

# Ellomay Capital Ltd.

## Monitoring | August 2020

*This credit rating report is a translation of a report that was written in Hebrew for a debt issued in Israel. The binding version is the one in the origin language.*

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## Ellomay Capital Ltd.

<b>Issuer rating</b>	<b>Baa1.il</b>	<b>Outlook: Stable</b>
<b>Series rating</b>	<b>Baa1.il</b>	<b>Outlook: Stable</b>

Midroog affirms the Baa1.il issuer rating for Ellomay Capital Ltd. (hereinafter: "the Company" or "Ellomay Capital"). Rating outlook is Stable. Midroog also affirms the Baa1.il rating for debentures issued by the Company (Ellomay Series B). Rating outlook is Stable.

**Outstanding debentures rated by Midroog:**

<b>Debenture series</b>	<b>Securities ID</b>	<b>Rating</b>	<b>Rating outlook</b>	<b>Final maturity</b>
Ellomay Series B	1140326	Baa1.il	Stable	June 30, 2024

### Summary of rating rationale

The rating takes into account, inter alia, the following considerations: (1) The Company primarily operates in the renewable energy electricity generation sector, in Israel and world-wide, which is estimated by Midroog to carry medium risk. The risk is primarily due to significant exposure to regulation in the generation segment and to market prices in countries in which the Company operates; (2) Purchasing strategy and project-based financing structure (typically by non-recourse debt), providing fixed rates for long-term agreements, which on the one hand is supportive of the certainty associated with the Company's cash flow, but on the other hand results in slow coverage ratios due to long-term project debt; (3) Barriers to entry into the power generation industry using renewable energy are low by comparison to the power generation industry using fossil power plants, which typically has higher barriers to entry due, inter alia, to significant capital investments as well as technology and engineering complexity; (4) The regulatory environment in countries in which the Company operates, along with long-term agreements for sale of energy with strong end customers, result in relative certainty with regard to stability of the anticipated cash flow over the long term; (5) Growth trend typical of the renewable energy sector in Israel and overseas, supported by setting of targets for promotion of renewable energy; (6) The Company's market share and size are small by comparison to the peer group, but should grow significantly over the short to medium term, with the expected commercial launch of the Talasol project (hereinafter: "**Talasol**") in Spain by end of 2020, as well as further growth potential due to significant backlog of other PV projects in Italy and in Spain; (7) The Company has relatively low operating margins due, inter alia, to the large component of development expenses and general and administrative expenses; (8) Exposure to financial markets, to interest rates and to credit risk of the countries in which the Company operates (Italy, Spain, Netherlands and Israel), as well as exposure to exchange rates, which is partially mitigated by hedging transactions; (9) Realization of PV projects in Italy, valued at EUR 39 million at end of 2019; (10) Improvement in balance sheet leverage, due to early redemption of debenture series, using cash flow obtained from sale of the PV projects in Italy and recognition of material capital gain; (11) As of the report date, the Company's operating cash flow is primarily derive from PV projects owned by the Company in Spain and in Israel. Over the short to medium term, Company operations in the PV sector should grow materially, with completion of construction of the Talasol project in Spain, but this completion should materially increase the concentration of operations and cash flows in Spain, prior to the development of a new material portfolio of projects in Italy; (12) Low ability to generate revenues over the short term, due to the sale of PV facilities in Italy, along with significant improvement expected upon completion of the

Talasol project and expected significant cash flow from this project; (13) The Company has a material multi-year investment plan including, inter alia, completion of construction of the Talasol project in Spain over the short term, another PV project in Spain and a new project portfolio in Italy. According to Company forecast, CapEx should amount to approximately EUR 400 million in 2020-2023; (14) The Company's balance sheet leverage is relatively low, as of end of March 2020, but is expected to increase over the short to medium term, after completion of construction of the Talasol project and development of other projects. However, we assume that the Company would balance its leverage by raising capital according to its ongoing needs, as progress is made on its investment plan; (15) Financial policy with regard to holding liquid reserves is supportive of the rating: as of March 31, 2020, liquid reserves amounted to approximately EUR 66 million (including short-term deposits and marketable securities), and over the short to medium term, the Company is expected to maintain minimum cash of EUR 30-40 million; (16) The Company has good financial flexibility reflected, inter alia, in access to banks and to the capital market; (17) The Company has subordinated structure and cash flow compared to its senior debt and subordinated debt at the project level, for projects it owns.

According to Midroog's baseline scenario, the Company would focus, over the short term, on completion of development of the Talasol project in Spain, with commercial operation expected during the fourth quarter of 2020, while making progress on construction of other projects in Israel, Spain and Italy in parallel. According to these assumptions, adjusted EBITDA is expected to be negligible in 2020, primarily due to sale of the PV project backlog in Italy, but in 2021-2022, after commercial launch of Talasol, along with other projects in Spain and in Italy, this parameter is expected to range between EUR 20-30 million. Moreover, funds from operations (FFO) in these years is expected to range between EUR 10-20 million. Concurrently, the Company's coverage ratios in the coming years is expected to be high for the rating, even after operation of Talasol and the other projects included in the investment plan. We also assumed that the Company's leverage, as reflected by the ratio of equity to balance sheet, would be maintained at similar levels, ranging between 30%-35%. Moreover, in accordance with statements of Company management, we assumed that the Company would not distribute dividends to shareholders in years when an extensive investment plan is under way.

## Rating outlook

### Factors which may result in a rating upgrade:

- Significant improvement in leverage and coverage ratios, compared to Midroog's baseline scenario
- Increased diversification of cash flows across high-quality underlying assets

### Factors which may result in a rating downgrade:

- Changes to the sector risk profile, including deterioration in the supporting regulatory environment
- Significant deterioration in leverage ratios, financial resilience and debt coverage ratios, compared to Midroog's baseline scenario

**Ellomay Capital Ltd. – Key financial data, EUR in thousands**

	March 31, 2020	March 31, 2019	December 31, 2019	December 31, 2018	December 31, 2017
Revenues	1,943	4,733	18,988	18,117	13,636
Adjusted EBITDA <sup>1</sup>	(1,208)	2,043	7,291	8,267	7,123
Cash and cash equivalents <sup>2</sup>	66,429	48,547	53,197	39,014	26,124
Shareholder equity	132,919	76,580	107,756	76,957	77,500
Gross financial debt	193,198	140,783	178,906	116,035	102,825
Total Assets	376,142	237,223	310,172	211,160	198,088
Equity to Total Assets	35.3%	32.3%	34.7%	36.4%	39.1%
FFO <sup>3</sup>	(1,900)	1,339	4,476	7,908	6,655

**Detailed rating considerations****The operating risk profile is medium, benefiting from supportive regulation including renewable energy generation targets and tariff regulation**

The Company operates in the renewable energy electricity generation sector in Europe and in Israel, through projects owned by the Company and mostly financed by senior non-recourse debt at project level. Company operations mostly rely on supporting regulation, with a commitment by local electricity / transmission companies and/or by another external party to purchase most or all of the electricity generated by the relevant projects (off-taker) for an extended period, in conjunction with PPA agreements. Consequently, Midroog estimates that the renewable energy electricity generation sector carries medium risk, primarily due to high exposure to regulation in the generation segment and to market prices in countries in which the Company operates. Furthermore, it is apparent that regulators (in Israel and in some world markets) are promoting transition to a new regulation which encourage stronger competition in this segment, with a reduction of infant entity protection provisions. Factors which mitigate this risk are the existence of supportive regulation, accompanied by renewable energy generation plans and targets for the short to medium term. These factors create cash flow certainty and transparency, which are appropriate for the rating.

<sup>1</sup> Excludes loan repayment from Dorad and includes cash flow adjustment with respect to Talmei Yosef financial asset.

<sup>2</sup> Includes securities and short-term deposits.

<sup>3</sup> Includes loan repayment from Dorad, normalized over the years, and cash flow adjustment with respect to Talmei Yosef financial asset.

Below is an overview of regulation and targets for generating electricity using renewable energy sources through 2020, in countries in which the Company operates<sup>4</sup>:

Country	Moody's rating	Company's installed capacity in this country, as of March 31, 2020	Generation using renewable energy, most current data	Target: generation using renewable energy in 2020
Israel	A1	9 MW	2.3% in 2019	7.6%
Netherlands	Aaa	9 MW	15% in 2018	37%
Spain	Baa1	7.9 MW <sup>5</sup>	38% in 2018	39%
Italy	Baa3	–	39% in 2018	26%

#### **Supportive regulatory framework in areas of operation, based on long-term agreements for sale of energy to high-quality end customers**

The Company's core operations involve power generation using renewable and conventional energy in various countries, each with a different regulatory framework for this industry. Energy generation plants constitute vital infrastructure and a key pillar of the energy market, mostly backed by PPA agreements with the local system administrator and, in our opinion, contribute significantly to stability of the Company's cash flow. Most of the Company's revenues are derived from its PV facilities. Revenues from these facilities are based, inter alia, on payments from Government entities, and impairment of the financial robustness of such entities may, directly or indirectly, impact revenue from such operations. In Israel, the renewable energy power industry is defined and fixed over the term of the license, whereas fossil-based power plants are exposed to changes to the generation component. In Spain, revenues from facilities subject to regulated tariff are set for each facility upon connecting it to the power grid, consisting of three components: Operation, investment and Spot prices. In the Netherlands, Company revenues are composed of multiple components, both for gas production as part of the process and for power generation, payment from the supplier for removal of "waste", offset in the price paid to the supplier for sludge removal and green certificates for production of gas and electricity, which are realized upon sale.

#### **A relatively small portfolio with diversified energy sources and geographic dispersion is expected to grow significantly in total MW over the short term**

The Company acts as an entrepreneur, developer and owner of facilities for generating electricity from renewable energy sources. The business model is based on investment in project development and construction, to be repaid out of revenues from sale of electricity to the grid and/or realization of assets owned by the Company, through sale of Company interest in such facilities. The projects are financed by a combination of equity and debt, provided by bank financing (at project level) and/or public financing (at solo level). The Company has appropriate experience in project financing in Israel and overseas, in co-operation with local and international banking corporations and institutional investors. Currently, the Company is focused on development, financing, construction and operation stages of the projects. In the Israeli market, the Company acquired a 9.4% interest in Dorad power plant, as well as the PV facility at Talmei Yosef. In the Manara project, the Company operates across the entire value chain of project development, construction and licensing. We should note that this project is in its early stages and has yet

<sup>4</sup> Renewables 2020, global status report.

<sup>5</sup> As well as construction of Talasol project, with capacity of 300 MW.

to be taken into account in the financial model. In the international market, up to 2017, the Company strategy was to only acquire projects in operation, but in that year, the Company acquired interest in the Talasol project and started development of this project. In late 2020, total MW generated by the Talasol project is expected to account, in our opinion, for over 50% of the Company's total share of its projects. Moreover, the Company is currently promoting development of multiple PV projects in Spain and Italy, with construction expected to start over the short to medium term.

**Relatively small market share, along with diversification of customers with strong financial robustness and large exposure to a single project over the short term**

The Company's market share is relatively limited compared to the peer group, with the Company owning Talmei Yosef project, at 9 MW<sup>6</sup>. The Company also owns PV projects of 7.9 MW in Spain and Biogas projects of 9 MW in the Netherlands. It is important to note that by end of 2020, the Talasol project is expected to be in commercial operation, which would significantly increase total MW capacity of projects in commercial operation, while creating material exposure to cash flow from this project and to its proper operation. As of the report date, Company customers include Israel Electric Company Ltd. (hereinafter: "IEC") as well as local electric authorities in Spain and in the Netherlands, that purchase electricity and gas from Company-owned PV and biogas facilities, respectively. By end of 2020, the Talasol project is expected to be in commercial operation, and the Company has signed a hedging transaction for the price of electricity with a leading international energy company operating in more than 40 countries. The hedging transaction covers 80% of total electricity generation of this project, to be sold at a pre-agreed price for a 10-year term, with electricity generated by this project expected to be sold at market price upon the sale date. The hedging agreement stipulates that should the market price drop below the price agreed in the electricity sale agreement, the hedging provider shall pay to Talasol the difference between the market price and the agreed price. Should the market price be higher than the agreed price, Talasol would pay to the hedging provider the difference between the market price and the agreed price. The electricity sale agreement is expected to hedge most of the risk associated with volatility of electricity prices on the market, by allowing Talasol to ensure fixed revenues for generation of electricity covered by the agreement. This project is expected to account for 50%-60% of revenues and EBITDA in the coming years. We believe that the hedging transaction somewhat mitigates the large exposure to significant revenues from a single operating facility.

**Significant increase in Company revenues over the short term, when Talasol becomes operational, with a mitigation to cash flow exposure to Talasol as other projects are put into operation in Spain and Italy, over the long term**

The Company has been growing in recent years, due to its operating strategy and accelerated project acquisition and development including, inter alia, acquisition of biogas facilities in the Netherlands and the PV facility at Talmei Yosef. In 2019, Company revenues amounted to EUR 19 million, compared to EUR 18 million in 2018 and to EUR 13.6 million in 2017. In late 2019, the Company sold its operating PV projects in Italy, with proceeds from this sale used to redeem debentures (Series A). According to Midroog's baseline scenario, following this move, Company revenues in 2020 are expected to decrease significantly, to EUR 10-12 million. Upon start of commercial operation of Talasol in late 2020, as well as other projects in Spain and Italy, accounting revenues are expected to increase and in 2021-2022 are expected to range between EUR 40-50 million.

**The Company has low operating margins by comparison to the peer group**

The Company's operating margin has been eroded in recent years due, inter alia, to material project development expenses at Manara, Talasol and the new project backlog in Italy, and due to low margins at its biogas operations in the Netherlands. In 2021-2023, we expect to see material improvement in operating margins due, inter alia, to

<sup>6</sup> As well as a small holding stake of approximately 9.4% of Dorad project (79 MW).

start of commercial operation of the Talasol project, improved operation of the biogas projects and significant reduction in development expenses.

### **Decrease in balance-sheet leverage over the short-term due to sale of projects in Italy, along with an upward trend in the coming years due to material project development**

The Company operates by holding project companies, whose typical debt structure is characterized by significant leverage between 60%-80%. The Company's balance sheet leverage ratio has been growing in recent years, as reflected by the ratio of equity to total assets, from approximately 56.8% at end of 2016 to approximately 35.3% as of March 31, 2020. This growth trend in leverage is primarily due to project acquisition (biogas and Talmei Yosef) and to new project development (mostly Talasol), which involved material development expenses and increased total debt on consolidated basis. However, the sale of projects in Italy and redemption of debentures (Series A) using proceeds from said sale, as well as capital raised, somewhat mitigated the growth in leverage. Under Midroog's baseline scenario, the ratio of equity to total assets in the coming years is expected to range between 30%-35%, a leverage ratio that is supportive of the rating.

### **Expected negative free cash flow over the short term, due to material investments in new project construction in Spain and Italy, along with material improvement over the medium term**

In recent years, cash flow from operations (CFO) ranged between EUR 2.0-7.0 million due, inter alia, to changes in working capital items and to increase in financing expenses. After commercial launch of Talasol, along with other projects in Spain and in Italy, in 2021-2022, cash flow from operations is expected to range between EUR 5-15 million. In 2019-2020, total CapEx by the Company should exceed EUR 200 million due to completion of construction of Talasol. In 2021-2022, total CapEx by the Company should range between EUR 50-80 million, primarily consisting of project construction in Spain and Italy. We regard the construction period of large-scale projects in these years to be a risk factor for the Company rating. Delays in commercial launch or increase in project construction budgets may impact the Company rating. Furthermore, assuming progress is made in development of the Manara project, we anticipate significant investments in construction of this project, which would be reflected, on consolidated basis, primarily in capital provided by owners, due to the Company's strategy to cease being in control of this project, a strategy which is expected to somewhat mitigate the risk associated with investments in and operation of a project of this type. Free cash flow (FCF) would be materially impacted in 2020-2022 by construction of Talasol and other projects in Spain and in Italy, and is expected to be negative in 2021-2022, ranging between EUR 50-70 million. We should note that in 2017-2019 no dividends were distributed and as certified by Company management, no dividend distributions to Company shareholders are expected in the coming years, while the Company is in the midst of a massive investment plan.

### **Slow coverage ratios for the rating**

The Company's coverage ratios deteriorated significantly in 2019-2020 and currently are not appropriate for the rating. This deterioration is due, inter alia, to consolidation of project debt of the Talasol project, low profitability of biogas projects compared to financial debt assumed with respect to these projects and material development expenses. Moreover, the sale of projects in Italy in later 2019 resulted in a significant decrease in operating cash flow and in coverage ratios. This is reflected, inter alia, in the ratio of debt to FFO, which in 2017-2018 ranged between 17.5-20.8 and was materially weaker in 2019-2020, with negligible FFO generated. In 2021-2022, this ratio is expected to decrease to between 15-25, which is still weak for the rating. We should note that the Company's rapid growth, through development and financing of new projects, significantly slows down its debt coverage ratios, but we expect that as projects currently under planning and construction go into commercial operation in the coming years, the coverage ratios should improve significantly.

### Policy of holding high liquid balances and appropriate financial flexibility

Throughout its years of operation, the Company has maintained high liquid reserves compared to total assets. This reflects the Company policy with regard to maintaining sufficient liquid reserves. Currently, it is Company policy to maintain minimum liquid reserves of EUR 30-40 million on consolidated basis, which should reflect principal and interest payments for at least 18-24 months over the coming years. We believe that the Company has a good financial flexibility reflected, inter alia, by access to capital and debt markets, as reflected by EUR 22 million in capital raised in the first half of 2020, and issuance of debentures (Series C) in 2019, amounting to EUR 22.3 million. The Company is also compliant with the financial covenants to holders of its debenture series, with large margins. The Company also has low leverage at solo level and a ratio of sources to uses in excess of 2.5 for 2018-2019 and is expected to, in our opinion, reach an average ratio in excess of 2.0 in 2020-2022. However, the Company has exposure to foreign currency at solo level, due to debentures issued and redeemed in the local market in NIS, with material revenues in EUR, further to the stronger NIS and generally weaker EUR in recent years. This exposure should increase due to the effect of material cash flows from the Talasol project and other projects in Spain and Italy, as from late 2020.

### Other rating considerations

#### The Company has a subordinated structure and cash flow compared to projects owned by the Company

The Company has a subordinated structure and cash flow, due to holding project companies with mostly senior and subordinated debt. The underlying assets in these companies, including the cash flows resulting from them, are typically pledged by a first-ranked lien to senior debt lenders. Moreover, distribution of retained earnings from the project companies is subject to compliance with distribution conditions.

#### No dividend distributions over the short to medium term

According to the Company statements, it is not expecting to distribute dividends in the coming years, while the Company is in the midst of a massive investment plan. We believe that this statement by Company management reduces the uncertainty associated with sources for debt service and is supportive for the Company rating.

### Company profile

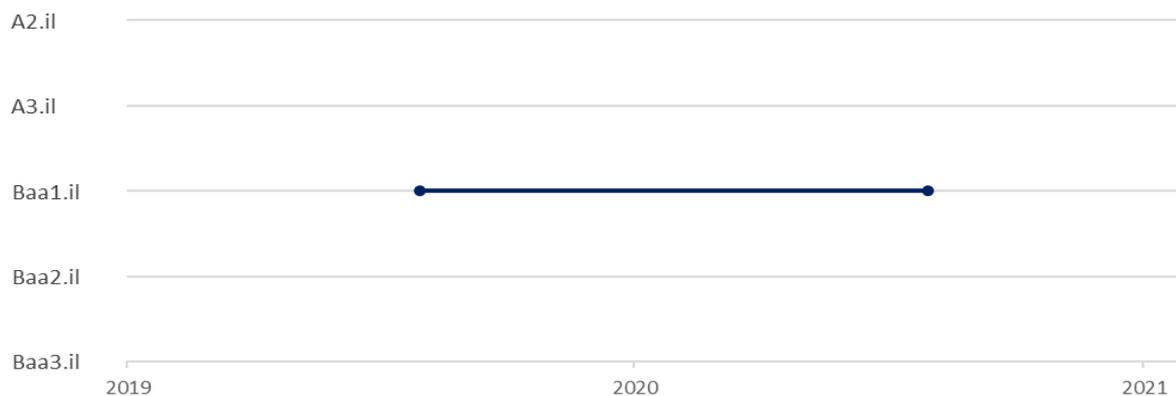
Ellomay Capital Ltd. is engaged in development, construction, operation and holding of power generation plants using renewable energy and conventional technologies, in Israel and in Europe. Since 2009, the Company business is focused on energy and infrastructure. The Company was incorporated in 1987, went public in 2011 with a listing on the stock exchange in New York (NYSE American) and is also traded on the Tel Aviv Stock Exchange (TASE) since 2013. The Company's primary operations involve power generation from renewable energy sources - the Company owns power generation facilities using PV technology<sup>7</sup>, and this segment currently accounts for most of its revenues. As part of these operations, the Company owns PV facilities with a total capacity of 7.9 MW in Spain and 9 MW in Israel; the Company also owns 2 biogas facilities in the Netherlands with a capacity of 6.8 m3 gas (equivalent to 9.0 MW); the Company also has approximately 9.4% interest in Dorad Energy Ltd. (hereinafter: "Dorad"), one of the largest private power plants in Israel, with power generation capacity of 860 MW. The Company is also in advanced construction stages of the Talasol project, a power plant using PV technology, with a capacity of 300 MW, in Talavan in Spain which is 51% owned by the Company as of the report date. The Company is also promoting a pumped storage facility at Manara Cliff, with a capacity of 156 MW, which is 75% owned by the Company. The controlling shareholders of the Company are Shlomo Nehama, Company Chairman (31.8%<sup>8</sup>),

<sup>7</sup> Photo-voltaic.

<sup>8</sup> Through S. Nehama Investments (2008) Ltd. And directly.

Hemi Raphael and Ran Fridrich, who is also Company CEO (20.6% through Kanir SM and directly<sup>9</sup>). As of the report date, these controlling shareholders hold approximately 55.3% of Company shares.

## Rating history



## Related reports

[Ellomay Capital Limited - Related Reports](#)

[Unregulated power companies - Methodology report, July 2020](#)

[Power projects finance - Methodology Report, February 2018](#)

[Generic project finance rating - Methodology Report, February 2018](#)

[Financial statements adjustments and presentation of main financial measures in rating - Methodology Report, May 2020](#)

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[Midroog's rating symbols and definitions](#)

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## General information

<b>Rating report date:</b>	August 3, 2020
<b>Most recent rating revision date:</b>	August 29, 2019
<b>Initial rating issue date:</b>	August 29, 2019
<b>Rating initiated by:</b>	Ellomay Capital Ltd.
<b>Rating paid for by:</b>	Ellomay Capital Ltd.

## Information from the issuer

Midroog relies in its ratings, inter alia, on information received from competent personnel at the issuer.

<sup>9</sup> Hemi Raphael holds another 2.8% and Ran Fridrich holds another 0.1% of Company shares.

**Long-Term Rating Scale**

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

Note: Midroog appends numeric modifiers 1, 2, and 3 to each rating category from Aa.il to Caa.il. The modifier '1' indicates that the obligation ranks in the higher end of its rating category, which is denoted by letters. The modifier '2' indicates that it ranks in the middle of its rating category and the modifier '3' indicates that the obligation ranks in the lower end of that category, denoted by letters.

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