Osem Investments Ltd.

Monitoring Report I March 2014

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Osem Investments Ltd.

ISSUER RATING	Aaa	Outlook: Stable

Midroog reaffirms its Aaa/stable outlook rating for the overall solvency/Issuer Rating of Osem Investments Ltd.

Summary of Main Rating Rationale

Osem is a leading food corporation in Israel with revenues totaling NIS 4.2 in the last twelve months up to September 30, 2013, about 85% of which coming from the domestic market. The Company's products cover a diverse range of categories in the food sector. Osem has a line of strong brands, commanding the first or second largest market share in each of the business categories. The Company is based on top-level, focused, and stable management, propped by its belonging to the Nestle Group, the world's largest food corporation (with a 63.7% stake in Osem). These characteristics support the Company's high profit recovery ability over time.

Osem is outperforming the moderate growth of the food industry in Israel. In the first nine months of 2013, Osem posted domestic market revenue growth of about 4.3%. In our assessment, this growth was due to product innovation, entry into the ice-tea beverage category with the Nestea brand, and its revision of retail prices towards the end of 2012, among other factors. The Company's ability to achieve internal growth in the domestic market is based on its marketing innovation and its entry into new categories, while relying to a large extent on Nestle's development and marketing platforms. At the same time, the Company has been taking steps in recent years to expand its overseas business in the meat substitutes, salads, and kosher food segments, although this is still on a fairly small scale, accounting for about 15% of the Company's total revenue. Overseas revenue was down in 2013, largely due to the strengthening of the shekel and stopping sales of money-losing products. Not counting these influences, Osem also posted growth in its core business overseas. The Company underwent a reorganization process in 2013 and set up its international division which consolidates all overseas activity, a measure designed to bolster the Group's operations in global markets and future international opportunities.

The Company's leading status in the domestic food market is reflected in its very high and stable profit margin. In 2013, the Company's profitability received a boost owing to the drop in some food commodity prices, primarily coffee, wheat, and sugar. Over time, Osem contends with rising input prices and some erosion in price flexibility, which we believe is typical of the market as a whole.

2013 saw 2%-3% growth in sales in Israeli food industry sales in monetary terms, which is entirely attributed to a rise in sale prices and reflects a drop in real sales, on the heels of very low real growth in 2012. In our assessment, this real decrease results from a cutback in purchases in response to rising food prices and concerns about an economic slowdown and a decrease in disposable income. We believe that Osem's ability to show continued streamlining of its production lines and purchasing and logistics processes contributes to its ability to maintain high and stable operating profitability, even in a highly pressurized price environment

Osem has a robust and stable financial profile. The Company's leverage remains low, and even decreased over the past year. Osem's financial positioning is a result of its fiscal conservatism, business focus, and moderate working capital requirements Capital investments (capex) in fixed assets and in acquiring activities made by the Company in recent years were mostly financed by funds from operations. The Company has a stable dividend payout policy that is compatible with its cash flow abilities and does not impair its financial flexibility.

The stable rating outlook is supported by expectations of continued growth in business, stable and sustained profitability, and its ability to generate a large cash flow and maintain a low level of leverage.

Osem (Consolidated): Key Financial Data (NIS Millions):

	30.9.13	30.9.12	31.12.12	31.12.11	31.12.10	31.12.09	31.12.08
Revenues	3,155	3,081	4,092	3,961	3,807	3,397	3,220
EBIT	398	388	511	502	485	435	374
Net profit	285	282	357	341	316	291	249
Gross profit margin (%)	42.0%	41.2%	41.0%	41.7%	43.1%	41.8%	40.5%
EBIT margin (%)	12.6%	12.6%	12.5%	12.7%	12.7%	12.8%	11.6%
EBITDA	523	507	677	655	635	565	474
FFO	403	393	496	498	477	426	353
Increase in working capital needs	(132)	(188)	(129)	(76)	(91)	(101)	(80)
Capital investments	(132)	(84)	(100)	(89)	(143)	(295)	(560)
Dividend paid	(150)	0	(150)	(300)	(150)	(100)	(100)
Liquidity balances	221	255	60	104	129	167	55
Debt	122	85	62	141	225	326	405
Liabilities for put option	351	324	357	340	609	841	366
Equity/total assets	60.2%	58.5%	59.7%	53.3%	50.5%	46.1%	49.3%
Adjusted debt/CAP*	17.6%	22.2%	16.8%	20.5%	31.3%	40.6%	33.6%
Adjusted debt/EBITDA*	1.1	1.4	1.1	1.5	1.8	2.4	2.0
Adjusted debt/FFO*	1.5	1.8	1.4	1.9	2.4	3.2	2.8

*The leverage ratio and coverage ratios are adjusted to liabilities and interest on put options for the acquisition of Materna and are adjusted to optional leasing obligations.

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Key Rating Factors

Osem is one of Israel's leading food concerns, with a broad defensive array of products and an internal growth rate higher than the market, based on innovation

Osem is a leading food conglomerate in Israel, with revenues totaling NIS 3.5 billion in the domestic market in the twelve months ending on September 30, 2013 (out of its total revenue of NIS 4.2 billion during that period). Israel is Osem's main market, accounting for 85% of revenue. The Company has a wide array of strong brands in diverse packaged-food categories, but does not operate at all in the dairy products sector, and is a rather small player in the beverages sector. In recent years, the Company has expanded its business in Israel, mainly by entering new categories of business (baby food, ice-tea beverages). Osem has very strong brands in all activity categories, consistently supported by innovative marketing and advertising support. This is reflected in very high market shares (ranked number one or number two) in all categories of activity. The Osem brand enjoys very strong goodwill and strong perception of quality and reliability.

The Company has demonstrated over time high marketing innovativeness, which contributes to its ability to post internal growth slightly higher than that of the market by launching new products, extending the life of existing products, and entering new product categories. Osem's innovativeness is based to a large extent on the extensive R&D infrastructure of Nestle, the parent company.

The Company's sales in the domestic market grew by about 4.3% in January-September 2013, following about 3.1% growth in all of 2012. According to figures from market research companies Nielsen and StoreNext, sales in monetary terms in the Israeli food market rose by about 2-3% in 2013 and by a similar rate in 2012. In our opinion, most of Osem's growth in the Israeli market in 2013 resulted from changes in sale prices towards the end of 2012 and during 2013, as was true for the market as a whole. Osem posted growth in most of its business categories, especially in baked goods and beverages (including coffee), prepared food, and the "miscellaneous" sector, which includes the Nestea beverage launched in the market in Israel in October 2013. In the baby food sector, sales fell in 2012 and the first half of 2013 due to the Company's coupon discount sales campaigns.

The Company's growth is hindered by the moderate growth in the Israeli food market. Therefore, in recent years the Company has expanded its overseas business in the product categories in which it has technological advantages, entering the US market with prepared salads and meat substitutes. Osem's revenue from overseas sales constituted 15% of its total revenue in January-September 2013, down from about 17% in 2012, following a 7.1% drop in shekel-denominated overseas sales caused mainly by the fall in currency exchange rates and the discontinuation of overseas sales of money-losing products. Discounting these factors, the Company's overseas sales rose.

We believe that the Company's sales in Israel will grow by about 2-3% annually in the short and medium term. At the same time, we believe that the Company will enjoy increased growth in its overseas sales, among other things as a result of focused strategic measures aimed at enhancing growth in its main overseas business segments.

Osem: Revenue and EBIT by Core Business Segments, in NIS M and Percentages

	Revenue			Change in Revenues, %		
	Jan-Sept. 2013	2012	2011	Jan.-Sept. 2013	2012	2011
Culinary	549	739	720	1.3%	2.6%	0.1%
Snacks and cereals	502	663	656	0.6%	1.0%	10.4%
Baked goods and beverages	408	529	489	3.6%	8.2%	2.9%
Ready-made foods	703	915	890	2.8%	2.8%	0.9%
Baby food	256	355	369	0.8	3.8	16.0%
Miscellaneous*	780	947	888	5.0%	6.7%	3.4%
	Segment Profit, in NIS Millions			**EBIT margin, %**		
	Jan-Sept. 2013	**2012**	**2011**	**Jan-Sept. 2013**	**2012**	**2011**
Culinary	73	97	96	13.3%	13.1%	13.3%
Snacks and cereals	120	169	175	23.9%	25.5%	26.7%
Baked goods and beverages	68	71	67	16.5%	13.5%	13.7%
Ready-made foods	55	72	52	7.9%	7.9%	5.8%
Baby food	43	59	65	16.8%	16.7%	17.6%
Miscellaneous	40	43	48	5.1%	4.5%	5.4%

* Includes, among other things, ice cream, light beverages, animal food, gift packages and exports to the U.S. and the U.K.

A well-established Industry with moderate growth and a trend towards an erosion in price flexibility

The food industry features stable demand compared to economic cycles, with variances in the various product categories, the main distinction being between premium and luxury products on the one hand and basic food commodities on the other. The sector has a few major local manufacturers, following accelerated consolidation in recent decades, and a large number of small producers and importers. Competition is lively but fairly stable. The main competition for shelf space is between importers and the private labels of the large marketing chains. The organized market (the three major marketing chains) is a balancing competitive force in the sector, although it has been gradually losing market share in recent years. The food manufacturers in Israel are exposed to wide fluctuations in raw material prices and manufacturing inputs, such as energy costs and minimum wage. It appears that the Israeli public's heightened awareness of and influence on the prices of consumer goods, especially food products, has eroded the price flexibility of the branded companies, Osem included.

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This is reflected in a drop in quantitative sales in the sector in 2013 in response to price hikes and concern about a further slowdown in the economy. Regulation in the sector focuses mainly on lifting import barriers and antitrust restraints. It is evident that the government is acting to reinforce regulation in the food sector in order to encourage competition, particularly in the basic food commodities category, including dairy products. We do not expect any significant effect in this area in the foreseeable future.

High and very stable profitability compared to the domestic market

Osem's strong brands create added value for the Company, thereby contributing to its high gross profitability (41-42% on average in recent years). Its leading business standing contributes to its price flexibility and ability to adjust its sale prices over time to a rise in production input prices, thereby preserving profit stability. The Company's profitability also stems from its ability to demonstrate consistent operating efficiency, based on investments in new production lines, consolidation of production sites, improved processes, and streamlining of purchasing, data systems and logistics. It should be noted that the Company has significantly stepped-up investments in manufacturing equipment in the aim of improving manufacturing processes. Among other things, the processes of improvement in the Company are supported by Nestle's know-how, data systems and cooperation with Osem. For example, Osem benefits from Nestle's global purchasing database.

In the first nine months of 2013, Osem's gross profitability rose by about 0.8% to about 42%. This improvement stemmed, among other things, from a rise in sale prices that took place in the fourth quarter of 2012 and from a halt in the rising trend in commodity prices typical of the preceding year. Prices of most commodities were on a downtrend over the past year, especially coffee, sugar, soy, and wheat. On the other hand, prices of sesame, a significant element in Osem's basket of purchases, and other inputs rose sharply. The drop in currency exchange rates also helped to improve gross profit. Osem has substantial marketing and selling expenses to support its extensive distribution network, array of brands and innovation. In recent years, these expenses have remained stable at approximately 22% of revenue.

As previously stated, in our assessment Osem, like the industry as a whole, has to contend with a trend of growing consumer power which threatens price flexibility, and this is on the backdrop of a long-term upward trend in input prices. We believe that the Company has a number of tools to cope with this trend: strength of the brand and continuing to reinforce it, bolstering its presence in basic foodstuff categories, and continued streamlining of operations. We expect the Company's operating profitability to remain stable in 2014.

Quick coverage ratios supported by very low leverage and strong cash flow from operating activities

The Company has a very solid and stable financial structure, reflected in its large equity, constituting 60% of total assets and very low direct debt. In addition to its equity, the Company is financed mainly by credit from suppliers, which averages at 100 credit days and accounts for about 17% of total assets. The Company has strong cash flow from operations which significantly outstrips the pace of its current capital investments and distribution of dividends, and which has enabled it to reduce its debt in recent years. The pace of investments in fixed assets rose in 2013 as a result of larger investments in production lines and automation designed to bolster its output per employee. We project there will be a moderation of these investments in the coming year. In 2012-2013, the Company distributed a NIS 150 million annual dividend to its shareholders, accounting for about 40% of its net profit.

In calculating the debt coverage ratios, Midroog takes into account Osem's liability in respect of put options granted to minority shareholders in Materna. In 2012, the liability for future payments in respect of Tivall was paid from the Company's internal resources, and consequently its coverage ratios improved. The (adjusted) debt-to-EBITDA coverage ratio as of September 30, 2013 was 1.1x, and the (adjusted) debt-to-FFO coverage ratio was 1.5x. In our opinion, the Company will continue to service its investment needs and dividends primarily from its own resources, and we therefore do not expect any significant increase in debt in the short and medium term. We believe that the Company will maintain its current coverage ratios

Rating Outlook

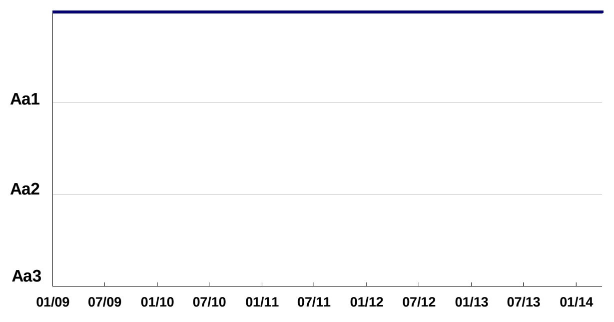
Factors likely to impair the rating:

- Increase in adjusted gross debt-to-EBITDA over 2.0x.
- Significant impairment of Company's goodwill and/or main brands

About the Company

Osem Investments Ltd., directly and in combination with a group of subsidiaries and investees, manufactures and markets food in Israel and overseas, and is one of the leading food concerns in Israel. The Company manufactures over 2,000 different food items currently produced at its production sites throughout Israel and overseas and marketed through regional distribution centers. In November 2013, the Company's major shareholder Nestle S.A. (Nestle) acquired the majority of Osem shares, which were held by the Chairman, Mr. Dan Propper. It therefore increase its stake of about 63.7% of the capital and voting rights. Nestle is the largest food corporation in the world. Among the Group's principal holdings are Migdanot Habait (100%), Tivall (1993) Ltd. (100%), Materna partnership (51%), Zabar Salads Food Industries Ltd. (100% through Tivall) and Beit Hashita-Assis Food Industries Limited Partnership (100%). The Company's principal holdings overseas: Tribe in the U.S., a company manufacturing and marketing cold Mediterranean salads as well as manufacturing and sales of cold meat substitutes marketed throughout the U.S. and Canada. The Company also has a 100% stake in Osem USA and Osem UK, which market all of the Group's products in the U.S. and the U.K. The CEO of the Osem Group is Mr. Itzik Saig.

Rating History



Related Reports

- Osem Industries Ltd. - Monitoring Report, March 2013
- Methodology for Rating Industrial and Trading Companies, October 2013
- Methodology for Adjusting Financial Ratios, November 2010

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KEY FINANCIAL TERMS

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

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

Obligations Rating Scale

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

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

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