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CREDIT OPINION
27 December 2023

Update

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RATINGS

Hera S.p.A.

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

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 outlook change to stable

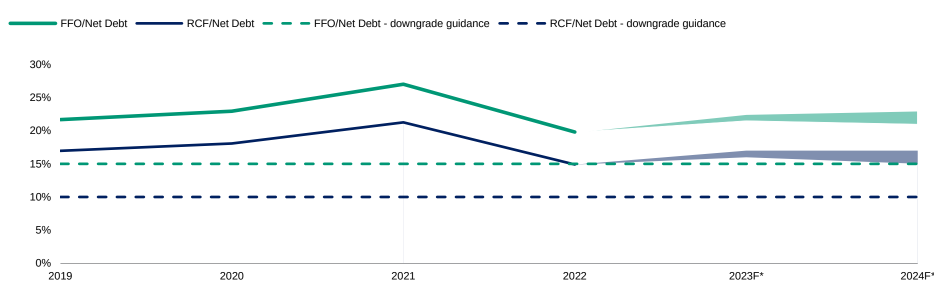
Summary

The credit profile of Hera S.p.A. (Hera, Baa2 stable) is supported by (1) the company's diversified business mix; (2) its portfolio of low-risk domestic fully regulated activities (37% of EBITDA in 2022), 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 2022) which supports 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 stable), 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 42% of EBITDA in 2022); and (3) the exposure, although limited, of Hera's power generation (around 2% of EBITDA in 2022) and waste businesses to volatile power prices in Italy.

From a financial perspective, we expect Hera to maintain its current sound financial profile, illustrated by funds from operations (FFO)/net debt ratio above 20% in 2023-24.

Exhibit 1
Hera's key credit metrics will remain solid in 2023-24



All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Periods are financial year-end unless indicated.
*Moody's forecasts (F) are Moody's opinion and do not represent the views of the issuer.
Source: Moody's Financial Metrics™ and Moody's Investors Service forecasts

The outlook on Hera was changed to stable from negative on 21 November 2023 following the outlook change to stable from negative 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 improving 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 stable rating outlook reflects our expectation that Hera will maintain financial metrics consistent with the current rating. It further takes into account the stable outlook on the Government of Italy's rating given that all Hera's earnings are generated in Italy and the consequent links with the sovereign.

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.

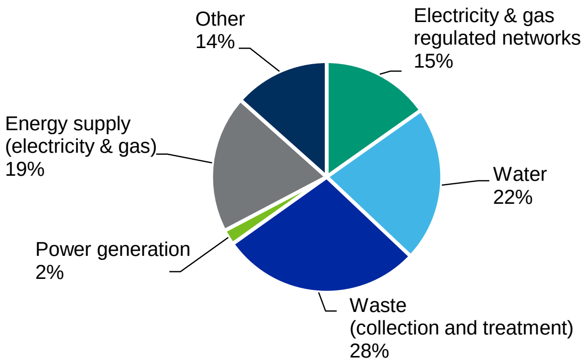
	2018	2019	2020	2021	2022	LTM	2023F*	2024F*
FFO interest coverage	7.4x	8.2x	10.4x	13.0x	11.2x	9.4x	6.5x - 7.5x	6.0x - 7.0x
FFO / Net Debt	23.2%	21.7%	23.0%	26.8%	19.8%	23.9%	22.0% - 23.0%	21.5% - 22.5%
RCF / Net Debt	18.0%	17.0%	18.2%	21.1%	14.9%	18.5%	16.0% - 17.0%	16.0% - 17.0%

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Periods are financial year-end unless indicated.
LTM = Last 12 months as of 30 June 2023.
*Moody's forecasts (F) are Moody's opinion and do not represent the views of the issuer.
Source: Moody's Financial Metrics™ and Moody's Investors Service forecasts

Profile

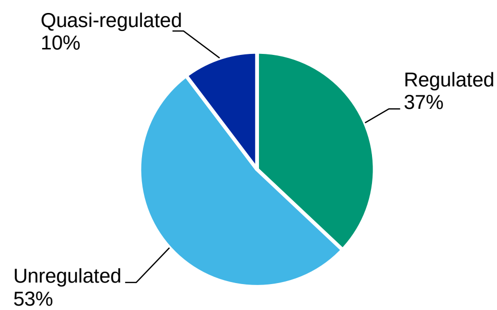
Hera S.p.A. (Hera) is one of the largest multi-utilities in Italy. 46% of the company's share capital is held by 111 municipalities, the largest of which is the City of Bologna (with a stake of around 8%). Hera has a strong territorial presence in the region of Emilia Romagna and more generally in the 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 2022, Hera reported consolidated revenue of €20.6 billion and EBITDA of €1.2 billion.

Exhibit 3
Hera's EBITDA breakdown (2022)



Source: Company

Exhibit 4
EBITDA split regulated/unregulated (2022)



Regulated activities include integrated water services and gas & electricity networks.
Quasi-regulated covers public lighting, waste collection and district heating.
Source: Company

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).

Increasingly established regulatory framework for integrated water activities supports earnings stability

Water distribution activities accounted for around 22% of Hera's consolidated EBITDA in 2022. These activities benefit from a regulatory framework (Metodo Tariffario Idrico, MTI) set by Autorità di Regolazione per Energia Reti e Ambiente (ARERA), 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 covering 2020-23, allows for the full recovery of efficient operating expenses and a periodic revision of the allowance for non-controllable costs incurred by the operators, in line with previous regulatory periods. The latest MTI-3 interim regulatory update of 30 December 2021 (valid for the 2022-23 period) confirmed the formula to calculate the allowed return on the capital invested (RAB remuneration) and updated the formula parameters. This translated into a 44 basis points reduction in the allowed return to 4.8% from 5.24%, corresponding to 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 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 [1] allocates 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 October 2023 [2], ARERA communicated the bonuses and penalties applicable to the water operators based on the technical standards achieved in 2020-21. For Hera, these corresponded to a €16.2 million bonus which helped to mitigate the adverse effects on profitability of rising energy and raw material costs.

More broadly, the regulatory framework for Italian integrated water service providers is stable and transparent and continues to enhance the predictability of Hera's revenue and cash flows. In February 2023, ARERA started the review of the tariff method for MTI-4 to be applied starting 2024. Based on consultations document published in October and November 2023 [3] we expect that the new regulatory period will be characterised by continuity with the current framework, as the tariff scheme should be confirmed. ARERA intends to extend the regulatory period for MTI-4 to 6 years (2024-29), with updates every two years. The formula currently used to calculate the allowed return on the capital invested (RAB remuneration) should be confirmed for the six years period (2024-2029).

ARERA also provided an indication of the updated formula parameters to be applied in the first interim period (2024-25). In particular, (1) the real risk free rate should rise to 1.58% (from 0.13%); (2) the Water Risk Premium should be set in the range 1.7-2.2% (vs. a current level of 1.7%); (3) the debt risk premium should be set in the range 2.34-3.53% (vs. a current level of 2.4%); and (4) the beta could slightly decrease from the current level of 0.79 to between 0.75-0.79. This would translate in allowed returns of 5.5-6.5%, an increase of 70-170 basis points (bps).

The consultation documents also include the proposal to make permanent the technical quality standards incentives and introduce two new incentives to enhance water services sustainability, the reuse of wastewater and the reduction in the energy costs. Given Hera's track record of efficient management of operations and high technical quality standards, we expect the company could benefit from these incentives.

During the nine months to September 2023, the company reported EBITDA of 209 million for its water activities (+1.7% compared to 2022). 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 15% of its consolidated EBITDA in 2022. Energy network activities benefit from a stable and transparent regulatory framework set by ARERA.

The sixth tariff cycle for gas distribution activities runs between 2020 and 2025, while the regulatory period for electricity distribution networks cover the 2016-23 period. The regulation for both gas and electricity grids ensures a good degree of cost recovery and adequate capital remuneration, although allowances are not updated annually (except for inflation and volume reference). Operating expenditure is subject to an efficiency parameter (X-factor), equal to 3.39% for gas infrastructure and 1.3% for electricity infrastructure, and operators are incentivised to outperform regulatory efficiency assumptions because additional efficiencies can be retained.

The regulator should publish the framework for the fifth period for electricity distribution before year-end for application starting in January 2024. We expect that the new regulatory period will continue to be characterised by good cost recovery mechanisms and adequate remuneration of investments. However, 2024 will also mark the introduction of ROSS-base for electricity grids.

The new ROSS system, which will be applied to electricity grids in January 2024 and to gas grids in January 2026, will mark a move to a total expenditure system for electricity and gas grids, with the aim of improving investment decisions and overall system efficiency. Through resolution 163/2023, published in April 2023, and resolution 497/2023 published in October 2023, ARERA outlined the general principles applying to all impacted infrastructure sectors as well as the determinations to be applied during the first phase of the ROSS framework (called ROSS-base). Under this framework, instead of receiving incentives on costs and coverage of spending (capital spending and operating expenditure), regulated activities will be remunerated according to the benefits delivered to the Italian system, with greater leeway for regulated companies to deliver these benefits. Total expenditure, equal to the sum of operating and capital expenditures, will be split between fast money (recovered through tariffs within the year) and slow money (added to RAB), as defined by a capitalization rate set on each company's past and projected split between operating and capital expenditures. While the impact of ROSS will only be clear when all parameters are set, we expect the move will likely be credit neutral (see Move to totex regulation likely credit neutral, with implementation gradual, June 2023).

On 23 December 2021, ARERA published its final resolution on the criteria for determining and updating the WACC over 2022-27 (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 electricity distribution, allowed returns were reduced by 70 bps between 2021 and 2022 (from 5.9% to 5.2%). For gas distribution, allowed returns were reduced by 70 bps between 2021 and 2022 (from 6.3% to 5.6%).

The WACC level can be revised yearly before 2025 according to a trigger mechanism based on the evolution of certain parameters. For 2024, the application of the trigger mechanism led to a sizeable increase of the WACC to be applied to electricity distribution by 80 bps (to 6.0%) and to gas distribution by 90 bps (to 6.5%)[4]. We estimate this will have a positive impact on Hera's EBITDA of around €14 million (see Regulatory update for energy infrastructure assets allows for higher return on capital, 5 December 2023).

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)
Tariff-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	Incentives / penalties related to networks leakage
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)	2022-23: 4.8% 2024-25: expected between 5.5% - 6.5%	2022-23: 5.2% 2024: 6.0% revised yearly according to a trigger mechanism on main market parameters	2022-23: 5.6% 2024: 6.5%
Next rewiew of allowed return on capital	Dec-23	Dec-24	Dec-24
Time lag on investments/D&A	2 years (investments and D&A)	1 year on investments, 1 year on D&A (from 2025)	1 year
Time lag compensation on WACC	1%	0%	0%
Total RAB (2022)		€ 3.19 billion	

Source: Company, ARERA, Moody's Investors Service

During the first nine months of 2023, the company reported an EBITDA of around €124 million for its gas and electricity distribution activities. This represented a small decrease (-1.9%) compared with the same period of 2022, mainly as a result of inflationary pressures. Looking ahead, we expect that Hera will continue to invest in its energy networks with a focus on digitalization and metering services.

Energy supply segment faces increasing risks

In 2022 almost 19% of Hera's consolidated EBITDA came from natural gas and electricity sales and trading businesses. We consider these activities as having a high risk profile because the company is exposed to volume and price fluctuations owing to the cyclical macroeconomic environment and market competition.

In the gas segment, Hera has a significant presence, with around 3.6 billion cubic meters (bcm) of gas sold in 2022 (excluding Ascopiave) to retail, industrial and commercial customers and a total of 2.1 million clients served. 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.

Hera has also a strong and growing presence in the electricity segment, with 10.7 terawatt hours (TWh) sold in the nine months to September 2023 to retail, industrial and commercial customers (1.7 million in total). While electricity supply activities remain smaller in size as compared to gas supply, these activities represent a natural hedge against shift in energy consumption.

In the supply market, Hera has grown to be the fourth national player. Moreover, Hera consolidated its presence in the in the last resort market, as in 2023 it was awarded 3 out of 4 tenders, becoming the national leader in the sector. 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 commodities. 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. Despite the exposure to last resort markets, Hera continues to benefit from a resilient customer base, with total unpaid ratio at around 1%.

The profitability of Hera's supply business is exposed to volatile prices and volumes. In the nine months to September 2023, the divisional EBITDA increased to €263 million (+40% compared to September 2022) as a result of an increased customer base (+9% vs. September 2022), partially offset by lower volumes in the gas supply business, and higher margins thanks to the review of most contracts.

In the future, Hera's supply margins could be hit by increased market competition because regulated electricity and gas retail tariffs for residential customers in Italy are due to be phased out in 2024. Nevertheless, we expect the potential margin reduction to be at least partly offset by (1) Hera's growing customer base; and (2) the solid track record of synergies extraction. Furthermore, we expect that the company will continue to participate in tenders for last resorts markets.

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

Hera's environmental activities (28% of 2022 consolidated EBITDA) are split between treatment of urban and industrial volumes (23% of EBITDA in 2022) and collection (5% of EBITDA in 2022). The company operates in the entire waste cycle with 101 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 electricity and 0.1 TWh of thermal energy generated in 2022).

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 is performed under concessions assigned by local authorities through tenders. Moreover, since the start of 2020, ARERA regulates collection activities, eliminating price exposure, while there is no mechanism covering volume risk. Tariffs are based on the recognition of regulatory opex based on a two-year lag, with the application of an efficiency factor, and a WACC-based RAB remuneration. Since the start of the second regulatory period in 2022, the regulation applies to collection and treatment of urban waste, although it does not apply to non-integrated operators that manage nonessential treatment plants (impianti aggiuntivi), delegating the identification of these plants to each Region. Pending identification of such plants, only Hera's collection and some disposal of urban waste activities are under regulated tariffs, leaving the majority of the company's waste business subject only to greater oversight and quality requirements.

In the first nine months of 2023, the EBITDA of Hera's waste management division (treatment and collection) grew by €11.8 million (+4.8%) compared with the same period of 2022. 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 industrial 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 8.7 total million tonnes treated in 2026 (from 6.9 million tonnes in 2022, 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.

ARERA's regulatory framework for waste activities enhances predictability although some uncertainties remain

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

MTR-1 also identified the activities of the integrated waste management service subject to regulation. For the initial period (2020-21), these activities included waste collection services and some treatment activities (mainly disposal or recovery) integrated in the operators' corporate perimeter. For these activities, the regulator 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 [5]for the second regulatory period (MTR-2) covering a four-year regulatory period (2022-25). Among others, the regulator confirmed the general framework of MTR-1, including a RAB-base remuneration system and the recognition in tariffs of regulatory opex. Under MTR-2, annual tariff increases are subject to a cap which is a function of inflation, quality parameters and an efficiency factor. 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, defined all urban waste treatment plants as essential, however the decision was cancelled by the regional administrative court and later by the Council of State. Hence, as of today Hera's treatment plants are not subject to regulation, but this could change going forward, as the region of Emilia Romagna will define essential plants.

In August 2022 [6] ARERA set a RAB remuneration for 2022-25 of 5.6% for integrated waste management services and 6.0% for waste treatment activities, although this can be subject to an update following the activation of trigger mechanism for the Italian energy networks.

Notwithstanding some uncertainties around the precise impact of the regulatory framework on Hera's waste treatment activities, related to the definition of essential plants, 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, the regulation enhances the predictability of Hera's waste earnings by decreasing exposure to price of part of the business.

Power generation and energy efficiency contribution is volatile

Hera's power generation activities expose the company to volatile power prices in Italy, although this exposure is limited by their small weight (around 2% of the company's 2022 EBITDA). We note that in addition to the power generated through its WTE plants, in 2022 Hera produced around 0.5 TWh of electricity through its cogeneration and renewable plants capacity.

As of 30 September 2023 the EBITDA contribution from power generation activities was down by €7 million (-64%) compared with the same period of 2022, mainly as a result of lower power prices in the first nine months of the year.

Energy efficiency EBITDA increased substantially in the first nine months of the year (+79%), contributing for €90 million, or 8% of group EBITDA. We expect the growth will not be sustained in 2024 as the results were mainly related to the effect of the so-called Superbonus scheme, which ends in 2023. Under the scheme, the government provides compensation for undertaking energy efficiency works, in the form of a tax credit to be recovered over 4 years. Hence, as a result of the growth of the business segment, we expect a sizeable working capital absorption. From 2024, we expect energy efficiency EBITDA decreasing to levels more aligned with historical levels, although the business unit could benefit from long term energy efficiency trends going forward.

Hera's plan to 2026 leaves business risk broadly unchanged and supports financial flexibility

In April 2023 Hera updated its five-year business plan (2022-2026) targeting EBITDA of €1.4 billion by 2025, implying an increase of around 15% from 2021. This growth will be underpinned by €4.1 billion of investments through 2026 (€300 million higher than under the previous five-year plan 2021-2025) mostly directed towards regulated activities (approximately 54%, excluding waste treatment). Around 53% of the total planned capital spending is earmarked for maintenance, while the rest focuses on organic development (€1.5 billion), M&A (€370 million), while a portion will come from EU funds (€135 million).

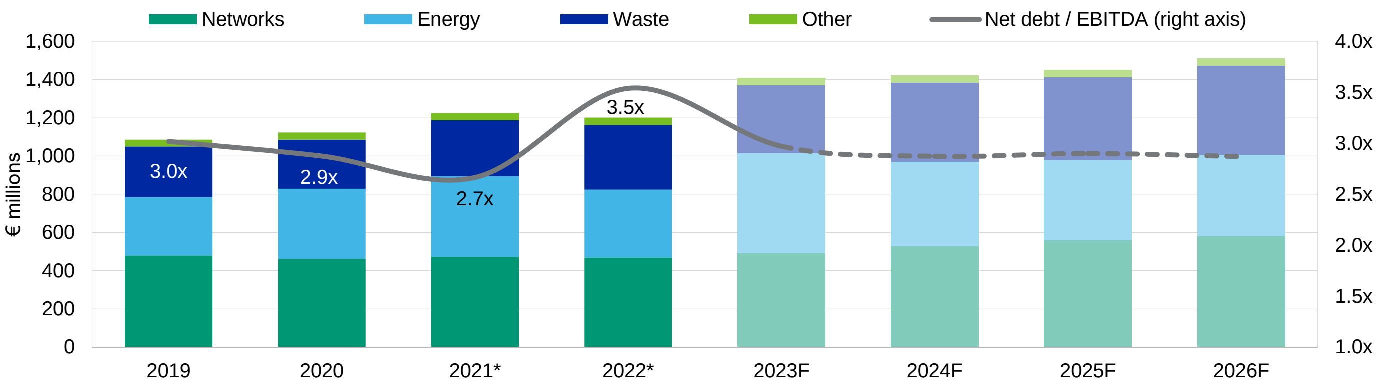
The key levers that management expects to help Hera achieve EBITDA of €1.4 billion by 2025 are (1) organic growth, amounting to around €192 million up to 2025, driven by regulated tariff increases, efficiencies and positive dynamics in the waste treatment segment and (2) small and medium scale credit-friendly 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, we anticipate regulated activities (including integrated waste services and district heating) to contribute to more than two-thirds of Hera's projected consolidated EBITDA in 2025.

Exhibit 6

Hera's business plan 2022-26: planned EBITDA growth and reported net debt/EBITDA evolution



Periods are financial year-end unless indicated.
Net debt/EBITDA includes the full consolidation of financial debt coming from M&A targets but excludes additional investments to seize new opportunities.
The evolution of leverage is calculated starting from Hera's 2021 reported net debt/EBITDA including the put option related to the Ascopiave deal.
*2021 and 2022 EBITDA does not include adjustment for a temporary accounting difference in gas stock valuation.
Sources: Company, Moody's Investors Service

After a peak in leverage in 2022, Hera's credit metrics have returned in line with targets

As of 30 September 2022 Hera's net debt peaked at 3.6x. 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. As Hera's gas storage reserves were fully hedged against price fluctuations, the negative effect on working capital was merely temporary, and it reverted at the end of the thermal season in spring 2023. Good operating performance across all business segments (including water, networks and waste management), and good track record of payments collection helped improve the company's key credit metrics. As a result, Hera reported net leverage of 2.9x as of 30 September 2023, in line with company's target of below 3.0x.

As a result of sustained operating performance and prudent financial management, we expect that Hera will maintain a financial profile comfortably in line with the ratio guidance commensurate with the current rating. Notably, we expect the company will maintain Moody's-adjusted FFO/net debt above 20% and RCF/net debt at around 15% until 2026.

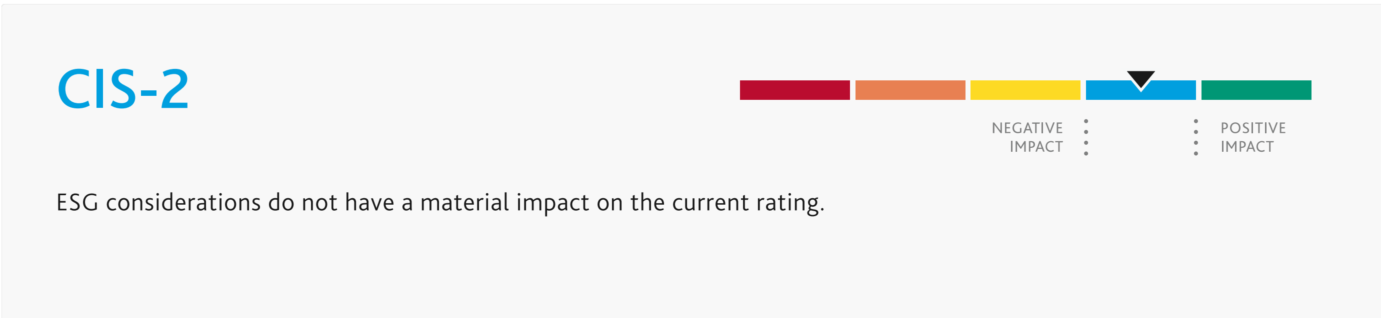
Consolidation strategy remains creditor friendly

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 CIS-2

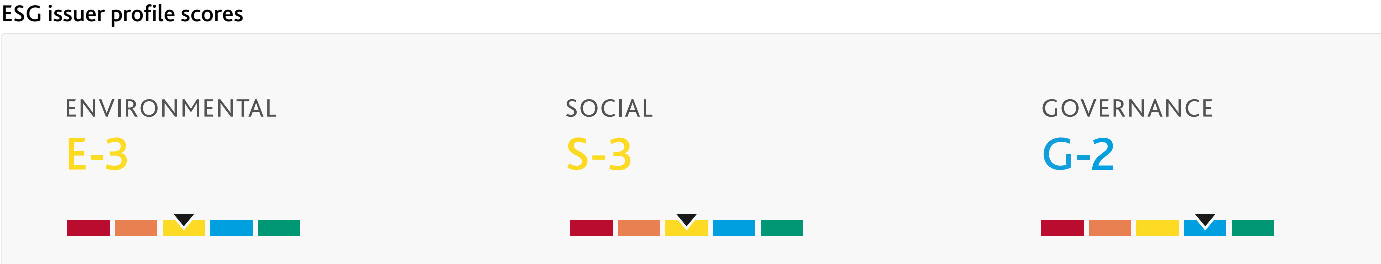
Exhibit 7
ESG credit impact score



Source: Moody's Investors Service

Hera´s CIS-2 indicates that ESG considerations are not material because its rating is constrained by that of the Government of Italy.

Exhibit 8
ESG issuer profile scores



Source: Moody's Investors Service

Environmental

Hera's environmental risk is E-3, 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 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 is E-3, 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 risk is G-2 because of 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.

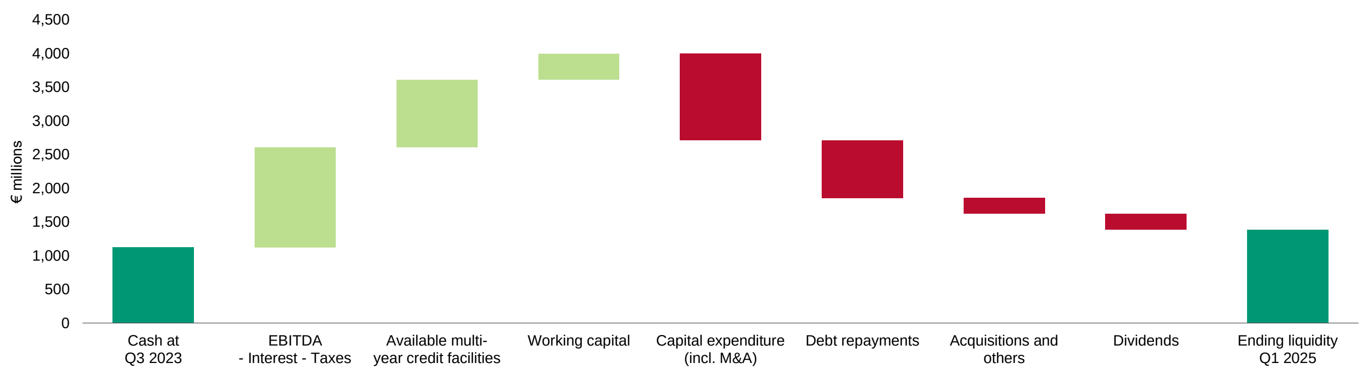
Liquidity analysis

As of September 2023, Hera had a good liquidity, backed by around €1,119 million in cash and cash equivalents and €1,005 million of committed credit lines, including the new €450 million sustainability-linked revolving facility secured last April. All the committed credit lines are currently undrawn and available until between 2026 and 2028. 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 until the end of 2024 (including working capital, debt repayments, investments and dividends), as shown in the exhibit below.

Exhibit 9

We expect Hera's cash availability to cover its liquidity needs
Liquidity as of September 2023

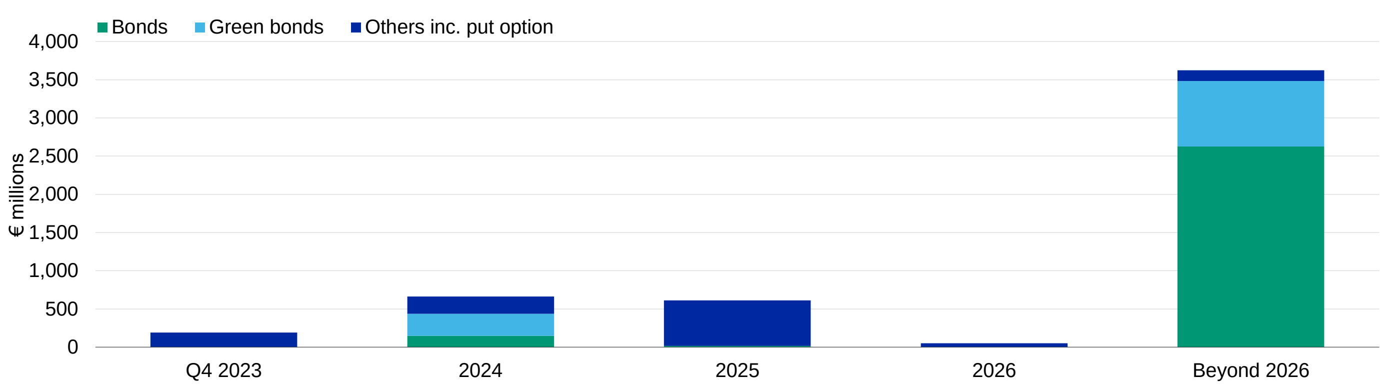


Moody's forecasts are Moody's opinion and do not represent the views of the issuer.
Source: Company, Moody's Investors Service

As of September 2023, Hera's reported net financial debt was around €4.15 billion with an average maturity of approximately six years. The net debt decreased by €350 million compared with the same period of 2022 (-7%) mainly due to higher EBITDA and working capital inflow. The company's latest bond issuance was in April 2023, when a €600 million sustainability-linked bond was issued, with a maturity in April 2033.

Exhibit 10

Hera's reported debt maturity profile as of September 2023



Source: Company

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 December 2023.

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 currently any uplift to Hera's standalone credit quality (or Baseline Credit Assessment [BCA]) for potential extraordinary support.

Exhibit 11

Rating factors

Hera S.p.A.

Unregulated Utilities and Unregulated Power Companies Industry	Current FY 12/31/2022		Moody's 12-18 month forward view*	
Factor 1 : Scale (10%)	**Measure**	**Score**	**Measure**	**Score**
a) Scale ($ billions)	Baa	Baa	Baa	Baa
Factor 2 : Business Profile (40%)				
a) Market Diversification	Ba	Ba	Ba	Ba
b) Hedging and Integration Impact on Cash Flow Predictability	Ba	Ba	Ba	Ba
c) Market Framework & Positioning	Baa	Baa	Baa	Baa
d) Capital Requirements and Operational Performance	Baa	Baa	Baa	Baa
e) Business Mix Impact on Cash Flow Predictability	Aaa	Aaa	Aaa	Aaa
Factor 3 : Financial Policy (10%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Factor 4 : Leverage and Coverage (40%)				
a) (CFO Pre-W/C + Interest) / Interest (3 Year Avg)	11.5x	A	6.0x - 7.0x	Baa
b) (CFO Pre-W/C) / Net Debt (3 Year Avg)	22.9%	Baa	21.5% - 22.5%	Baa
c) RCF / Net Debt (3 Year Avg)	17.7%	Baa	16.0% - 17.0%	Baa
Rating:				
a) Scorecard-Indicated Outcome		Baa1		Baa2
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

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
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.
*Moody's forward view is Moody's opinion and does not represent the views of the issuer.
Source: Moody's Financial Metrics™ and Moody's Investors Service forecasts

Ratings

Exhibit 12

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

Source: Moody's Investors Service

Appendix

Exhibit 13
Peer Comparison
Hera S.p.A.

	Hera S.p.A. Baa2 Stable			ACEA S.p.A. Baa2 Stable			A2A S.p.A. Baa2 Stable		
(in € millions)	FY Dec-20	FY Dec-21	FY Dec-22	FY Dec-20	FY Dec-21	FY Dec-22	FY Dec-20	FY Dec-21	FY Dec-22
Revenue	7,079	10,555	20,082	3,205	3,816	4,957	6,655	11,352	22,946
EBITDA	991	970	990	1,023	1,137	1,189	1,118	1,351	1,427
Total Assets	11,035	14,032	17,119	9,674	10,629	11,339	12,226	18,008	21,367
Total Debt	4,337	4,264	6,416	4,653	5,149	5,407	4,645	5,204	6,999
Net Debt	3,350	3,378	4,473	4,011	4,469	4,847	3,633	4,240	4,415
FFO / Net Debt	23.0%	26.8%	19.8%	22.5%	21.5%	20.1%	28.5%	27.5%	28.4%
RCF / Net Debt	18.2%	21.1%	14.9%	20.2%	19.3%	17.1%	21.5%	21.3%	21.6%
(FFO + Interest Expense) / Interest Expense	10.4x	13.0x	11.2x	11.5x	12.4x	11.9x	11.7x	14.6x	12.6x
Debt / Book Capitalization	57.0%	54.6%	62.4%	66.7%	67.2%	66.2%	53.0%	54.7%	61.0%

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
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 Financial Metrics™

Exhibit 14
Moody's-Adjusted Net Debt reconciliation
Hera S.p.A.

(in € millions)	2019	2020	2021	2022
As Reported Total Debt	**3,700.6**	**4,234.7**	**4,170.0**	**6,336.4**
Pensions	112.0	102.2	93.7	79.4
Non-Standard Adjustments	(13.6)	0.0	0.0	0.0
Moody's Adjusted Total Debt	**3,799.0**	**4,336.9**	**4,263.7**	**6,415.8**
Cash & Cash Equivalents	(364.1)	(987.1)	(885.6)	(1,942.4)
Moody's Adjusted Net Debt	**3,434.9**	**3,349.8**	**3,378.1**	**4,473.4**

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Periods are financial year-end unless indicated.
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.
Non-Standard Public Adjustments include the reclassifications of fair value hedges and guarantees.
Source: Moody's Financial Metrics™

Exhibit 15
Moody's-Adjusted FFO reconciliation
Hera S.p.A.

(in € millions)	2019	2020	2021	2022
As Reported Funds from Operations (FFO)	**871.5**	**853.6**	**997.6**	**963.3**
Alignment FFO	(46.8)	1.7	2.9	54.5
Non-Standard Adjustments	(80.5)	(83.4)	(94.4)	(133.9)
Moody's Adjusted Funds from Operations (FFO)	**744.2**	**771.9**	**906.1**	**883.9**

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Periods are financial year-end unless indicated.
Non-Standard Public Adjustments include the reclassification of bad debt provisions.
Source: Moody's Financial Metrics™

Exhibit 16
Overview of Moody's-Adjusted financial data
Hera S.p.A.

(in € millions)	2019	2020	2021	2022
INCOME STATEMENT				
Revenue	6,913	7,079	10,555	20,082
EBITDA	1,095	991	970	990
EBIT	666	534	500	512
Interest Expense	104	82	75	86
Net income	411	316	347	268
BALANCE SHEET				
Net Property Plant and Equipment	2,087	2,020	2,041	2,067
Total Assets	10,322	11,035	14,032	17,119
Total Debt	3,799	4,337	4,264	6,416
Cash & Cash Equivalents	364	987	886	1,942
Net Debt	3,435	3,350	3,378	4,473
Total Liabilities	7,514	8,074	10,831	13,720
CASH FLOW				
Funds from Operations (FFO)	744	772	906	884
Cash Flow From Operations (CFO)	730	891	1,045	36
Dividends	162	163	193	220
Retained Cash Flow (RCF)	583	609	713	664
Capital Expenditures	(552)	(529)	(611)	(753)
Free Cash Flow (FCF)	16	200	241	(937)
INTEREST COVERAGE				
(FFO + Interest Expense) / Interest Expense	8.2x	10.4x	13.0x	11.2x
LEVERAGE				
FFO / Net Debt	21.7%	23.0%	26.8%	19.8%
RCF / Net Debt	17.0%	18.2%	21.1%	14.9%
Debt / EBITDA	3.5x	4.4x	4.4x	6.5x
Net Debt / EBITDA	3.2x	3.4x	3.5x	4.5x

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Periods are financial year-end unless indicated.
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 Financial Metrics™

Moody's related publications

- Electricity Markets – Europe: Supply-demand imbalance to ease, but prices to remain above historical levels, 5 December 2023
- Regulatory update for energy infrastructure assets allows for higher return on capital, 5 December 2023
- Moody's changes outlook to stable on eight Italian utility issuers, 21 November 2023
- Regulated electric and gas networks - Europe: 2024 Outlook - Stable as higher interest rates feed through to returns, 13 November 2023
- Unregulated electric and gas utilities - Europe: 2024 Outlook - Stable amid manageable market challenges, 13 November 2023
- Move to totex regulation likely credit neutral, with implementation gradual, 22 June 2023

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 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).

2 Resolution 476/2023/R/id

3 Consultation document 442/2023/R/idr, 3 October 2023, "Metodo Tariffario Idrico per il quarto periodo regolatorio (MTI-4). Inquadramento generale e linee d'intervento" and consultation document 543/2023/R/idr, 21 November 2023, "Metodo Tariffario Idrico per il quarto periodo regolatorio (MTI-4). Orientamenti finali".

4 ARERA resolution 556/2023/R/COM, published on 29 November 2023.

5 Resolution 363/2021/R/rif

6 Resolution 68/2022/R/rif

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