Ellomay Capital Ltd.

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Issuer rating	Baa1.il	Rating Outlook: Stable

Midroog affirms the Baa1.il issuer rating for Ellomay Capital Ltd. (hereinafter: "the Company" or "Ellomay Capital"). Rating outlook – Stable.

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 exposure to regulation in the generation segment and exposure to market prices in countries in which the Company operates; (2) acquisitions strategy and project-based financing structure (typically by non-recourse debt), providing fixed rates in 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) Entry barriers to the power generation industry using renewable energy are low in comparison to the power generation industry using fossil power plants, which typically has higher entry barriers 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, alongside long-term agreements for energy sale with strong end customers, create relative certainty with regard to anticipated cash flow stability ; (5) Growth trend typical of the renewable energy sector in Israel and overseas, supported by setting of targets for promoting renewable energy; (6) The Company's market share and size are small in comparison to the peer group, but we should note that it has grown significantly upon the commercial operation of the Talasol project (hereinafter: "**Talasol**"), and is expected to continue to grow over the short to medium term, with commercial operation of other projects in Italy; (7) The Company has relatively low operating margins due, *inter alia*, to the large component of development 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) As of the report date, the Company's operating cash flow is primarily due to Talasol, Ellomay Solar, PV projects owned by the Company in Spain and in Israel, and bio-gas projects in the Netherlands. Over the short to medium term, Company operations in the PV sector are expected to continue to grow, with construction completion of additional projects in Italy. Completion of the Talasol and Ellomay Solar projects significantly increased the concentration of operations and cash flow from Spain, pending completion of a material new project portfolio in Italy; (10) Good revenue generation capacity, due to commercial operation of Talasol and Ellomay Solar, as well as expected improvement upon completion of projects under construction; (11) The Company has a significant multi-year investment program, primarily consisting of construction of the pumped storage project at the Manara cliff (hereinafter: "**Manara Project**"), which is under construction, and a new project portfolio in Italy. We believe that CapEx in 2022-2024 should amount to EUR 300-350 million, including project financing at investee level; (12) The Company's balance sheet leverage at the end of March 2022 is materially high compared to what is customary for this sector, primarily due to effects of derivatives and re-financing of the Talasol project; (13) On June 6, 2022, the General Meeting of Company debenture holders (Series C) approved in a special resolution, the amendment of the Deed of Trust which includes a revised definition of balance sheet equity, which eliminates from the calculation changes in fair value of hedging transactions for electricity prices; (14) The Company maintains high liquidity relative to total assets; (15) The Company has good financial flexibility reflected, *inter alia*, in accessibility to banks and to the capital market; (16) The Company's inferior structure and cash flow compared to its senior project-level debt; (17) We believe that the Company has low exposure to environmental and corporate risk, due to being involved in renewable energies and to supportive regulation and growing demand trends in this market.

According to Midroog's baseline scenario, the Company would focus, over the short term, on completion of projects in Italy, with commercial operation scheduled for 2022-2024, while concurrently making progress on construction of other projects in Israel, Spain and Italy. Based on these assumptions, djusted EBITDA in 2022 should range between EUR 25-30 million, primarily due to commercial operation of the Ellomay Solar project and to higher electricity prices, and in 2023-2024, after commercial operation of other projects in Italy, this parameter is expected to range between EUR 35-40 million. Moreover, funds from operations (FFO) in these years are expected to range between EUR 18-24 million. We believe that the high electricity prices environment would not be permanent. However, the expected increase in projects in commercial operation may somewhat offset the future decline in electricity prices, and maintain the trend of larger cash flows, although at a slower pace. Concurrently, the Company's coverage ratios in the coming years are expected to be slow for the rating level, even after commercial operation of the other projects on the investment plan due, *inter alia*, to the inclusion of project debt in the projects in Italy and in the Manara Project. Moreover, in accordance with certification by Company management, we assumed that the Company would not distribute dividends to shareholders in years with an extensive investment plan under way.

Rating outlook

The stable rating outlook is supported by cash flow certainty, based on supportive regulation and long-term agreements for energy sale to high-quality end customers.

Factors which may result in a rating upgrade:

- Significant improvement in leverage and coverage ratios
- Increased of cash flows diversification 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, 2022	March 31, 2021	December 31, 2021	December 31, 2020	December 31, 2019
Revenues	11,761	7,200	44,783	9,645	18,988
Adjusted EBITDA[1]	1,937	3,068	22,006	(527)	7,152
Cash and cash equivalents[2]	121,194	105,020	71,585	76,719	53,197
Shareholder equity	69,220	123,820	113,483	125,026	107,756
Gross financial debt[3]	436,851	335,145	370,565	296,469	178,906
Total balance sheet	630,499	491,647	551,147	460,172	310,172
Equity to balance sheet	11.0%	25.2%	20.6%	27.2%	34.7%
FFO[4]	N/A	N/A	12,200	(2,407)	1,113

[1] Excludes dividend from Dorad, includes cash flow adjustment with respect to Talmei Yosef financial asset.
[2] Includes securities and short-term deposits.
[3] Net of reserves for debt service in projects.
[4] Includes dividend from Dorad, normalized over the years, and cash flow adjustment with respect to Talmei Yosef financial asset.

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 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 exposure to market prices in countries in which the Company operates. Furthermore, it would appear that regulators (in Israel and in some world markets) are advocating transition to new regulation to promote 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, which creates cash flow certainty and transparency, which is appropriate for the rating.

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 production in various countries, each with different regulatory framework. 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 and bio-gas facilities. Revenues from these facilities are based, *inter alia*, on payments from Governmental and private entities, and an impact to the financial robustness of such entities may, directly or indirectly, impact revenues from such operations. In Israel, revenues from sale of electricity from renewable energy sources are mostly hedged 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 arranged 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, a Company's revenues are composed of multiple components, both from gas production as part of the process and from power generation, payment from the supplier for removal of "waste", offset by 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 geographical diversification, along with expected further expansion of the asset portfolio

The Company develops, constructs and owns 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. In the Israeli market, the Company acquired approximately 9.4% interest in Dorad power plant, as well as the PV facility at Talmei Yosef and the manara pumped storage project. In Spain, the Company has acquired interest in the Talasol and Ellomay Solar projects, were commercially operated at the end of 2020 and in 2022, respectively. As of the report date, total production of the Talasol project accounts for over 50% of total production of all the company's projects (Company's share). However, the Company is currently promoting development and construction of multiple PV projects in Spain and Italy, some of which are scheduled for commercial operation in 2023-2024.

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

The Company's global market share is small compared to the peer group. Company projects in commercial operation are: Talmei Yosef project in Israel (9 MW capacity[5]), PV projects in Spain (approximately 7.9 MW capacity), bio-gas projects in the Netherlands (approximately 19 MW capacity) and the Talasol and Ellomay Solar projects in Spain (300 MW and 28 MW capacity, respectively). 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 bio-gas facilities, respectively. We note that for the Talasol project, the Company has signed a hedging transaction for the electricity price. The hedging transaction covers approximately 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. We note that this project is expected to generate most of the Company's EBITDA over the coming years. We estimate that the hedging transaction significantly mitigates the large exposure to revenues from this asset.

Significant growth in Company revenues, due to Talasol commercial operation, with expected further revenue growth as other projects reach commercial operation

In recent years, the Company has been growing with faster development and project acquisition, including development of additional PV projects in Italy and in Spain. In 2021, Company revenues amounted to EUR 45 million, compared to EUR 10 million in 2020. The significant increase in revenues is mostly due to commercial operation of the Talasol project at end of 2020. We etimate that in the coming years, revenues are expected to continue to grow and would range between EUR 50-65 million, with commercial launch of the Ellomay Solar project (in 2022) and expected commercial operation of other projects in Italy. Concurrently, we estimate that in 2022-2023 revenue growth would also be supported by higher electricity prices. We believe that this electricity prices environment would not be permanent. However, the expected increase in projects in commercial operation may somewhat offset the future decline in prices, and maintain the trend of revenue growth, although at a slower pace.

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, in Spain and in Israel, and due to low profitability rates at its bio-gas operations in the Netherlands. However, in 2021 the Company's operating margin improved to 9% of revenues, primarily due to commercial operation of the Talasol project. We anticipate that in 2022-2024 the Company's margins would improve significantly due, *inter alia*, to commercial operation of the Ellomay Solar project and other projects in Italy, and due to some expected improvement in bio-gas project operations.

Significant increase in leverage on the balance sheet, primarily due to effects of derivatives and due to re-financing of the Talasol project

In recent years, the Company's balance sheet leverage increased, as reflected by the ratio of equity to total assets, which decreased from 57% at end of 2016 to 25% as of March 31, 2021. This growth in leverage was primarily due to project acquisition (acquisition of another bio-gas project in the Netherlands) and to new project development, which involved material development expenses and increased total debt project on consolidated basis. However, in the first quarter of 2022, balance sheet leverage further significantly decreased and the ratio of equity to total assets as of March 31, 2022, was 11%. This ratio is significantly low due, *inter alia*, to the impact of hedging of

[5] As well as a small holding stake of 9.4% of Dorad project (80 MW).

electricity prices at the Talasol project. Given the unusually high electricity prices environment, this hedging resulted in an accounting loss charged to a capital reserve, which materially impacted the leverage ratios. We note that although this hedging impacted leverage on the balance sheet, it is an important factor in increasing the certainty of the Company's cash flows. Another cause for the increased leverage is re-financing of the Talasol project, completed in January 2022. As part of this process, the previous debt for this project, amounting to EUR 121 million, was repaid by a new loan amounting to EUR 175 million. We etimate that further increase in electricity prices and/or increase in total debt may further erode the Company's leverage ratios, which may be bolstered by improved margins.

Revision of covenants on the Company's Deed of Trust

On June 6, 2022, the General Meeting of Company debenture holders (Series C) approved in a special resolution the amendment of the Deed of Trust. In this amendment, calculation of covenants in the Deed were revised so that in lieu of measuring "balance sheet shareholder equity", the "adjusted balance sheet shareholder equity" would be measured. This revised definition of balance sheet shareholder equity eliminates from the calculation any changes in fair value of hedging transactions for electricity prices. Concurrently, as part of this amendment, the annual interest rate was increased by 0.25%.

Expected negative free cash flow, due to material investments in new project construction in Spain, Italy and in the Manara Project

In 2021, the Company's current cash flow (CFO) increased significantly, from a negative cash flow of EUR 5.8 million in 2020, to a positive cash flow of EUR 15 million in 2021 due, *inter alia*, to increase in revenues from the Talasol project. We expect that in 2022-2024, current operating cash flow is expected to range between EUR 12-20 million, with the commercial operation of the Ellomay Solar project and other projects in Italy, along with higher electricity prices over the short term. Concurrently, in 2022-2024, total CapEx of the Company should range between EUR 60-160 million, due to construction of the manara pumped storage project and additional projects in Italy and Spain. We regard the construction period of large-scale projects in these years to be a risk factor for the Company rating. Delays in commercial operation or increase in project construction budgets may impact the Company rating. Free cash flow (FCF) would be materially impacted in 2022-2024 by construction of the pumped storage project in Manara and other projects in Spain and in Italy, and is expected to be negative, ranging between EUR 50-140 million. We should note that in 2017-2021 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 during a broad investment plan.

Slow coverage ratios

The Company's coverage ratios were low in recent years and currently are not correlating with the rating. This environment is due, *inter alia*, to full consolidation of project debt of the Talasol project, which is 51% owned by the Company, low profitability of bio-gas projects compared to financial debt assumed with respect to these projects and material development expenses. Moreover, sale of the PV portfolio in Italy in late 2019 resulted in a significant decrease in operating cash flow and in coverage ratios. This is reflected, *inter alia*, by a debt to FFO ratio of 30 in 2021. However, we believe that in 2022-2024, this ratio is expected to decrease to 19.0-26.0. 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 project currently under development and construction go into commercial operation in the coming years, the coverage ratios should improve.

Policy of holding high liquid balances and appropriate financial flexibility

The Company usually maintaining high liquid balances compared to total assets. We believe that the Company's financial flexibility is good, as reflected, *inter alia*, in accessability to capital and debt markets, in raising capital and debt in recent years (in particular over the past year), as re-financing of the Talasol project was completed.

The Company is also compliant with the financial covenants to holders of its debenture series, with large margins. Furthermore, the Company has low leverage on solo basis. 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 is expected to increase due to the effect of material cash flows from the Talasol project and other projects in Spain and Italy. We should note that this exposure is partially offset by hedging transactions.

Other rating considerations

The Company has inferior structure and cash flow compared to projects owned by the Company

The Company has inferior structure and cash flow, due to holding projects mostly with senior debt, including significant concentration of expected cash flows from the Talasol project. The underlying assets in these companies, including the cash flows there from, 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.

Policy of no dividend distributions over the coming years

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

Environmental, social and governance (ESG) considerations

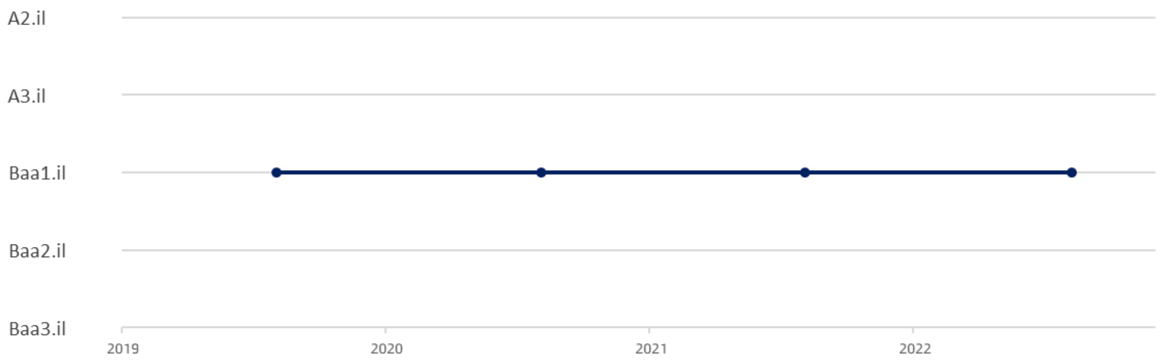
Company exposure to environmental risk is low, due to its operations in development and maintenance of renewable energy projects (primarily PV technology, bio-gas and pumped storage). Solar projects and resulting deliverables do not involve any greenhouse gas emissions. However, the Company has indirect exposure to climate risk, such as extensive fires in areas where the Company operates. Due to its operations in the renewable energy sector, the Company benefits from growing preference of companies involved in solar projects world-wide, due to undertakings by Western countries to reach zero greenhouse gas emissions by 2050.

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. The Company was incorporated in 1987, its shares are traded on the stock exchange in New York (NYSE American) since 2011, 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, and this segment currently accounts for most of its revenues. As part of these operations, the Company owns multiple projects, including the Talasol PV facility (300 MW capacity) in Telavan, Spain (51% holding stake); Ellomay PV facility in Spain (28 MW capacity) and a project in Israel (9 MW capacity) (both 100% owned); the Company also owns 3 bio-gas facilities in the Netherlands with a capacity of 18 million m^3 gas (equivalent to approximately 19.0 MW); the Company also holds 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 acting to construct a pumped storage facility at Manara Cliff, with a capacity of 156 MW, which is approximately 83.84% owned by the Company. Currently, the controlling shareholders of the Company are Shlomo Nehama, Chairman of the Company (27.95%[6]), Kanir Limited Partnership (20.3%), whose General Partner is controlled by Ran Friedrich, who also serves as CEO of the Company, and Ms. Anat Refael and the estate of the Late Mr. Menachem Refael (1.98%). These controlling shareholders hold 50.2% of Company shares.

[6] Through S. Nehama Investments (2008) Ltd. and directly.

Rating history



Related Reports

Ellomay Capital Limited – Related Reports
Methodology report for rating of electricity companies and providers operating in markets with no arranged tariff, July 2020
Rating of fossil power stations and renewable energy – Methodology Report, February 2018
Rating financing for construction and operation of projects and infrastructure – Methodology Report – February 2018
Adjustments to financial statements and presentation of key financial benchmarks for corporate ratings – Methodology Report, May 2020
Guidelines for review of environmental, social and governance risk as part of credit ratings – Methodology Report, February 2022
Table of affinities and holdings
Midroog's rating scales and definitions

These reports are available on the Midroog website at www.midroog.co.il

General information

Rating report date:	August 9, 2022
Most recent rating revision date:	August 5, 2021
Initial rating date:	August 29, 2019
Rating initiated by:	Ellomay Capital Ltd.
Rating paid for by:	Ellomay Capital Ltd.

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