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CREDIT OPINION
28 November 2022

Update

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RATINGS

Hera S.p.A.

Domicile	Bologna, Italy
Long Term Rating	Baa2
Type	LT Issuer Rating - Dom Curr
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Hera S.p.A.

Update following publication of Q3 results

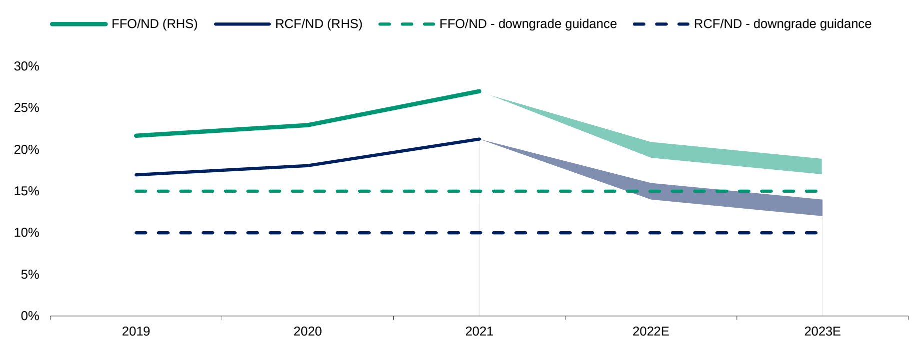
Summary

The credit profile of Hera S.p.A. (Hera, Baa2 negative) is supported by (1) the company's diversified business mix; (2) its portfolio of low-risk domestic fully regulated activities (37% of EBITDA in 2021), with limited price and volume exposure, and underpinned by supportive and transparent regulatory frameworks; (3) the contribution from quasi-regulated activities (10% of EBITDA in 2021) which support cash flow stability; (4) the company's strategy of growth through small and medium scale acquisitions mainly funded with exchange of shares; and (5) solid liquidity and financial profiles.

These positives are balanced by (1) the exposure to the credit profile of the Government of Italy (Baa3 negative), given that Hera generates all its earnings domestically; (2) Hera's exposure to the macroeconomic cycle and competitive pressure through its electricity & gas supply businesses and waste-treatment (around 43% of EBITDA in 2021); and (3) the exposure, although limited, of Hera's power generation (around 3% of EBITDA in 2021) and waste businesses to volatile power prices in Italy.

From a financial perspective, despite negative working capital dynamics that led to a temporary increase in net leverage, we expect Hera to maintain its current sound financial profile, illustrated by funds from operations (FFO)/net debt ratio around 20% in 2022-23.

Exhibit 1
Despite an increase in leverage, Hera's key credit metrics will remain solid in 2022-23



All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. 2022-23 metrics and ratios represent Moody's forward view and not the view of the issuer. RCF stands for retained cash flow and ND stands for net debt.
Source: Hera, Moody's Investors Service

The outlook on Hera was changed to negative from stable on 9 August 2022 following the outlook change to negative from stable on the Italian government's Baa3 debt rating.

Credit strengths

» Diversified business mix including a portfolio of low-risk domestic regulated networks, with limited price and volume exposure

» Contribution from quasi-regulated activities improves cash flow stability

» Credit-friendly strategy of external growth based on small and medium scale acquisitions funded through exchange of shares

» Solid financial and liquidity profiles

Credit challenges

» Exposure to potential changes in the Government of Italy's credit profile

» Exposure of unregulated businesses to the cyclical macroeconomic environment and to volatile power prices

» Planned liberalisation of the retail energy supply market in Italy will increase competition and could weigh on Hera's energy business margins

Rating outlook

The negative outlook reflects the company's linkages with the sovereign, given that all its earnings are generated in Italy and its consequent exposure to the macroeconomic risks associated with a weaker sovereign, in particular for its unregulated activities.

Factors that could lead to an upgrade

» An upgrade of the Government of Italy's rating; and

» Hera maintaining its current underlying credit profile, reflected in funds from operations (FFO)/net debt above the high teens and retained cash flow (RCF)/net debt above the low teens, both in percentage terms, and a good liquidity position.

Factors that could lead to a downgrade

» A downgrade of the Government of Italy's rating

» A structural deterioration in Hera's own credit profile as might be illustrated, for example, by a weakening of its financial ratios, including FFO/net debt below the mid-teens or RCF/net debt below the low double digits, both in percentage terms

» A deterioration in Hera's business risk profile as a result of its growth strategy, with no offsetting strengthening in its credit metrics

Key indicators

Exhibit 2
Hera S.p.A.

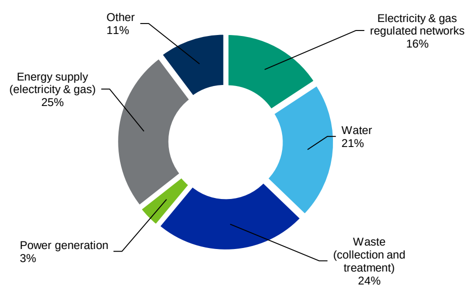
	2018	2019	2020	2021	2022E	2023E
FFO interest coverage	7.4x	8.2x	10.0x	13.0x	7.0x - 8.0x	6.0x - 7.0x
FFO / Net Debt	23.2%	21.7%	22.9%	27.0%	19.0% - 21.0%	17.0% - 19.0%
RCF / Net Debt	18.0%	17.0%	18.1%	21.3%	14.0% - 16.0%	12.0% - 14.0%

(1) All figures and ratios are calculated using Moody's standard adjustments. (2) Ratios for 2022-23 represent Moody's forward view and not the view of the issuer.
Source: Moody's Investors Service

Profile

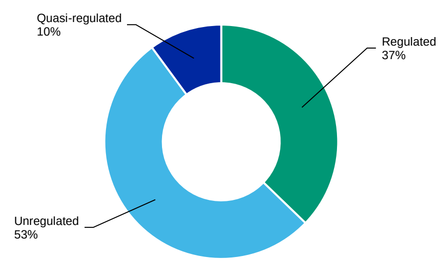
Hera S.p.A. (Hera) is one of the largest multi-utilities in Italy. 46% of the company's share capital is held by 111 municipalities, the largest of which is the City of Bologna (around 9%). Hera has a strong territorial presence in the region of Emilia Romagna and more generally in the northeast of Italy. The company has a diversified and vertically integrated portfolio of public utility services, which includes regulated water and energy networks, waste collection, treatment and energy from waste generation activities, gas and electricity retail sales, as well as ancillary activities such as district heating and public lighting. In 2021, Hera reported consolidated revenue of €10,955 million and EBITDA of €1,224 million.

Exhibit 3
Hera's EBITDA breakdown (2021)



Source: Hera, Moody's Investors Service

Exhibit 4
EBITDA split regulated/unregulated (2021)



Regulated activities mainly include integrated water services and gas & electricity networks. Quasi-regulated covers public lighting, waste collection and district heating.
Source: Hera, Moody's Investors Service

Detailed credit considerations

Hera's credit profile is constrained by its exposure to Italy

Hera's rating is positioned one notch above that of Italy because of the company's limited reliance on domestic funding sources, resilience to economic cycles and our expectation that government interference will not significantly hurt Hera's cash flow (see Assessing the impact of Sovereign Credit Quality on Other Ratings, published in June 2019).

Negative working capital dynamics led to a temporary increase in net leverage

Ad of 30 September 2022, Hera's reported net financial debt increased by around €1.2 billion (+27% vs. September 2021), translating into a Net Debt/EBITDA ratio of around 3.6x (previously 2.8x, as of 30 September 2021). The increase was largely driven by a negative working capital effect (around €1.1 billion) resulting from (1) a higher value of gas storage (around €820 million cash outflow since 1 January) and (2) higher receivables from the sale of electricity.

Hera's gas storage reserves are fully hedged against price fluctuations and we expect the negative effect on working capital, and thus cash flow generation, to revert over the next six months. We anticipate that the seasonal increase in gas consumption during the winter and a good track record of payments collection will help to improve the company's key credit metrics, which will be also sustained by the good operating performance across other business segments (mainly water, networks and waste management). Accordingly, we expect Hera's FFO/net debt ratio to hover around 20% over the next twelve months, comfortably in line with the ratio guidance commensurate with the current rating.

Increasingly established regulatory framework for integrated water activities supports earnings stability

Hera's integrated water activities, together with its gas and electricity distribution businesses, accounted for 37% of its consolidated EBITDA in 2021. The revenues generated by these activities are fully regulated by the Autorità di Regolazione per Energia Reti e Ambiente (ARERA) through similar capital remuneration and cost recovery mechanisms. The regulatory frameworks applicable to Italian water operators and energy distribution networks are stable and transparent, supporting the predictability of Hera's revenues and cash flows. The regulatory frameworks also leave the company exposed to little or no volume risk.

More specifically, water distribution activities accounted for around 21% of Hera's consolidated EBITDA in 2021. These activities benefit from a regulatory framework (Metodo Tariffario Idrico, MTI) which is similar to the well-established regulations that ARERA applies to Italy's electricity and gas networks (see below). The third regulatory period (MTI-3) for water distribution activities started in January 2020 and extends over four years, with two interim periods (2020-21 and 2022-23). The update of the tariff methodology for MTI-3 of December 2019 was based on principles of continuity with the previous MTI-1 and MTI-2 (see Regulator's final determination is credit neutral for Italian water networks). Among others, MTI-3 continues to allow for a full recovery of efficient operating expenses and an annual revision of the allowance for non-controllable costs incurred by the operators.

The latest MTI-3 interim regulatory update of 30 December 2021 (valid for the 2022-23 period) is consistent with the regulator's historical approach and continues to support the full recovery of invested capital and efficient operating costs. Among others, the ARERA confirmed the tariff remuneration of sludge disposal costs and introduced some mitigating measures to account for the recent increase in the costs of electricity incurred by water operators[1]. The interim determination also confirmed the formula to calculate the allowed return on the capital invested (RAB remuneration) whilst updating some of the formula parameters. In particular, (1) the real risk free rate was reduced to 0.13% (from 0.5%), to align with the latest regulatory determination for electricity and gas grids; (2) the Water Risk Premium was confirmed at 1.7% and (3) the debt risk premium was revised downward to 2.4%, (from 2.77% under the previous MTI-3 interim regulatory period). These changes translate into a 44 basis points reduction in the allowed return to 4.8% from 5.24% and will result in lower allowed revenue of €6-8 million per annum over 2022-23, which is considered negligible in comparison to the company´s total revenue (less than 0.1%).

With the beginning of MTI-3 in January 2020, additional provisions that the ARERA issued in previous years also started to apply. Among these, a new incentive mechanism related to the technical quality of the service provided allocates[2] bonuses or penalties to the water operators based on the achievement of specific and general standards (i.e. amount of leakages in the network, water quality etc.) over a two-year period. On 29 April 2022, through resolution 183/2022/R/idr, ARERA communicated the bonuses and penalties applicable to the water operators based on the technical standards achieved in 2018-19. For Hera, these corresponded to a €22.8 million bonus which, coupled with the regulatory tariff increases, helped to mitigate the effects on profitability of rising energy and raw material costs.

Moving forward, we expect Hera to continue investing in its water networks in line with its strategic plan, thus supporting future tariff increases and the profitability of its regulated water business.

Regulated energy networks also offer visibility into future cash flow in the context of well-tested regulatory framework
Hera's electricity and gas distribution networks accounted for around 16% of its consolidated EBITDA in 2021.

The fifth six-year tariff cycle for gas distribution activities started in January 2020 and it is essentially in line with the previous regulatory periods, albeit with a reduction in the allowance for efficient operating costs for distribution services and tightened levels of efficiency requirements. Similarly, the new four-year regulatory semi-period for electricity distribution networks started in 2020. In this case too, the approved measures are fundamentally in line with the methodology used in the first semi-period (2016-19), with the introduction of a net revenue sharing mechanism and an update of the bonus scheme for service quality.

On 23 December 2021, ARERA published its final resolution on the criteria for determining and updating the WACC over 2022-27. The final resolution followed two consultations on the subject, held in July and November 2021 (see Lower returns will likely weaken credit metrics from 2022 and Second regulatory consultation points to a progressively lower WACC). The regulator validated a methodology exhibiting broad continuity with the historical approach, with the main adjustments reflecting a progressive implementation of parameters that more closely reflected the macroeconomic environment prevailing at the time of the regulatory update, characterised by low yields. For gas distribution, allowed returns were reduced by 70 basis points (bps) between 2021 and 2022 (from 6.3% to 5.6%). For electricity distribution, allowed returns were reduced by 70 basis points (bps) between 2021 and 2022 (from 5.9% to 5.2%). Overall, the regulator decided to implement this new, less-generous cost-of-debt approach in a progressive manner, moderating the decline of the WACC in 2022-24 versus the 2021 level, but with a further WACC reduction (of around 30 bps) during 2025-27, assuming the macroeconomic parameters remain broadly unchanged. However, the WACC level can be revised in 2023 and 2024 according to a trigger mechanism.

Potentially offsetting some of the negative impact, in June 2021, the Italian regulator published a consultation that starts the process to implement a total expenditure system for the electricity and gas grids from 2024 and 2026, respectively. The consultation process is likely to be completed by year-end 2022. The credit implications of the potential shift to a total expenditure system are unclear at this stage.

During the first three quarters of 2022, the company reported an EBITDA of around €127 million for its gas and electricity distribution activities. This represented a small decrease (-1.8%) compared with the same period of 2021, mainly driven by the reduction in the regulatory remuneration. Looking ahead, we expect that Hera will continue to invest in its energy networks with a focus on digitalization and metering services.

Exhibit 5
Summary of regulatory frameworks applicable to Hera's energy and water distribution businesses

	Water distribution	Electricity distribution	Gas distribution
Regulatory body	ARERA	ARERA	ARERA
		Independent authority, 7-year mandate. 2/3 majority vote by Parliament required to appoint board members	
Start of regulatory period	Jan-20	Jan-16	Jan-20
End of regulatory period	Dec-23	Dec-23	Dec-25
Length of regulatory period	4-year period divided in two interim periods (2020-21 and 2022-23)	8-year period divided in two interim periods (2016-19 and 2020-23)	6-year period divided in two interim periods (2020-22 and 2023-25)
Teriff-setting framework	Price-cap with incentives	Price-cap with incentives	Price-cap with incentives
Incentives	Incentives on quality of service provided (inc. environment sustainability)	Incentives on investments and quality of service provided	
Volume exposure	No long term exposure given ex post volume correction	No long term exposure given ex post volume correction	No long term exposure given ex post volume correction
RAB calculation	Re-evalued historical cost: RAB adjusted for inflation annually	Re-evalued historical cost: RAB adjusted for inflation annually	Re-evalued historical cost: RAB adjusted for inflation annually
Allowed return on capital (real pre-tax) (1)	4.8%	5.2%	5.6%
Next rewiew of allowed return on capital	Dec-23	Dec-24	Dec-25
Time lag on investments/D&A	2 years (investments and D&A)	1 year on investments, 2 years on D&A	1 year
Time lag compensation on WACC	1%	0%	0%
Total RAB (2021)		€ 3.05 billion	

Source: Hera, ARERA, Moody's Investors Service

The process for the reorganisation of Italy's gas distribution districts kicked off in 2016 and is proceeding at a pace slower than expected. In particular, the number of tenders awarded nationwide is still small and several of the awarded tenders were subsequently subject to appeal. Hera confirmed its intention to participate in tenders where it is already the incumbent operator, thus limiting potential execution risk. However, new tenders will be subject to delays and the company's latest business plan of January 2022 includes low investments allocated to new gas tenders during 2022-24 and potentially higher amount (around €119 million) in 2025.

Energy supply segment faces increasing risks

We estimate that almost 25% of Hera's consolidated EBITDA in 2021 came from natural gas and electricity sales and trading businesses. We consider these activities as exhibiting a high risk profile because the company is exposed to volume and price fluctuations owing to the cyclical macroeconomic environment and market competition. Wholesale gas and electricity prices in Italy have risen materially since the start of the Russia-Ukraine conflict in February 2022.

In the gas segment, Hera has a significant presence, with around 3.4 billion cubic meters (bcm) of gas sold in 2021 (excluding Ascopiave) to retail, industrial and commercial customers and a total of 2.1 million clients served (-0.2% increase compared to whole-year 2020). Around 17.5% of Hera's gas sales (excluding distribution activities) are under regulated retail tariffs, which are set by ARERA and are linked to gas spot prices, while the remaining 82.5% are sold in the liberalised market where retail prices are generally determined in relation to reference market prices.

During the first nine months of 2022, EBITDA from Hera's gas supply activities rose by nearly 24% compared with the same period in 2021. The positive trend was driven by (1) the award of last resort tenders; (2) small scale acquisitions; and (3) higher margins from trading activities. More specifically, in September 2021 the company was selected as preferred provider of last resort gas services (for public customers without a supplier) for two years until September 2023. The award contributed to the 16% year-on-year increase of total gas sold in the nine months to September 2022, with a 135% increase in volumes sold to public administrations. In Italy, last resort markets (as well as protected markets) include an equalisation component covering incremental volumes which works as a compensatory measure for the higher purchasing cost of raw material. This provision helps to protect Hera's gas supply margins from highly volatile market conditions. Additionally, in the liberalised market, the company's exposure to volatile spreads and prices is mitigated by its short-term/spot gas procurement strategy.

Hera has also a strong presence in the electricity segment, with 11.71 terawatt hours (TWh) sold in 2021 to retail, industrial and commercial customers (1.4 million in total). The profitability of Hera's electricity supply business is more exposed to volatile prices and volumes than the gas supply business. As a consequence, in the nine months to September 2022, the prolonged volatility in the Italian electricity market led to a 79% decrease (-€81.4 million) in the divisional EBITDA in comparison to 2021. The reduction was driven by unfavorable timing mismatches between purchases/sales of electricity and modulation costs in the context of highly volatile power prices. More positively, Hera continues to benefit from a resilient customer base, with total unpaid ratio at around 1%.

In future, Hera's supply margins could be also hit by increased market competition because regulated electricity and gas retail tariffs for residential customers in Italy are due to be phased out from January 2024. Further delays to full liberalisation cannot be ruled out though given the history of repeated postponements. Nevertheless, we expect the potential margin reduction to be at least partly offset by (1) Hera's growing customer base; (2) the solid track record of synergies extraction; and (3) the positive contribution from energy-related services (e.g. facade insulation interventions), anticipated to continue through at least 2023. Furthermore, we expect that the company will continue to participate in the tenders for last resorts markets, however we anticipate lower margins and a reduced EBITDA contribution from these services due to the increased competition in the tenders for the reassignment of these contracts.

Waste management is exposed to cyclical macro-economic conditions, although the regulated nature of the domestic waste treatment market mitigates volume and price risks

Hera's environmental activities (24% of 2021 consolidated EBITDA) are split between treatment of urban and industrial volumes (18% of EBITDA in 2021) and collection (6% of EBITDA in 2021). The company operates in the entire waste cycle with 99 plants used for municipal and special waste treatment as well as plastic recycling.

Waste treatment activities expose the company to the cyclical macroeconomic environment and, to a lesser extent, to volatile power prices in Italy through the electricity produced from its waste to energy (WTE) plants (around 0.8 TWh of power generated in 2021). However, potential volume fluctuations are somewhat mitigated by the increasingly regulated nature of the waste treatment market in Italy, which is now subject to a RAB-based remuneration and to a cap for annual tariff growth (see highlighted box below).

The company also relies on a solid urban waste collection base, which is a natural upstream contributor to waste treatment activities. Collection activities reduce the overall risk of this segment. This is because the waste collection business in Italy is performed under concessions assigned by local authorities through tenders. Furthermore, the introduction of a new regulatory framework for waste collection activities by ARERA in January 2020 (which took over the responsibility to oversee the sector in 2018) will increase in the medium-term the share of Hera's regulated activities, a credit positive.

In the first nine months of 2022, the EBITDA of Hera's waste management division (treatment and collection) grew by €27.8 million (+12.7%) compared with the same period of 2021. This was mainly driven by the increase in the price of waste treated, by-products and energy sold from WTE. These positive dynamics were partly offset by higher costs of raw materials (including chemicals) and a slowdown of manufacturing activities during the period, which reduced waste volumes.

Looking ahead, we believe that the fragmented and under-supplied waste treatment market in Italy increases the potential for Hera to reach its target of 5.0 total million tonnes treated in 2025 (from 4.6 million tonnes in 2021, excluding M&A and by-products). This target mainly relies upon increasing market share in the northeastern regions and capturing part of the intra-regional waste flows from southern and central Italy. In recent years Hera has been pursuing a strategy of vertical integration and expansion through small and medium scale acquisitions that contributed to the growth of its waste business. As an example, in 2017 the company acquired the 80% of Aliplast, operating in plastic recycling. and in 2019 finalized the full acquisition of Cosea Ambiente, a company managing urban and assimilated waste services in the province of Bologna. More recently, in November 2022 Hera announced the acquisition of 60% of A.C.R., one of Italy's largest companies in the reclamation sector. In 2021 A.C.R. generated around €17 million EBIITDA and its full consolidation is expected during 2023.

ARERA's new regulatory framework for waste activities enhances predictability but precise impact still difficult to quantify

With resolution 443/2019/R/rif of 31 October 2019[3], ARERA approved the first waste tariff method (MTR-1) for the period 2018-21. The new regulation is implemented under principles similar to those applied to more established regulated activities such as energy networks and water services. In particular, the regulation recognizes a RAB-base remuneration system, the recognition of regulatory opex and a soft cap on annual tariff increases based on an asymmetric approach which acknowledges the uneven level of efficiency of waste management activities across Italian regions.

The new method also identifies the activities of the integrated waste management service that are subject to regulation. For the initial period (2020-21), these activities included waste collection services and some treatment activities (mainly disposal or recovery) that are integrated in the operators' corporate perimeter. For these activities, the regulator has set a RAB remuneration with a real pre-tax WACC of 6.3%.

In this context, on 3 August 2021 ARERA published the final ruling for the second regulatory period (MTR-2) covering a four-year regulatory period (2022-25)[4]. Among others, the regulator confirmed the general framework of MTR-1, including the recognition of regulatory opex based on a two-year lag and a WACC-based RAB remuneration (WACC is currently being defined). ARERA also clarified that the regulation currently does not apply to non-integrated operators that manage non-essential treatment plants ("*impianti aggiuntivi*"). The region of Emilia-Romagna, where the majority of Hera's treatment plants are concentrated, defines the majority of its urban waste treatment plants as essential ("*impianti minimi essenziali")*, thus the new regulatory framework is applicable to Hera's treatment activities.

Notwithstanding some uncertainties around the precise impact of the regulatory framework to Hera's waste treatment activities, we continue to see positively the authority's efforts to provide regulatory stability and promote efficiency in the management of the waste cycle services. More broadly, while historical sector margins might be under threat from the introduction of a regulatory framework, the regulation could enhance the predictability of Hera's waste earnings.

Power generation is exposed to volatile power prices

Hera's power generation activities expose the company to volatile power prices in Italy, although this exposure is limited by their small weight (around 3% of the company's 2021 EBITDA). We note that in addition to the power generated through its WTE plants, in 2021 Hera produced more than 0.6 TWh of electricity through its cogeneration and renewable plants capacity.

As of 30 September 2022 the EBITDA contribution from power generation activities was down by €11 million (-10.7%) compared with the same period of 2021. This trend was driven by the normalization of dispatching services (Mercato servizi dispacciamento [MDS]), following the very strong performance during the same period in 2021. Over the next twelve months, we expect high wholesale electricity prices to support the profitability Hera's power generation activities. However, government interventions to address affordability, including the extraordinary levy approved in March 2022 (see Extraordinary levy is credit neutral, but points to increasing political risks) and the recent revision of the windfall taxation on energy companies[5], coupled with a weakening demand of electricity, will offset this effect.

Hera's plan to 2025 leaves business risk broadly unchanged and supports financial flexibility

In January 2022 Hera updated its five-year business plan (2021-2025) targeting EBITDA of €1.4 billion by 2025, implying an increase of around 15% from 2021. This growth will be underpinned by €3.8 billion of investments through 2025 (€600 million higher than under the previous five-year plan 2020-2024) mostly directed towards regulated activities (approximately 53%, excluding waste treatment). Around 53% of the total planned capital spending is earmarked for maintenance, while the rest focuses on organic development (€1.3 billion, +76% versus previous plan), gas tenders (€159 million, +20% versus previous plan) and M&A (€312 million, +108% versus previous plan).

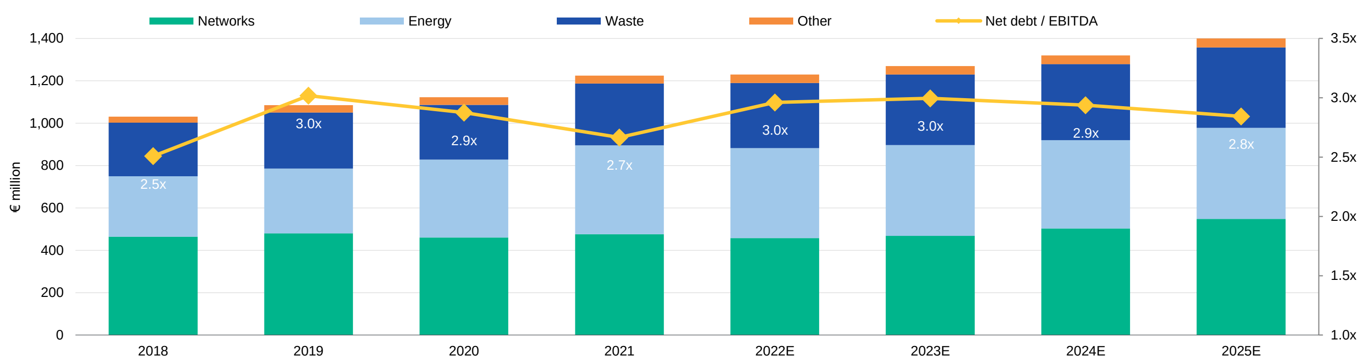
The key levers that management expects to help Hera achieve EBITDA of €1.4 billion by 2025 are (1) organic growth, amounting to around €192 million up to 2025, driven by regulated tariff increases, efficiencies and positive dynamics in the waste treatment segment and (2) small and medium scale credit-friendly M&A, contributing €100 million EBITDA by 2025, largely directed towards the waste and energy segments.

Among others, the additional top-line growth will be sustained by an increase in waste treatment capacity (WTEs, biomethane) and the development of new energy supply services. Furthermore, efficiencies could be achieved through predictive networks maintenance, digitalization of operations and a reduction in the cost to serve for energy customers.

The share of Hera's EBITDA generated by fully unregulated activities is expected to decrease over time because of future investments in regulated water and energy networks and the full roll out of ARERA's new regulation for integrated waste services. At the same time, the renewed focus on commercial activities and the delays in the participation to gas tenders will partly slow down the shift towards regulated activities. Overall, regulated activities (including integrated waste services and district heating) are anticipated to contribute to more than two-thirds of Hera's projected consolidated EBITDA in 2025.

Exhibit 6

Hera's business plan 2021-25: planned EBITDA growth (3.4% CAGR) and reported net debt/EBITDA evolution
Published January 2022



(1) Net debt/EBITDA includes the full consolidation of financial debt coming from M&A targets but excludes additional investments to seize new opportunities. (2) The evolution of leverage is calculated starting from Hera's 2021 reported net debt/EBITDA including the put option related to the Ascopiave deal.
Sources: Hera, Moody's Investors Service

We expect that Hera's strategic plan to 2025 plan will support its current credit profile. Notably, we expect that the company will maintain FFO/net debt at around 20% and RCF/net debt at around 15%.

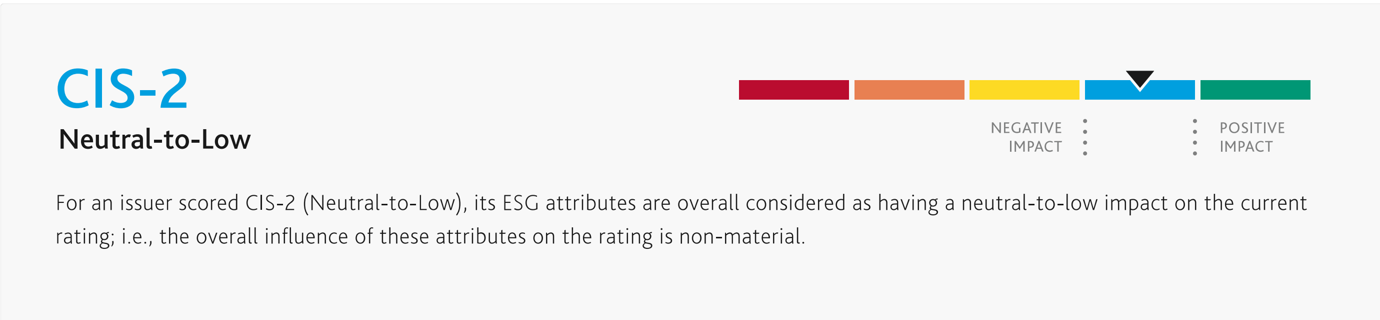
Consolidation strategy remains creditor friendly

The high degree of voting rights fragmentation, resulting from Hera's ownership by more than 100 local municipalities, has historically prevented any major shareholder interference in the company's corporate strategy. This ownership structure has favoured the execution of a balanced financial policy over the years, based on growth through small and medium-scale acquisitions mainly financed through share exchanges and ensured the company's stable dividend policy. Hera's strategy of external growth has created a solid track record of synergy extraction from the acquired entities, which positions the company well to achieve additional synergies in future.

ESG considerations

Hera S.p.A.'s ESG Credit Impact Score is Neutral-to-Low CIS-2

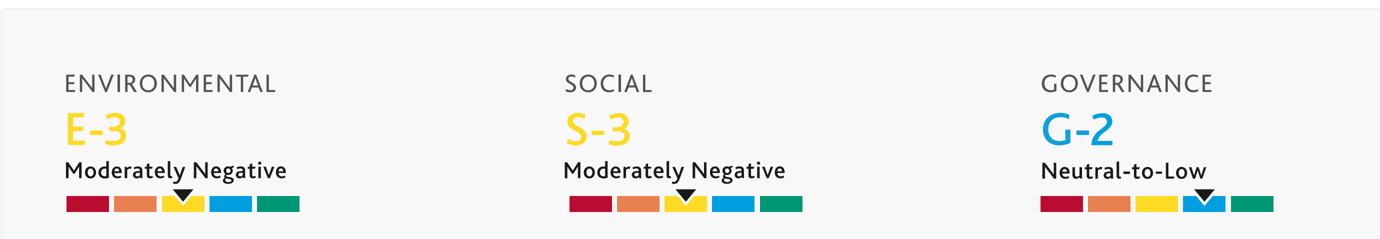
Exhibit 7
ESG Credit Impact Score



Source: Moody's Investors Service

Hera's ESG Credit Impact Score is neutral/low (**CIS-2**) because its rating is constrained by that of the Government of Italy and ESG considerations dot not currently materially influence the rating.

Exhibit 8
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

Hera's environmental risk is moderately negative (**E-3** issuer profile score), reflecting the exposure of the company's distribution assets to physical climate risks (e.g. water stress). However, the low share of consolidated EBITDA from power generation activities (around 3% as of December 2021, excluding renewables) translates in low to neutral exposure to carbon transition risks. In addition, the group has neutral to low risk exposure from water management, waste & pollution and natural capital risks.

Social

We assess Hera's social risk as moderately negative (**S-3** issuer profile score) reflecting its exposure to the risk that public concern over environmental, social or affordability issues could lead to adverse regulatory or political intervention, similar to other regulated network operators. These risks are balanced by neutral to low risks to health and safety, human capital, customer relationships and responsible production

Governance

Hera's governance risks are neutral/low (**G-2** issuer profile score). The score considers the track record of sound financial and liquidity management as well as the consistent achievement of synergies from consolidation activities. In addition, the assessment reflects management credibility and low to neutral exposure to organization structure risks.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

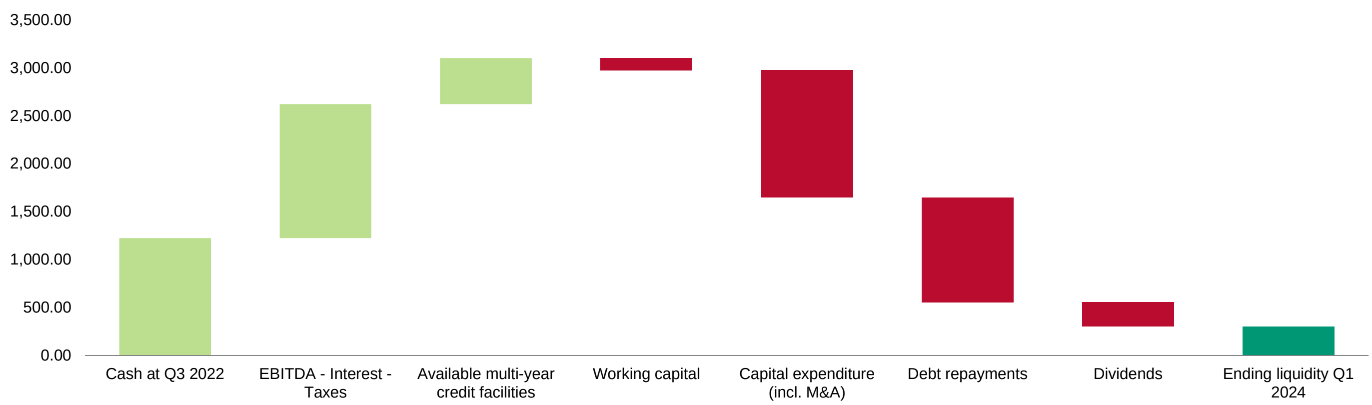
Liquidity analysis

As of September 2022, Hera had strong liquidity, backed by around €1,225 million in cash and cash equivalents and €480 million of committed credit lines. All the committed credit lines are currently undrawn and available until 2027. These lines benefit from the absence of any financial covenant and material adverse change clauses.

We expect Hera's cash, available committed lines and internal cash flow generation to be sufficient to cover its liquidity needs over the next eighteen months (including working capital, debt repayments, investments and dividends), as evidenced in the exhibit below.

Exhibit 9

We expect Hera's cash availability to cover its liquidity needs
Liquidity as of September 2022, € million

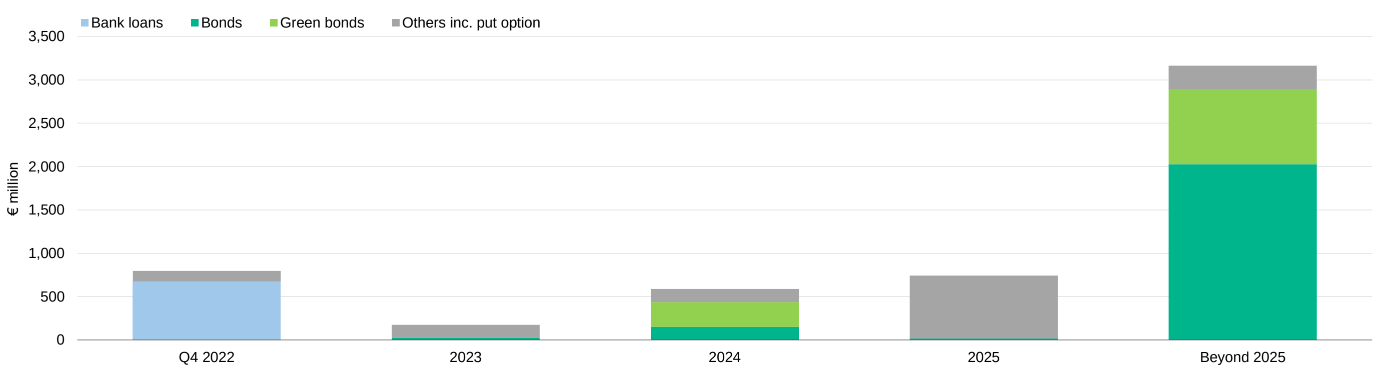


Source: Hera, Moody's Investors Service

As of September 2022, Hera's reported net financial debt was around €4.5 billion with an average maturity of approximately six years. The debt increase compared with the same period of 2021 (+27%) is mainly driven by the material working capital absorption (€1.1 billion) reflecting the higher value of gas storage and higher receivables from the sale of electricity. The company's latest bond issuance was in May 2022, when a €500 million sustainability-linked bond was issued, with a maturity in May 2029.

Exhibit 10

Hera's reported debt maturity profile as of September 2022



Source: Hera, Moody's Investors Service

Rating methodology and scorecard factors

When assessing Hera's standalone credit profile, we apply our rating methodology for Unregulated Utilities and Power Companies, published in May 2017.

Given its public shareholder base, Hera also falls within the scope of our Government-Related Issuers rating methodology, published in February 2020. However, given the limited capacity of its public shareholders to provide support to the company in a scenario of financial distress, the rating does not incorporate any uplift to Hera's standalone credit quality (or Baseline Credit Assessment [BCA]) for potential government support.

Exhibit 11

Methodology grid

Unregulated Utilities and Unregulated Power Companies Industry [1][2]	Current FY 12/31/2021		Moody's 12-18 Month Forward View As of November 2022 [3]	
Factor 1 : Scale (10%)	**Measure**	**Score**	**Measure**	**Score**
a) Scale (USD Billion)		Baa		Baa
Factor 2 : Business Profile (40%)				
a) Market Diversification		Ba		Ba
b) Hedging and Integration Impact on Cash Flow Predictability		Ba		Ba
c) Market Framework & Positioning		Baa		Baa
d) Capital Requirements and Operational Performance		Baa		Baa
e) Business Mix Impact on Cash Flow Predictability		Aaa		Aaa
Factor 3 : Financial Policy (10%)				
a) Financial Policy		Baa		Baa
Factor 4 : Leverage and Coverage (40%)				
a) (CFO Pre-W/C + Interest) / Interest (3 Year Avg)	10.3x	A	6.5x - 7.5x	Baa / A
b) (CFO Pre-W/C) / Net Debt (3 Year Avg)	23.9%	Baa	18.0% - 20.0%	Ba / Baa
c) RCF / Net Debt (3 Year Avg)	18.8%	Baa	13.0% - 15.0%	Ba / Baa
Rating:				
a) Scorecard-Indicated Outcome		Baa1		Baa2 / Baa3
b) Actual Baseline Credit Assessment Assigned				baa2
Government-Related Issuer				**Factor**
a) Baseline Credit Assessment				baa2
b) Government Local Currency Rating				Baa3
c) Default Dependence				Moderate
d) Support				Low
e) Actual Rating Assigned				Baa2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] All figures and ratios shown do not include the adjustment related to Hera's securitisation of receivables as the company does not disclose such amounts. [3] This represents Moody's forward view, not the view of the issuer
Source: Moody's Financial Metrics™

Ratings

Exhibit 12

Category	Moody's Rating
HERA S.P.A.	
Outlook	Negative
Issuer Rating -Dom Curr	Baa2
Senior Unsecured	Baa2

Source: Moody's Investors Service

Appendices

Exhibit 13

Hera S.p.A.
Adjusted net debt calculation

(in EUR million)	FYE Dec-18	FYE Dec-19	FYE Dec-20	FYE Dec-21
As Reported Total Debt	3,296	3,701	4,235	4,146
Pensions	115	112	102	94
Leases	83	0	0	0
Non-Standard Adjustments	(29)	(14)	0	0
Moody's Adjusted Total Debt	3,466	3,799	4,337	4,240
Cash & Cash Equivalents	(536)	(364)	(987)	(886)
Moody's Adjusted Net Debt	2,930	3,435	3,350	3,354

(1) All figures and ratios are calculated using Moody's estimates and standard adjustments. (2) All figures and ratios shown do not include the adjustment related to Hera's securitisation of receivables as the company does not disclose such amounts. (3) Non-Standard Public Adjustments include the reclassifications of fair value hedges and guarantees.
Source: Moody's Investors Service

Exhibit 14
Hera S.p.A.
Selected historical financial data

(in EUR million)	FYE Dec-18	FYE Dec-19	FYE Dec-20	FYE Dec-21
INCOME STATEMENT				
Revenue	6,134	6,913	7,079	10,555
EBITDA	919	1,081	991	970
EBIT	524	652	534	500
Interest Expense	106	104	82	75
Net income	293	411	316	347
BALANCE SHEET				
Net Property Plant and Equipment	2,084	2,087	2,020	2,041
Total Assets	9,135	10,322	11,035	14,032
Total Debt	3,466	3,799	4,337	4,240
Cash & Cash Equivalents	536	364	987	886
Net Debt	2,930	3,435	3,350	3,354
Total Liabilities	6,474	7,514	8,074	10,831
CASH FLOW				
Funds from Operations (FFO)	679	744	772	906
Cash Flow From Operations (CFO)	632	730	891	1,045
Dividends	151	162	163	193
Retained Cash Flow (RCF)	527	583	609	713
Capital Expenditures	(474)	(552)	(529)	(611)
Free Cash Flow (FCF)	6	16	200	241
INTEREST COVERAGE				
(FFO + Interest Expense) / Interest Expense	7.4x	8.2x	10.4x	13.0x
LEVERAGE				
FFO / Net Debt	23.2%	21.7%	23.0%	27.0%
RCF / Net Debt	18.0%	17.0%	18.2%	21.3%
Debt / EBITDA	3.8x	3.5x	4.4x	4.4x
Net Debt / EBITDA	3.2x	3.2x	3.4x	3.5x

(1) All figures and ratios are calculated using Moody's estimates and standard adjustments. (2) All figures and ratios shown do not include the adjustment related to Hera's securitisation of receivables as the company does not disclose such amounts.
Source: Moody's Investors Service

Exhibit 15
Hera S.p.A.
Adjusted Funds from Operations calculation

(in EUR million)	FYE Dec-18	FYE Dec-19	FYE Dec-20	FYE Dec-21
As Reported Funds from Operations (FFO)	755	872	854	998
Leases	10	0	0	0
Alignment FFO	3	(47)	2	3
Non-Standard Adjustments	(89)	(81)	(83)	(94)
Moody's Adjusted Funds from Operations (FFO)	679	744	772	906

(1) All figures and ratios are calculated using Moody's estimates and standard adjustments. (2) Non-Standard Public Adjustments include the reclassification of bad debt provisions.
Source: Moody's Investors Service

Exhibit 16
Hera S.p.A.
Peer comparison

	Hera S.p.A. Baa2 Negative			ACEA S.p.A. Baa2 Negative			A2A S.p.A. Baa2 Negative		
(in EUR million)	FYE Dec-19	FYE Dec-20	FYE Dec-21	FYE Dec-19	FYE Dec-20	FYE Dec-21	FYE Dec-19	FYE Dec-20	FYE Dec-21
Revenue	6,913	7,079	10,555	3,022	3,205	3,816	7,122	6,655	11,352
EBITDA	1,081	991	970	893	1,023	1,137	1,205	1,118	1,353
Total Assets	10,322	11,035	14,032	8,954	9,674	10,629	10,725	12,226	18,008
Total Debt	3,799	4,337	4,240	4,285	4,653	5,149	3,770	4,645	5,204
Net Debt	3,435	3,350	3,354	3,449	4,011	4,469	3,336	3,633	4,240
FFO / Net Debt	21.7%	23.0%	27.0%	21.8%	22.5%	21.5%	28.8%	28.5%	27.5%
RCF / Net Debt	17.0%	18.2%	21.3%	19.7%	20.2%	19.3%	21.9%	21.5%	21.3%
(FFO + Interest Expense) / Interest Expense	8.2x	10.4x	13.0x	9.2x	11.5x	12.4x	8.6x	11.7x	14.4x
Debt / Book Capitalization	54.6%	57.0%	54.4%	67.0%	66.7%	67.2%	50.8%	53.0%	54.7%

(1) All figures and ratios are calculated using Moody's estimates and standard adjustments. (2) Hera and ACEA's figures and ratios do not include the adjustment related to the companies' securitisation of receivables, given the lack of publicly available data.
Source: Moody's Investors Service

Moody's related publications

Industry Outlook

» Regulated electric and gas networks - Europe: 2022 outlook stable, with limited changes to key regulatory parameters, 10 January 2022

» Unregulated electric and gas utilities - EMEA: 2022 outlook stable as intervention risk, high capex overshadow earnings growth, 9 December 2021

Sector In-Depth

» Europe's electricity markets: Tight supply will keep power prices high and prompt further government intervention (slides), 16 November 2022

» Europe's electricity markets - Italy: In Italy, higher power prices support decarbonisation ambition (slides), 30 November 2021

Sector Comment

» Unregulated electric and gas utilities - Italy: Extraordinary levy is credit neutral, butpoints to increasing political risks, 25 March 2022

Rating Action

» Moody's changes outlook to negative on nine Italian utility issuers and on Endesa, 9 August 2022

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 Later, these measures have been extended by the resolution 229/2022/R/Idr

2 Resolution 917/2017/R/IDR, 27 December 2017, "Regolazione della qualità tecnica del servizio idrico integrato ovvero di ciascuno dei singoli servizi che lo compongono (RQTI).

3 See Definizione dei criteri di riconoscimento dei costi efficienti di esercizio e di investimento del servizio integrato dei rifiuti per il periodo 2018-2021

4 See Approvazione del metodo tariffario rifiuti (MTR-2) per il secondo periodo regolatorio 2022-2025

5 DISEGNO DI LEGGE: Bilancio di previsione dello Stato per l'anno finanziario 2023 e bilancio pluriennale per il triennio 2023 - 2025, Novembre 2022

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