingent resources	
	Natural Gas (BCM)	Hydrocarbon liquids (MMBBL)
Karish	45.0	28.7
Tanin	21.7	4.1
<b>Total</b>	<b>66.7</b>	<b>32.8</b>

### 4.2 The Consideration

Following is a description of the consideration components in the Purchase Agreement:

- a. The Purchaser will purchase from Delek Drilling (the “**Seller**”) all of the rights of the Seller and of Noble in Karish and Tanin leases (the “**Sold Rights**”).

<sup>19</sup> Energean Israel Ltd. Serves as the operational arm of Energean E&P Holdings Ltd. In Israel.

<sup>20</sup> According to reports received by Energean from NSAI, Net Resources.



- b. In consideration for the Sold Rights, the Purchaser will pay the Seller a total amount of \$148.5 million which will be received in the following manner:
- i. Cash payment of \$10 million which was paid to the Seller on the transaction closing date;
  - ii. An additional payment of \$30 million which was paid to the Seller on the transaction closing date;
  - iii. The consideration balance, in an amount of \$108.5 million, will be paid to the Seller in ten annual equal installments plus interest according to the mechanism set in the agreement. These payments will be made immediately after the date on which a Final Investment Decision (FID) will be adopted regarding the development of the leases, or on the date which the total expenses of the Purchaser in relation to the development of the leases will exceed \$150 million, whichever is earlier (for elaboration see Annex B);
  - iv. Note that on March 27, 2108, Energean notified the Partnership of making a Final Investment Decision in the development of Karish reservoir and on March 29 it paid the Partnership the first payment in an amount of \$10.85 million.
  - v. The Purchaser will transfer to the Seller royalties for natural gas and condensate which will be produced from the leases at a rate of 7.5% before payment of a petroleum profits levy by virtue of the Natural Resources Taxation Law (the “**Levy**”) and 8.25% after the commencement of payment of the Levy, net of the rate of the existing royalties<sup>21</sup> borne by the Partnerships in respect of their original share in the leases.

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<sup>21</sup> As defined in the reports of Delek Drilling and Avner to the Tel Aviv Stock Exchange on December 25, 2016.



## 5. Valuation of Royalties

### 5.1 Methodology

According to International Financial Reporting Standard 3, contingent consideration is defined as: “...a commitment of the purchaser to transfer further assets or capital rights to the previous owners of the purchased asset as part of the exchange transaction for the control over the purchased asset, if defined future events will occur or if conditions shall be fulfilled.”

As specified in Chapter 4 above, the consideration to which the Partnership is entitled includes a possibility of receiving future proceeds, in addition to the amounts to be received in cash (\$40 million), which are contingent upon the occurrence of future events as specified below:

- i. Consideration in the amount of \$108.5 million which will be paid to the Seller in ten equal annual payments plus interest commencing from the date on which the Purchaser made a Final Investment Decision (FID) or the Purchaser invested in the development of the reservoir an aggregate sum exceeding \$150 million (the “**Investment Decision**”), whichever is earlier. Therefore, this consideration component is similar in its nature to a financial debt of the Purchaser to the Seller, which is contingent upon the development of the leases, whether by a Final Investment Decision (FID) or the actual performance of the investment (the “**Debt Component**”).

Note that on March 27, 2018 Energean notified the Partnership of the adoption of a Decision of Investment in the development of the Karish reservoir and therefore the Debt Component is defined as deferred consideration. As to the valuation of the Debt Component see Annex B.

- ii. Royalties from revenues (net of existing royalties<sup>22</sup>) which will be paid to the Seller at rates of 7.5% before the Levy and 8.25% after the Levy. Therefore, the royalties are also contingent upon the development of the leases and the ability of the Purchaser to produce revenues from natural gas and condensate from the reservoirs (the “**Royalties**”).

According to the characteristics of the consideration components specified above and in view of our estimate of the materialization of the transaction and development of the reservoirs, the value of the Royalties in the transaction for the sale of Karish and Tanin leases is assessed through the Discounted Cash Flow method, while adjusting the discounting rates to the risks involved in the development of the reservoirs and the cash flow.

### 5.2 Work Assumptions

#### 5.2.1 General

The main work assumptions as specified below are based on market data from public sources, information appearing in the Prospectus released by Energean on March 16, 2018, and the financial model of holdings which was received from the Partnership and whose main assumptions were examined by us and were found to be reasonable. **It is emphasized that the assumptions and information specified below, including with respect to forecasts and the**

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<sup>22</sup> The sold rights will be transferred to the Purchaser together with the existing royalties in the leases borne by each of the Sellers, with respect to their original share (26.4705%)



**main commercial conditions in the agreement for the sale of the reservoirs, as well as regarding the types of the hydrocarbon liquids which will be produced from the reservoirs and in respect of which royalties will be paid to the Partnership, constitute forward-looking information in the meaning thereof in the Securities Law, 5728-1968, which there is no certainty of the materialization thereof, in whole or in part, in the said manner or in any other manner.**

### **5.2.2 The Valuation Date**

The valuation was carried out as of March 31, 2018.

### **5.2.3 Timetable**

Within our Work we assumed that in order to develop the leases and provide the amounts of gas assumed, Energean will be required to execute agreements for the sale of natural gas. The agreements executed during the last year between Energean and the Israeli Corporation, Dorad, Rapak and Edeltech reflect the sale of more than 90% of the contingent natural gas resources in the reservoirs and support the reasonability and feasibility of the estimate that the reservoirs will be developed.

Note that the development of the natural gas reservoirs Karish and Tanin is a strategic move for the State of Israel with respect to the variation of the gas supply sources and redundancy regarding the infrastructures of transporting natural gas onshore. Therefore, in our estimation, there is high probability that the State of Israel will act so that the reservoirs will be developed by the removal of possible barriers on the way to the development of the reservoirs.

On March 22, 2018, Energean announced the adoption of a Decision of Investment in the development of Karish and Tanin and as a result of the Purchase Agreement, the first payment for the Debt Component was received on March 29, 2018 (the other annual payments will be received on March 31 of each of the years 2019-2027). Furthermore, it was assumed that the development of the reservoirs will be done gradually, such that the commencement of the production from Tanin lease will begin towards the completion of the production from Karish lease.

### **5.2.4 Quantity forecast and annual production rate**

From an analysis of the demand forecast in the local market as released on the MAYA system by the Partnership, it arises that the forecasted annual demand during the running-in period and in the beginning of the commercial operation period in 2022, is expected to be approx. 15-18 BCM with the main demand deriving from an increase in electricity production (as a result of natural growth) and as a result of the conversion of coal plants to the use of natural gas (as specified in Section 3.2.4 above).

According to the development plan of the reservoirs released by Energean in the Prospectus, Energean estimates that it is expected to sell approx. 5.0 BCM on average throughout the years of the forecast, out of which approx. 3.3 BCM to 3.8 BCM are within the Take or Pay mechanisms included in the agreements with its customers. Therefore, we assumed a natural gas production rate of approx. 3.0 BCM in the first year of operation, with a gradual increase up to a rate of maximal annual natural gas sale rate of approx. 4.0 BCM from the third year of operation onwards, with the annual condensate quantity deriving from the ratio between the overall condensate quantity and the overall natural gas quantity, in each reservoir, and based



on the work assumption that all of the hydrocarbon liquids which will be produced are of the condensate type (for a specification of the annual production rate forecast see Annex 6.1).

Following is a summary of the assumptions regarding the date of commencement of production and annual production with respect to each of the leases:

Lease	Karish	Tanin
Operation period commencement	1/2022	7/2033
Operation period end	12/2033	9/2039
<u>Natural Gas</u>		
Average annual production rate (BCM)	3.85	3.57
Total (BCM)	44.7	22.1
<u>Condensate</u>		
Production ratio*	17.6	5.2
Total (MMBBL)	28.7	4.1

\* bbl of condensate per 1 mmcf of natural gas

### 5.2.5 Natural Gas Prices Forecast

The natural gas prices forecast relied on the following assumptions:

- The base price in the contracts under which the valuation was carried was estimated through the formulas specified in the price mechanism between Energean and ICL and ORL, and between Energean and OPC, and the parameters specified below:
  - i. **The Production Component Tariff:** as of the valuation date, the production component tariff is 28.16 Agorot, as determined commencing in January 2018. In the years 2018 and until the end of 2027, an approx. 2% (nominal) annual growth was assumed, except for the years 2021 and 2024 for which it was assumed that no increase shall occur in the production tariff, due to the update of the gas prices expected for the IEC, in view of the weighting of the conditions that in our estimation will prevail on the dates of the update and will affect the conditions of the negotiations between the parties (including the prices of alternative fuels, the difference between the price of the IEC and the Private Electricity Producers and the alternatives that each of the parties shall have). From 2028 onwards, a growth rate of approx. 1.5% of the production component tariff was assumed.
  - ii. **ICL and ORL** – floor price of US\$3.975 per mmbtu according to an agreement between the company and ICL and ORL.
  - iii. **OPC** – floor price of US\$3.975 per mmbtu when the production component is larger or equal to 26.4 Agorot, and a floor price of US\$3.8 per mmbtu when the production component is lower than 26.4 according to an agreement between the company and OPC.
- It was assumed that the gas amount which will be sold will be equally distributed between Private Electricity Producers (contracts such as the contract with OPC) and industrial producers (contracts such as the contracts with ICL and ORL).





### 5.2.6 Condensate Prices Forecast

The condensate prices forecast was estimated based on the average of the long-term petroleum prices forecast of the World Bank<sup>23</sup> and the EIA<sup>24</sup> and based on the Partnership's assumption that the condensate price will be derived from the Brent price while corresponding to the differences in the petroleum quality.

### 5.2.7 The Royalties Rate

The rate of the royalties to be paid to the State was set, according to the Petroleum Law, at 12.5% of the value of the gas at the wellhead. The actual royalties rate is lower as a result of deduction of expenses for the transmission systems and the treatment of the gas up to the gas delivery point on shore. According to the Partnership's estimates, it was assumed that the effective royalty rate which will be paid to the State for the gas and condensate is 11.5%. Furthermore, the rate of the existing royalties in the leases, borne by each of the Partnerships were similarly adjusted. We shall note that the actual rate of royalties could change and is not final.

### 5.2.8 Petroleum Profits Levy

The Petroleum Profits Levy is a progressive levy which is set according to a mechanism which connects the rate of the levy to the ratio of the net accrued revenues from the petroleum and gas production project and the total accrued investments for the exploration and initial development of the reservoir (the "**Investment Coverage Ratio**"). The minimal levy at a rate of 20% will be charged when the Investment Coverage Ratio will reach 1.5 and rise gradually to a rate of 50% (according to the corporate tax rate<sup>25</sup>) with the Investment Coverage Ratio reaching 2.3. The levy will be calculated and imposed for every reservoir separately.

Within the cash flow forecast for the royalties, we deducted the levy from the net royalties (after offsetting the existing royalties) which will be received by the Partnership from every lease, based on the rate of the levy calculated in the financial model of each of the leases.

### 5.2.9 Royalties Discounting Rate

The royalties discounting rate was estimated according to the methodology described in Section 5.2.9.2 in the previous work prepared by us as of December 31, 2017 (the "**Previous Work**") according to which it was assumed that the investment decision would be made towards the end of Q1/2019 and the discounting rate is approx. 10%, based on the discounting rate estimated for the Leviathan reservoir after the date of adoption of the Investment Decision (March 2018). Therefore, the Previous Work assumed a gradual reduction of approx. 0.5% until the date of the Investment Decision.

Since the Investment Decision for the Karish reservoir occurred earlier than our estimate in the Previous Work, within this Work we accelerated the rate of reduction of the discounting rate. However, several excess risks still remain compared with the risks which were applicable on the Leviathan project FID date, being mainly – failure to perform production tests and recognition of the contingent resources as reserves (in Leviathan, at the FID stage, production tests were carried out and reserves were recognized). Therefore, we estimated the rate of

<sup>23</sup> A world Bank Quarterly Report: Commodity Markets Outlook, April 2018

<sup>24</sup> U.S Energy Information Administration: Annual Energy Outlook 2018

<sup>25</sup> Corporate tax of 23% was assumed according to the historical tax rate known as of the date of the valuation.





discounting for royalties in this Work at approx. 11% based on the discounting rate of Leviathan after the FID, as was estimated in the Previous Work at approx. 10% plus a premium of 1% which reflects the excess risks of the project compared with Leviathan as aforesaid.

### 5.3 Results of the Valuation

According to the assumptions specified in the Work itself, the value of the royalties is estimated at approx. \$114.6 million. For specification regarding the valuation of the debt component, see Annex B.

### 5.4 Sensitivity Analyses

Following is a sensitivity analysis for the value of the royalties compared with the discounting rate and the changes in the natural gas prices in US Dollars in millions:

		Change in the natural gas vector (US Dollar per mmbtu)						
		(1.50)	(1.00)	(0.50)	-	0.50	1.00	1.50
Change in the discounting rate (in base points)	+250bp	79.3	83.7	89.6	94.5	98.6	103.2	109.8
	+150bp	85.6	90.2	96.6	101.9	106.3	111.3	118.4
	+50bp	92.6	97.5	104.4	110.2	114.9	120.3	128.0
	-	96.3	101.5	108.7	<b>114.6</b>	119.5	125.2	133.2
	-50bp	100.3	105.7	113.1	119.4	124.5	130.4	138.7
	-150bp	109.0	114.8	122.8	129.6	135.1	141.7	150.7
	-250bp	118.7	124.9	133.7	141.1	147.1	154.4	164.2

Following is a sensitivity analysis for the value of the royalties compared with the discounting rate and the changes in the annual production quantity, in US Dollars in millions:

		Change in the annual production quantity of natural gas (BCM)						
		(1.50)	(1.00)	(0.50)	-	0.50	1.00	1.50
Change in the discounting rate (in base points)	+250bp	80.4	88.7	92.0	94.5	96.0	96.9	99.4
	+150bp	87.2	96.0	99.4	101.9	103.4	104.3	106.7
	+50bp	94.7	104.1	107.6	110.2	111.6	112.4	114.7
	-	98.8	108.5	112.1	<b>114.6</b>	116.0	116.8	119.0
	-50bp	103.2	113.2	116.8	119.4	120.7	121.4	123.6
	-150bp	112.7	123.4	127.1	129.6	130.9	131.5	133.5
	-250bp	123.5	134.9	138.7	141.1	142.3	142.7	144.5

Following is a sensitivity analysis for the value of the royalties compared with the discounting rate and the changes in the condensate prices, in US Dollars in millions:

		Change in the condensate vector (US Dollar per bbl)						
		(15.00)	(10.00)	(5.00)	-	5.00	10.00	15.00
Change in the discounting rate (in base points)	+250bp	91.2	92.3	93.4	94.5	95.7	94.5	95.6
	+150bp	98.4	99.5	100.7	101.9	103.1	102.0	103.1
	+50bp	106.4	107.6	108.9	110.2	111.5	110.2	111.5
	-	110.7	112.0	113.3	<b>114.6</b>	116.0	114.7	116.0
	-50bp	115.3	116.6	118.0	119.4	120.7	119.5	120.8
	-150bp	125.3	126.7	128.1	129.6	131.1	129.8	131.2
	-250bp	136.5	138.0	139.5	141.1	142.7	141.3	142.9

## Annex A – Cash Flow Forecast (nominal)

Year	Unit	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
<b><u>Production</u></b>													
Gas production - Karish	bcm/y	-	-	-	3.00	3.50	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Gas production - Tanin	bcm/y	-	-	-	-	-	-	-	-	-	-	-	-
Condensate production - Karish	bbl/y m	-	-	-	1.86	2.17	2.48	2.48	2.48	2.48	2.48	2.48	2.48
Condensate production - Tanin	bbl/y m	-	-	-	-	-	-	-	-	-	-	-	-
<b><u>Prices</u></b>													
Natural gas price	US\$	-	-	-	4.18	4.27	4.27	4.35	4.44	4.53	4.60	4.67	4.74
Condensate Price	US\$	-	-	-	71.52	74.27	76.56	78.72	81.23	83.44	85.95	88.41	90.63
<b><u>Revenues</u></b>													
<b>Karish - Revenues</b>													
Natural Gas Revenues	US\$ MM	-	-	-	451.6	537.4	614.2	626.4	639.0	651.7	661.5	671.4	681.5
Condensate Revenues	US\$ MM	-	-	-	133.3	161.5	190.2	195.6	201.9	207.3	213.6	219.7	225.2
Total Gross Revenues	US\$ MM	-	-	-	584.9	698.9	804.4	822.1	840.8	859.1	875.1	891.1	906.7
<b>Tanin - Revenues</b>													
Natural Gas Revenues	US\$ MM	-	-	-	-	-	-	-	-	-	-	-	-
Condensate Revenues	US\$ MM	-	-	-	-	-	-	-	-	-	-	-	-
Total Gross Revenues	US\$ MM	-	-	-	-	-	-	-	-	-	-	-	-
<b>K&amp;T - Total Gross Revenues</b>	<b>US\$ MM</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>584.9</b>	<b>698.9</b>	<b>804.4</b>	<b>822.1</b>	<b>840.8</b>	<b>859.1</b>	<b>875.1</b>	<b>891.1</b>	<b>906.7</b>
<b><u>Delek Drilling - Transaction Revenues</u></b>													
Transaction ORRI, Net*	US\$ MM	-	-	-	27.5	32.9	33.0	18.7	16.6	17.2	14.9	14.0	14.3
<b>Total Discounted Transaction Revenues</b>	<b>US\$ MM</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>17.7</b>	<b>19.0</b>	<b>17.3</b>	<b>8.8</b>	<b>7.0</b>	<b>6.5</b>	<b>5.1</b>	<b>4.3</b>	<b>4.0</b>

\*Net of Existing ORRI net of Petroleum Tax



**GIZA SINGER EVEN**

Year	Unit	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
<u><b>Production</b></u>											
Gas production - Karish	bcm/y	4.00	4.00	3.70	-	-	-	-	-	-	-
Gas production - Tanin	bcm/y	-	-	0.25	4.00	4.00	4.00	4.00	4.00	2.05	-
Condensate production - Karish	bbl/y m	2.48	2.48	2.30	-	-	-	-	-	-	-
Condensate production - Tanin	bbl/y m	-	-	0.05	0.74	0.74	0.74	0.74	0.74	0.38	-
<u><b>Prices</b></u>											
Natural gas price	US\$	4.81	4.88	4.95	5.03	5.10	5.18	5.26	5.33	5.41	5.50
Condensate Price	US\$	94.11	96.95	100.14	103.60	106.86	109.70	114.20	117.77	121.30	125.16
<u><b>Revenues</b></u>											
<b>Karish - Revenues</b>											
Natural Gas Revenues	US\$ MM	691.7	702.1	659.2	-	-	-	-	-	-	-
Condensate Revenues	US\$ MM	233.9	240.9	230.2	-	-	-	-	-	-	-
Total Gross Revenues	US\$ MM	925.6	943.0	889.4	-	-	-	-	-	-	-
<b>Tanin - Revenues</b>											
Natural Gas Revenues	US\$ MM	-	-	44.0	723.3	734.2	745.2	756.4	767.7	400.0	-
Condensate Revenues	US\$ MM	-	-	4.5	76.2	78.6	80.7	84.0	86.6	45.8	-
Total Gross Revenues	US\$ MM	-	-	48.5	799.5	812.8	825.9	840.4	854.3	445.8	-
<b>K&amp;T - Total Gross Revenues</b>	US\$ MM	925.6	943.0	937.9	799.5	812.8	825.9	840.4	854.3	445.8	-
<u><b>Delek Drilling - Transaction Revenues</b></u>											
Transaction ORRI, Net*	US\$ MM	14.6	14.9	16.3	32.8	14.4	13.3	13.2	13.5	7.0	-
<b>Total Discounted Transaction Revenues</b>	US\$ MM	3.7	3.4	3.3	6.0	2.4	2.0	1.8	1.6	0.8	-

\*Net of Existing ORRI net of Petroleum Tax



## Annex B – Valuation of the Debt Component

### A. General

Within the agreement for the sale of all of the rights in the leases it was provided that the Partnership will be entitled, *inter alia*, to consideration in an amount of \$108.5 million which will be paid in ten equal annual payments plus interest commencing from the date on which the Purchaser made a Final Investment Decision (FID) or the Purchaser invested in the development of the reservoir an aggregate sum exceeding \$150 million, whichever is earlier. Therefore, this consideration component is similar in its nature to a financial debt of the Purchaser, contingent upon the development of the leases, whether by a Final Investment Decision (FID) or by an actual performance of investment. In view of the Investment Decision adoption of March 2018, the Debt Component was defined within this Work as deferred consideration and valued as a financial debt.

### B. Discounting Rate

The discounting rate of the Debt Component was estimated at 7.5% according to the methodology described in Section 5.2.9.1 of the Previous Work carried out by us as of December 31, 2017, according to which it was assumed that the discounting rate after the investment decision is approx. 7.5%, based on the average rate of return of the Ratio Series B bond, after the release of the FID for the Leviathan reservoir plus a non-negotiability premium of approx. 0.5%. In the Previous Work it was assumed that the investment decision would be made towards the end of Q1/2019 and that the discounting rate would be gradually reduced by approx. 0.5% up to this date. However, since the investment decision for the Karish reservoir occurred already during Q1/2018, within this Work we accelerated the rate of reduction of the discounting rate up to 7.5% as aforesaid.

We shall note that according to the report in the Energean Prospectus<sup>26</sup>, on March 2, 2018, it executed with a consortium of local and international lenders an agreement for the raising of senior debt in the sum of approx. \$1.275 billion, in favour of the development of Karish reservoir (the “**Financing Agreement**”). According to the terms of the Financing Agreement, the senior debt will be paid by a single payment upon the lapse of 3.75 years, with the interest for the first year being LIBOR plus a 3.75% margin; the interest for the second year is LIBOR plus a margin of 4%; the interest for the third year is LIBOR plus a margin of 4.25% and the interest for the last 9 months is LIBOR plus a margin of 4.75% (the weighted average of the margin is 4.15%). The fixed interest included in the Financing Agreement was estimated by us at approx. 6.8% through a transaction for the swap of variable interest (LIBOR 3 months) to fixed interest (IRS – Interest Rate Swap) plus the average margin.

According to information received from the Partnership, the senior debt is at a higher seniority level than the level of the debt component contemplated in our Work. In addition, in our estimate, on the date of the valuation, not all of the conditions precedent in the Financing Agreement have been fulfilled yet and no withdrawal has been actually carried out yet, and therefore, it was assumed that the discounting rate of the Debt Component is higher than the rate of return embedded in the senior debt.

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<sup>26</sup> See page 289 of the Energean Prospectus of March 22, 2018



### C. The results of the valuation

According to the balance of the cash flows expected to be received by the Partnership (9 equal annual payment in the sum of \$10.85 million, plus interest commencing on March 31, 2019), the value of the Debt Component was estimated at approx. \$86.7 million.

Following is a sensitivity analysis for the value of the Debt Component compared with the discounting rate (in US Dollars in millions):

	Profit (loss) from Changes		Fair value	Profit (loss) from Changes	
	2%	1%		-1%	-2%
<i>Change in the discounting rate</i>			<i>Dollars in millions</i>		
<b>Total</b>	<b>(6.5)</b>	<b>(3.3)</b>	<b>86.7</b>	<b>3.6</b>	<b>7.4</b>



## Definitions

<b>Delek Drilling/the Partnership</b>	Delek Drilling Limited Partnership
<b>Avner</b>	Avner Oil Exploration Limited Partnership
<b>Natural Gas</b>	A gas mixture containing mainly Methane, used mainly for the production of electricity and as a source of energy for industry
<b>The Purchaser/Energean</b>	Energean E&P Holdings Ltd. through Energean Israel Limited (Formerly Ocean Energean Oil and Gas Ltd.).
<b>The Partnerships/Sellers</b>	Delek Drilling and Avner
<b>The Petroleum Law</b>	The Petroleum Law, 5712-1952
<b>The Gas Framework or the Framework</b>	The resolution of the Israeli government on the creation of a framework for increasing the amount of natural gas produced from the Tamar natural gas field and the quick development of the Leviathan, Karish and Tanin natural gas fields as well as other gas fields
<b>Noble</b>	Noble Energy Mediterranean Ltd.
<b>Condensate</b>	Hydrocarbon liquid created during the production of natural gas, used as raw material for the production of fuels and constitutes a petroleum substitute
<b>Petroleum Asset</b>	A lease with a preliminary permit, license or lease by virtue of the Petroleum Law in Israel or a right of similar meaning granted by the entity authorized therefor outside Israel
<b>Ratio</b>	Ratio Oil Exploration (1992), Limited Partnership
<b>BCM</b>	Billion Cubic Meters
<b>DCF</b>	Discounted Cash Flows
<b>FID</b>	The date on which the Purchaser adopted a decision for the investment for the development of Karish and Tanin natural gas reservoirs
<b>LNG</b>	Liquid Natural Gas
<b>MMBTU</b>	A Million BTU – an energy unit used as a basis for the determination of natural gas prices