

**Rating Action: Moody's affirms Hera's Baa1 rating; negative outlook**

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London, 03 December 2013 -- Moody's Investors Service, ("Moody's") has today affirmed the Baa1 long-term issuer and senior unsecured ratings of Hera S.p.A., one of the largest multi-utilities in Italy. Concurrently, Moody's has also affirmed the provisional (P)Baa1 long-term rating on the company's euro medium-term note (EMTN) programme. The outlook on the ratings remains negative.

**RATINGS RATIONALE**

As a result of Moody's affirmation, Hera's rating remains one notch above that of the Italian sovereign (Baa2 negative). This reflects that, although Italy's weak macroeconomic environment, constrained public finances and some adverse regulatory measures have affected Hera's activities, the company has been able to mitigate their negative effects substantially as a result of its widely diversified business mix and its moderate exposure to cyclical activities.

The rating also factors in the ongoing improvement of Hera's credit metrics in 2013, following the company's acquisition of Acegas-APS, positive interim operating results (on a like-for-like basis, as well as including Acegas) and the EUR100 million capital increase completed in November 2013, in spite of the abovementioned challenging environment. However, Moody's notes a deterioration in Hera's net working capital, as a consequence of the macroeconomic decline seen in Italy and several one-off factors. While management is executing measures to stabilise and eventually reduce Hera's net working capital, Moody's cautions that an adverse evolution of working capital pressure would likely result in negative pressure on the ratings, if not counterbalanced with appropriate measures to sustain the company's credit positioning.

In addition, the rating takes into consideration Hera's external growth strategy. This targets small local utilities and is executed through share swap agreements with no recourse to additional debt, therefore preserving the company's balance sheet strength. Moody's also notes that, historically, the company has been able to extract synergies from acquired entities. The rating agency expects Hera to continue to pursue such a growth strategy, maintaining the same credit-supportive features.

Furthermore, Hera's Baa1 rating factors in (1) the company's strong liquidity position, recently reinforced by the issuance of a EUR500 million bond and the access to EUR200 million financing from the European Investment Bank; and (2) its sustainable debt structure, whose features include high duration, very limited refinancing needs for the next two to three years, and a level of leverage on assets and cash flows that is commensurate with Hera's business risk profile.

The rating affirmation factors in Moody's assumption that Hera will continue to strengthen its financial profile from current levels. Moody's expects the company to exhibit a funds from operations (FFO)/net debt ratio of at least 16% and a retained cash flow (RCF)/net debt ratio of around 12% in 2013, confirming the improvement on its historical levels. However, in order to support the current Baa1 rating over the medium term, Hera would need to exhibit FFO/net debt positioned at least in the upper teens in percentage terms, and RCF/net debt in the low teens.

**RATIONALE FOR NEGATIVE OUTLOOK**

The negative outlook on Hera's rating is in line with Moody's outlook on Italy's sovereign rating. This reflects Hera's exposure to the challenging economic situation in Italy and the additional pressures that it could exert on the company's financial and business risk profiles. The outlook also reflects Hera's weak, albeit improving, credit metrics relative to its current Baa1 rating and the risk that they could deteriorate to a level no longer consistent with the company's current rating positioning.

However, Moody's believes that the company retains a significant degree of flexibility in the context of its diversified business portfolio, investment plan and financial policies to potentially implement measures aimed at strengthening its financial profile.

**WHAT COULD CHANGE THE RATING UP/DOWN**

Given the negative outlook, Moody's does not expect upward rating pressure in the short term. Preconditions for Moody's to consider stabilising the current negative outlook on the company's rating would be financial metrics at levels commensurate with the guidance discussed above, associated with an improvement in the macroeconomic environment and a stabilisation of the outlook on the Italian sovereign rating.

Any deterioration in Italy's creditworthiness as captured by a downward movement in the Italian government's rating would likely result in a corresponding adjustment of Hera's rating. Moody's would also consider downgrading Hera's rating if (1) the company were unable to continue to improve its credit metrics in line with the guidance discussed above; (2) its liquidity profile deteriorated, or the projected recovery of a lower net working capital level failed to materialise; (3) the company's cyclical operations (waste treatment and energy sales) were significantly affected by a further deterioration of the Italian macroeconomic environment; or (4) new adverse regulatory changes or other unfavourable political actions materially affected Hera's activities.

## PRINCIPAL METHODOLOGY

Hera S.p.A.'s ratings were assigned by evaluating factors that Moody's considers relevant to the credit profile of the issuer, such as the company's (i) business risk and competitive position compared with others within the industry; (ii) capital structure and financial risk; (iii) projected performance over the near to intermediate term; and (iv) management's track record and tolerance for risk. Moody's compared these attributes against other issuers both within and outside Hera S.p.A.'s core industry and believes Hera S.p.A.'s ratings are comparable to those of other issuers with similar credit risk.

Hera is one of the largest integrated multi-utilities in Italy. The majority of Hera's shares, listed on the Milan stock exchange, are currently held by 186 different municipalities, the largest of which, the City of Bologna, owns approximately 10% of the company. Hera group operates mainly within Emilia Romagna region and, following the integration with the multi-utility Acegas-Aps also in the neighbouring provinces of Padua and Trieste. The group provides a variety of public services, including the sale and distribution of gas and electricity, the provision of integrated water services, urban and special waste collection, treatment and disposal services, as well as ancillary activities, such as district heating and public lighting.

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