S&P Global Ratings

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# Hera SpA

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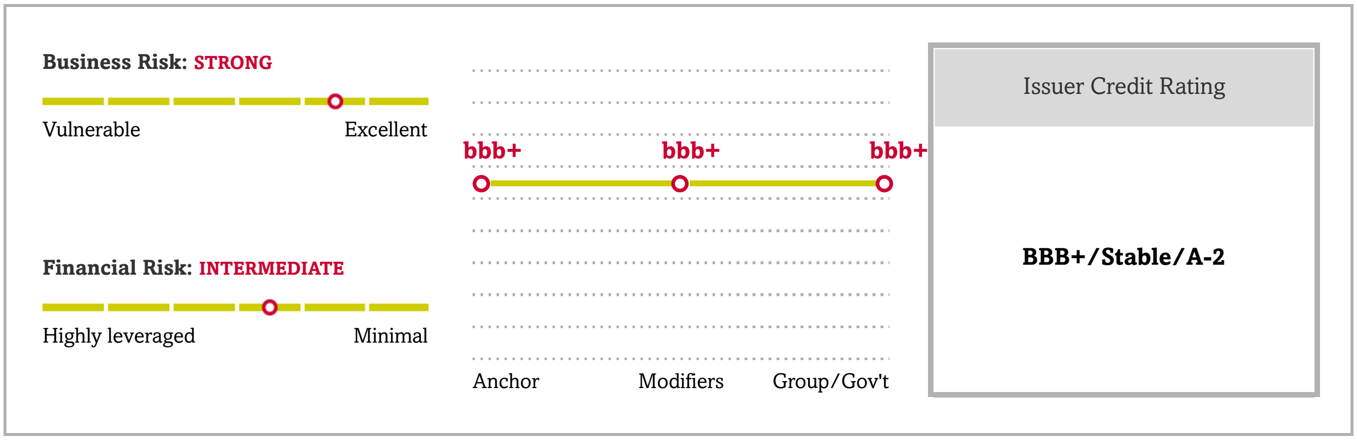
# Hera SpA




## Credit Highlights

### Overview

| Key strengths | Key risks |
|---|---|
| Stable and predictable cash flow generation from fully regulated activities in electricity, gas, and water distribution, and waste collection, together representing about 45% of EBITDA over 2020-2023. | Exposure to Italy, because we believe that a default of Italy would affect the company's capacity to finance itself. As a result, the rating on Hera is limited to one notch above the Italy sovereign rating. |
| Dominant position in northeastern Italy in waste and water management, and a leading position among domestic energy suppliers (mainly gas). | We expect negative, though improving, free cash flow after investments and dividends on average over 2021-2023. |
| Sound financial policy with a strong commitment to the current rating level. | Highly acquisitive growth strategy, though credit-friendly (i.e., with limited debt financing and share swaps). |

***Hera reported 2020 results that were above our expectations, demonstrating resilience amid the COVID-19 pandemic.*** These stronger-than-expected results notably stemmed from the robust performance of Hera's network activities and ancillary services, which more than offset declining waste prices due to relatively low hedging amid declining power prices and volumes. Reported net debt for 2020 stood at €3.23 billion, declining from €3.28 billion in 2019, with better-than-expected working capital management throughout the pandemic. This signals the resilient nature of Hera's business, supported by regulated activities, limited exposure to power prices at its waste-to-energy plants, and no direct exposure to power generation capacity. Thanks to the strong 2020 results, adjusted funds from operations (FFO) to debt including income from last-resort clients neared 24%, only marginally lower than the 24.3% registered in 2019. Income from last-resort clients has an about 80 basis points (bps)-100 bps effect on adjusted FFO to debt, depending on its magnitude year from year. This income is derived from interest on delayed payments from public administration authorities in Italy.

***Organic growth and strong cash flow will lead to improved credit metrics over 2021-2023 despite capital expenditure (capex) acceleration.*** Under its strategic plan to 2024, Hera plans to invest an aggregate of €3.2 billion, 40% higher than in the previous five years. We expect a strong EBITDA increase over the period to offset the spending, led primarily by the retail business, which will add about €100 million thanks to the €84 million contribution from the Ascopiave acquisition in 2019. This, combined with stable revenue from regulated businesses and growth in merchant activities, will support Hera's adjusted EBITDA growth above €1.2 billion by 2023. Therefore, we expect adjusted FFO to debt (including income from last-resort clients) will consistently hover at about 24% over 2021-2023. The total regulated asset base (RAB; excluding district heating) should expand at a compound annual growth rate of 2.8% to

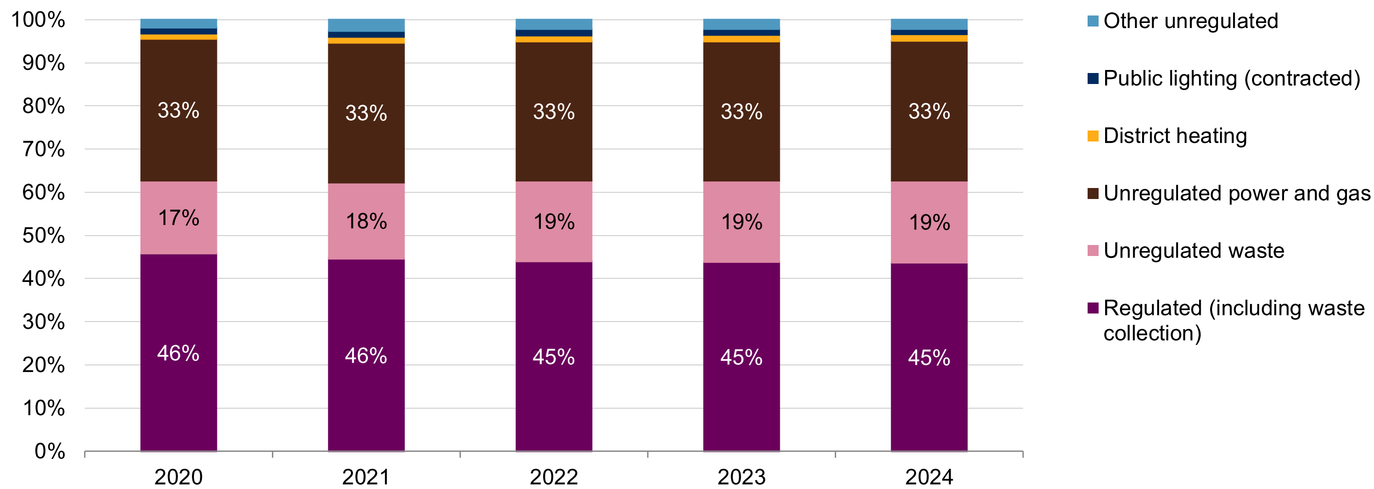
€3.8 billion in 2024 from €3 billion in 2020. As a result of the higher investments, reported net debt should increase by about €400 million by 2024. Nevertheless, we project that adjusted leverage will remain under control at 3.4x-3.5x, thanks to stronger EBITDA growth and healthy operating cash flow.

***Solid performance in the first quarter of 2021 confirmed Hera's strong position to expand organically in a normalizing environment.*** During the first quarter of 2021, reported EBITDA increased 3.7% year on year to €362 million, thanks to a particularly strong performance in the energy division, followed by continued growth in the waste segment. The energy division saw a rebound from the negative effects of the COVID-19 pandemic that were registered in first-quarter 2020, with about 70% of such negative effects effectively normalized. Furthermore, colder temperatures this winter also boosted the division's revenue. In the waste activities, EBITDA increased 0.9% year on year thanks to an increase in both household and special waste volumes (up 5.1%) and a growing market appetite for regenerated plastics, in which Hera's subsidiary Aliplast has a competitive advantage.

**Chart 1**

**EBITDA Evolution In The New Strategic Plan**

% regulated and unregulated, 2020-2024




Source: S&P Global Ratings.

**Outlook: Stable**

The stable outlook reflects our expectation that Hera will maintain adjusted FFO to debt (including income from last-resort clients) at or above 24% over 2021-2023. We also take into account management's commitment to the 'BBB+' rating, with our understanding the company is willing to adjust financial policy should credit metrics deteriorate close to the rating thresholds. Our stable outlook also factors in Hera's timely execution of the strategic plan.

### Downside scenario

We could downgrade Hera if FFO to debt (including income from last-resort clients) falls below 23% over a prolonged period. This could happen if:

- Hera undertakes larger cash acquisitions or increases its dividend, deviating from what we would view as a prudent financial policy;
- Hera does not successfully implement its strategic plan until 2024; or
- Changes in the regulatory framework for Hera's network business (water, gas, and electricity) impede its ability to achieve EBITDA targets.

Risk of rating downside could occur if the economic environment in Italy turns more negative, thereby constraining Hera's growth strategy and EBITDA. We would also revise the outlook to negative if we take a similar action on Italy (unsolicited; BBB/Stable/A-2), because we cap our rating on Hera at one notch above the sovereign rating.

### Upside scenario

Although unlikely at this stage, we could revise up our stand-alone credit profile for Hera if it strengthens its credit metrics and achieves adjusted FFO to debt (including income from last-resort clients) at or above 30% on a sustainable basis.

An upgrade would also depend on our unsolicited rating on Italy. Given Hera's sensitivity to the Italian economy, we allow the long-term rating to be only one notch higher than our long-term sovereign rating.

## Our Base-Case Scenario

### Assumptions

In our base case for 2021-2023, we assume:

- GDP growth has only a limited effect on Hera as a large share of its revenue is derived from long-term contracted or regulated activities.
- Revenue increases by 3% per year on average.
- Reported EBITDA increases by about 3.4% on average, reaching above €1.1 billion by 2023.

- A stable EBITDA margin hovering at about 15%.
- Income from last-resort clients of about €32 million annually.
- Current taxes of €115 million-€125 million.
- Negative changes in working capital by €50 million on average.
- Annual capex of €600 million on average, up from about €500 million in 2019 and 2020.
- A stable cash dividend distribution of €190 million-€230 million, in line with the pay-out ratio recently revised upward.
- Net reported debt of €2.9 billion-€3.2 billion.

## Key metrics

**Hera SpA -- Key Metrics***

| (Mil. €) | 2019a | 2020a | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|
| EBITDA | 1,027.2 | 1,038.9 | 1,082.9 | 1,120.9 | 1,170.4 |
| Capital expenditure | 538.5 | 511.7 | 615-625 | 615-625 | 580-600 |
| Debt§ | 3,580.3 | 3,441.6 | 3650-3700 | 3750-3950 | 4000-4200 |
| Dividends | 161.5 | 163.3 | 190-195 | 200-210 | 220-230 |
| Debt to EBITDA (x) | 3.5 | 3.3 | 3.3-3.5 | 3.4-3.6 | 3.4-3.6 |
| FFO to debt (%) | 23.3 | 23.0 | 24-24.5 | 24-24.5 | 23.5-24 |

*All figures adjusted by S&P Global Ratings. The credit metrics represented for 2021-2023 include income from last-resort clients. §2019 year-end debt consists of financial debt of €3,599 million with key adjustments being €94 million in leases, €114 million in pensions, €137 million in asset-retirement obligations, and €402 million of put options on minority stakes. a--Actual. f--Forecast. FFO--Funds from operations.

***We expect operating conditions to normalize in 2021, which will allow solid EBITDA growth in the first year of implementation of the new strategic plan.*** In 2021, we expect Hera's EBITDA to increase by about 4%, mainly as a result of normalizing market conditions in Italy, after the pandemic-induced shock witnessed last year. We expect higher volumes and prices in the company's unregulated businesses, mainly gas retail and waste treatment, thanks to a rebound in demand after the COVID-19 lockdown measures. We also expect increasing commercial demand in Hera's regulated power, gas, and water distribution activities. First-quarter 2021 performance was solid and gives Hera a good start to the year.

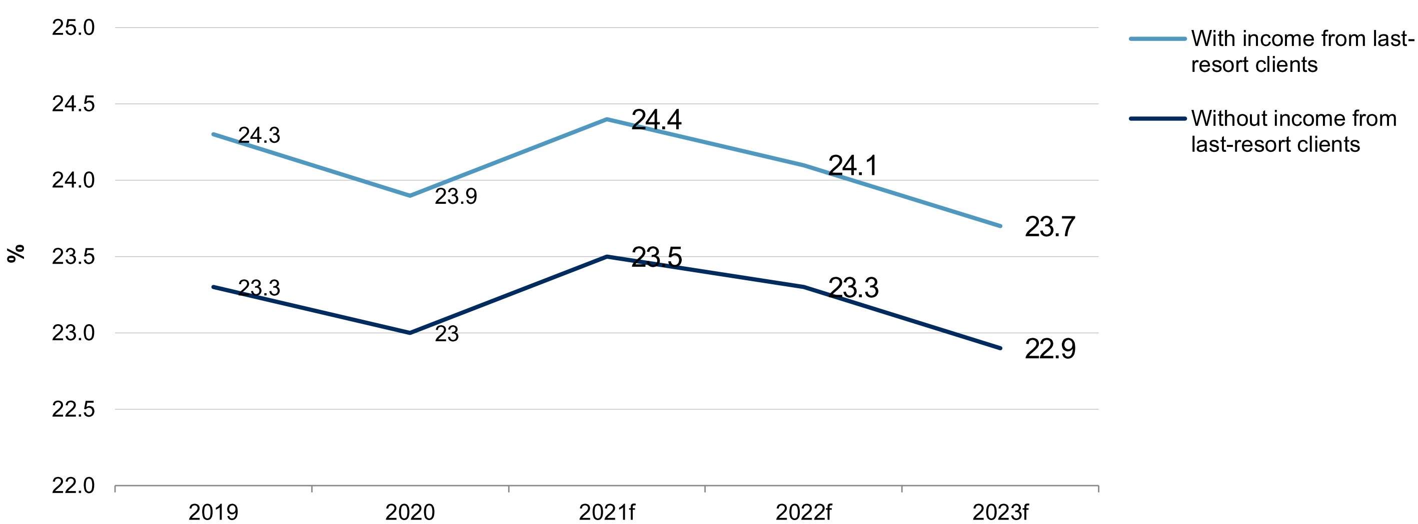
***Hera's business plan to 2024 continues to target high capex, growth through mergers and acquisitions, and dividends.*** As part of the business plan to 2024 announced earlier this year, Hera revised its guidance on investments, expecting to invest €3.2 billion in 2020-2024, which is 40% higher than the previous five years. This figure includes cash acquisitions of small players in the fragmented Italian energy and waste markets, which continues to be a key growth lever for Hera, in our view. Following strong 2020 results, dividend distribution was revised upward, resulting in €40 million additional return to shareholders by 2024 versus the previous plan.

***We expect the accelerated investment plan will be financed by a moderate increase in debt over the planned period.*** Despite a positive free operating cash flow generation every year (around €450 million in aggregate over 2021-2023), we believe Hera will post negative discretionary cash flow after dividends (€630 million cumulated in 2021-2023)and acquisitions (€280 million in aggregate in 2021-2023), which should entail approximately €600 million of additional debt in 2023 compared with 2020, as per our adjusted debt figures. Hera expects net financial debt to increase to €3.60 billion by 2024, compared to €3.27 at end-2020. Reported net leverage, however, will remain stable at 2.9x-2.8x, thanks to EBITDA growth. This is reflected in our S&P Global Ratings-adjusted debt to EBITDA reaching a maximum of 3.6x in 2023, versus 3.3x in 2020. We believe cost of debt should gradually decrease toward 2.6% by 2024, compared with 3% in 2020.

In our assessment of Hera's overall creditworthiness, we consider the company's significant income from last-resort clients, which we treat as operating income. Historically, we have seen that this additional income positively affects our calculation of Hera's FFO by about 80-100 bps, depending on its magnitude year by year (see chart 2).

**Chart 2**

**FFO-To-Debt Evolution With And Without Income From Last-Resort Clients**
2019-2023




f--Forecast. Source: S&P Global Ratings.



## Company Description

Hera is one of Italy's largest domestic utilities, with headquarters in Bologna. It operates in four core businesses--gas, electricity, water, and environment--as well as providing other services.

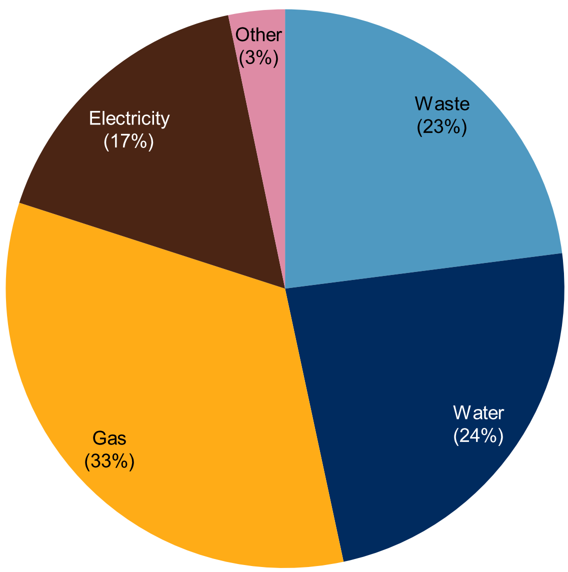
- Gas (33% of 2020 EBITDA): distribution (about 36% of Gas EBITDA) and sales (about 53%), district heating and heat management (about 10%).
- Electricity (17% of 2020 EBITDA): distribution (about 24%), sales (about 50%), and co-generation (about 26%).
- Waste (23% of 2020 EBITDA): entire waste cycle, waste collection (about 26%), treatment, recovery, and disposal (about 74%).
- Water (24% of 2020 EBITDA): integrated water cycle, covers aqueducts, purification, and sewerage services, notably builds and operates the water infrastructure (sewerage systems and wastewater treatments plants).
- Other services (3% of 2020 EBITDA): public lighting, telecom, and minor services

The group has over 8,900 employees and serves about 4.4 million customers in more than 350 municipalities in eight regions in northern and central Italy: Emilia-Romagna, Friuli-Venezia Giulia, Marche, Tuscany, and Veneto; as well as Sardinia.

On Dec. 31, 2020, Hera's shareholding structure included 111 of the municipalities it serves. Together with the other public shareholders, these municipalities hold approximately 46% of the share capital. There is a relatively low concentration of shares and a widespread private shareholding, which holds 54% (floating). The group reported an EBITDA of €1.123 billion in 2020.

**Chart 3**

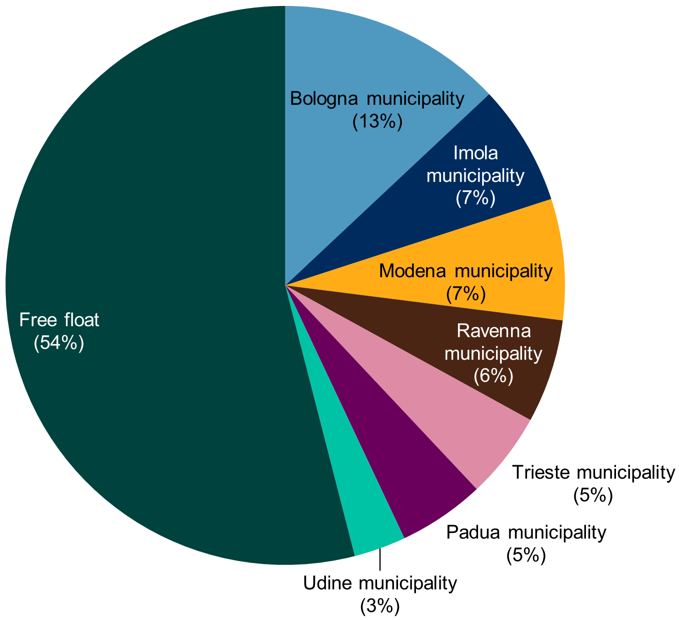
**2020 EBITDA Split By Segment**




Source: S&P Global Ratings.

**Chart 4**

**Shareholding Structure**
Dec. 31, 2020




Source: S&P Global Ratings.

## Peer Comparison

**Table 1**

| Hera SpA -- Peer Comparison | | | | |
|---|---|---|---|---|
| **Industry sector: Energy** | | | | |
| | **Hera SpA** | **A2A SpA** | **Energie AG Oberoesterreich** | **EVN AG** |
| Ratings as of June 16, 2021 | BBB+/Stable/A-2 | BBB/Stable/A-2 | A/Stable/-- | A/Negative/-- |
| | **--Fiscal year ended--** | | | |
| | **Dec. 31, 2020** | **Dec. 31, 2020** | **Sept. 30, 2020** | **Sept. 30, 2020** |
| **(Mil. €)** | | | | |
| Revenue | 7,079.0 | 6,862.0 | 1,926.8 | 2,171.2 |
| EBITDA | 1,038.9 | 1,174.0 | 311.0 | 650.5 |
| Funds from operations (FFO) | 790.0 | 971.0 | 256.0 | 564.7 |
| Interest expense | 103.3 | 86.0 | 22.5 | 45.6 |
| Cash interest paid | 64.3 | 80.0 | 19.5 | 41.5 |
| Cash flow from operations | 929.6 | 854.0 | 185.3 | 452.6 |

**Table 1**

| Hera SpA -- Peer Comparison (cont.) | | | | |
|---|---|---|---|---|
| Capital expenditure | 511.7 | 738.0 | 192.8 | 366.2 |
| Free operating cash flow (FOCF) | 417.9 | 116.0 | (7.5) | 86.4 |
| Discretionary cash flow (DCF) | 199.8 | (140) | (61.5) | (25.2) |
| Cash and short-term investments | 987.2 | 1,012.0 | 156.1 | 468.1 |
| Debt | 3,441.6 | 4,184.6 | 682.3 | 1,127.9 |
| Equity | 3,155.3 | 4,116.0 | 1,343.0 | 4,543.3 |
| **Adjusted ratios** | | | | |
| EBITDA margin (%) | 14.7 | 17.1 | 16.1 | 30.0 |
| Return on capital (%) | 9.2 | 7.8 | 7.5 | 6.2 |
| EBITDA interest coverage (x) | 10.1 | 13.7 | 13.9 | 14.3 |
| FFO cash interest coverage (x) | 13.3 | 13.1 | 14.1 | 14.6 |
| Debt/EBITDA (x) | 3.3 | 3.6 | 2.2 | 1.7 |
| FFO/debt (%) | 23.0 | 23.2 | 37.5 | 50.1 |
| Cash flow from operations/debt (%) | 27.0 | 20.4 | 27.2 | 40.1 |
| FOCF/debt (%) | 12.1 | 2.8 | (1.1) | 7.7 |
| DCF/debt (%) | 5.8 | (3.3) | (9.0) | (2.2) |

Peers for Hera are selected based on the exposure to a common operating environment, such as A2A, and on the portfolio of activities, such as Austrian peers Energie AG Oberoesterreisch and EVN AG.

A2A is the closest peer sizewise, regulatory environment and market conditions, given both companies are almost exclusively exposed to Italy. A2A, however, has a weaker business risk profile assessment due to its lower share of regulated activities (38% in 2020, versus 46% for Hera).

The Austrian peers are much smaller than Hera, as measured by EBITDA, but are exposed to lower jurisdiction and operational risk, as measured by a lower country risk assessment. Energie AG Oberoesterreisch and EVN AG compare well with Hera on the business mix, with Energie AG Oberoesterreisch having 40% of EBITDA stemming from regulated network activities under a supportive regulatory framework, and EVN AG having 35% of EBITDA fully regulated, including district heating.

## Business Risk: Strong

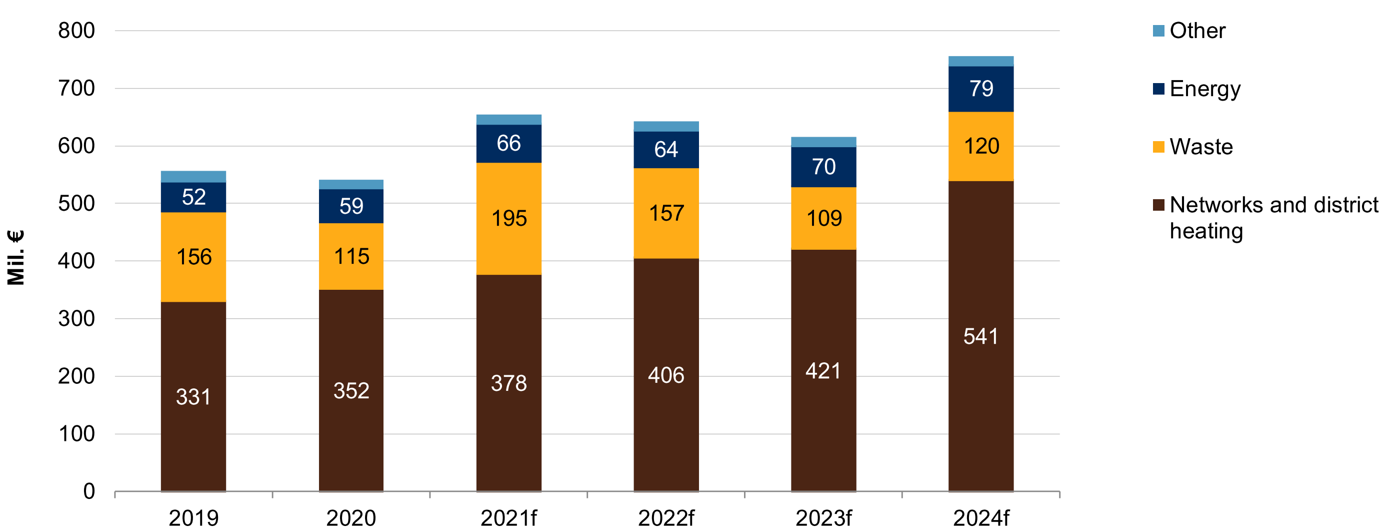
***Hera's business risk profile continues to benefit from a large share of regulated activities and its diversified portfolio in one of Italy's wealthiest regions, where it holds a dominant market position.*** We positively view Hera's diversified portfolio of utility businesses in one of Italy's wealthiest regions, and its dominant local market position. Hera's business risk profile benefits from the significant (about 46% of 2020 EBITDA) contribution from fully regulated water, gas, power distribution and, since 2020, urban waste collection activities that are remunerated under long-term concessions based on tariffs established by the national regulatory authority (ARERA). Indeed, since last year, urban waste collection activities (6% of 2020 EBITDA) are also regulated in Italy, which further improves cash flow stability and visibility for Hera's core waste operations. The Italian regulator ARERA has defined the new regulation for waste collection for the period 2018-2021 with a return calculated on a RAB and a weighted average cost of capital set at 6.3%. We expect fully regulated activities to represent about 45% of total EBITDA at the end of Hera's 2021-2024 business plan. This stems from sizable investments in networks, which will represent about 65% of total investments, with waste collection and recycling representing more than 20% (see Chart 5). The remainder will be invested in retail activities and ancillary services (such as public lighting and energy management). About 17% of EBITDA comes from stable waste treatment activities focused in northern Italy. More volatile earnings come from energy, including retail power and gas supply activities, which account for 33% of 2020 EBITDA. Other services, including public lighting and telecommunication, account for 3%.

***We expect acquisitions will contribute to Hera's growth in the subdued economic environment that we anticipate in Italy over the next few years, even despite the recovery from COVID-19.*** The consolidation of small multi-utilities has become more competitive because Hera's competitors have also become increasingly aggressive in consolidating local players. The last big acquisition of Ascopiave's gas and power clients has had a marginally negative effect on Hera's business risk position, with the group losing about 4% of its fully regulated EBITDA from gas distribution in 2020. At the same time, it has increased Hera's capabilities in the liberalized gas and electricity retail market and proven its skills in integrating new businesses and extracting cost synergies. This is supportive of the business risk profile and enables the company to mitigate the impact of adverse regulatory decisions. In the recent years, Hera has also strengthened its position in the waste treatment segment, in which it now holds a leading position. In 2017, it started the acquisition of Aliplast, a company specialized in regenerating plastic waste, by acquiring a 40% share. In 2018, it bought an additional 40%. The remaining 20% should be acquired by June 2022.

***Hera's strengths are partly offset by its exclusive exposure to Italy.*** We think Hera's profitability may remain under pressure owing to the sluggish economic conditions in Italy, even after factoring in the rebound from the COVID-19-induced recession. On top of this, there is increasing competitiveness in liberalized businesses such as power and gas retail. In our view, this remains a risk that is only partly mitigated by Hera's efforts to cut costs and its strong brand reputation.

**Chart 5**

**Capex Split Over 2019-2024**
**Business plan horizon**




f--Forecast. Source: S&P Global Ratings.

## Financial Risk: Intermediate

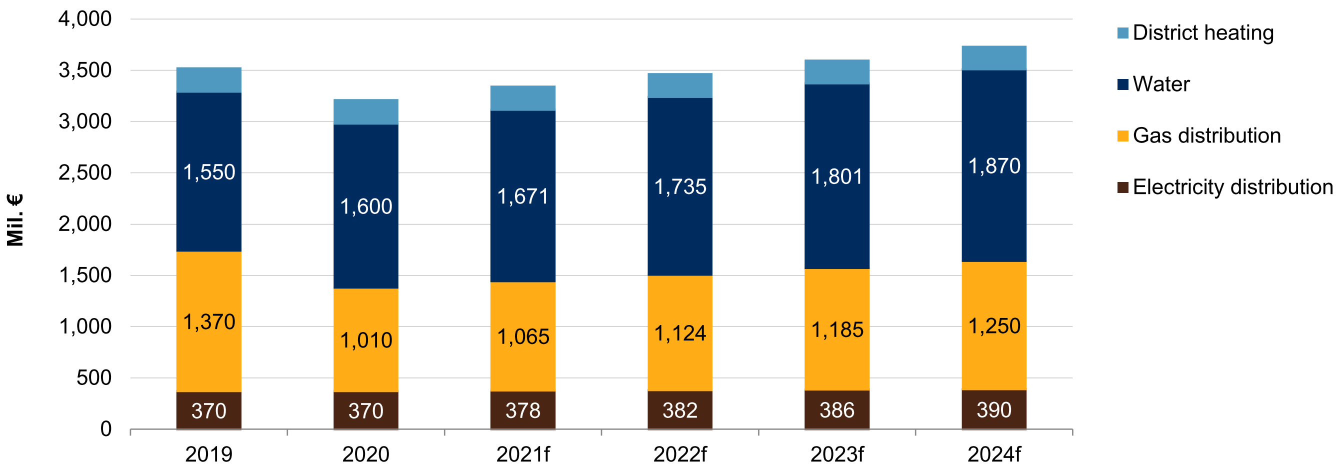
***Hera's financial profile is supported by the group's stable cash flow generation, with about 45% of profits coming from fully regulated activities.*** Stable revenue from regulated businesses and growth in merchant activities will support Hera's EBITDA above €1.2 billion by 2023, in our opinion. Therefore, we expect adjusted FFO to debt (including income from last-resort clients) will consistently hover at about 24% over 2021-2023. Under the 2020-2024 business plan, Hera is maintaining a high level of capex with €3.2 billion versus €2.86 billion in the previous five-year plan, 65% of which will go into regulated networks. This should allow the total RAB (excluding district heating) to expand at a compound annual growth rate of 2.8% to €3.8 billion in 2024 from €3.0 billion in 2020 (see chart 6).

***Hera's acquisitive strategy will not be detrimental to the rating as long as it continues to finance sizable transactions in credit-friendly ways.*** In the past, Hera's strategy was acquisitive, with the last large acquisition being that of Ascopiave's gas and power clients in 2019. In that instance, Hera acquired Ascopiave's client portfolio (EBITDA of about €60 million-€80 million) in exchange for 188,000 gas-distribution delivery points in northeast Italy. This did not result in any cash outflow, but left Hera with a put option on the remaining shares in EstEnergy SpA (52% owned by Hera), which can be exercised wholly or in part each year over seven years. This is why, starting from 2019, we have consolidated the Ascopiave-related put option in Hera's adjusted debt, for an amount of about €402 million in 2020, which we expect to increase to €445 in 2023. Although we do not include any large acquisition in our base case up to 2023, we do not exclude that there might be additional opportunities for Hera in the highly fragmented Italian power and gas sector. That said, we believe that such acquisitions will not be detrimental to the rating so long as Hera continues to finance sizable transactions through share swaps, as it did with Ascopiave, or with additional credit remedy measures. As a result, we expect adjusted debt to EBITDA to only slightly increase to 3.4x-3.6x by 2023, compared with the 3.3x in 2020.

***Hera has a sound financial policy with a strong commitment to the current rating level.*** In our view, Hera's board of directors considers a balance between healthy growth and dividend payments and is supportive of management's decisions, also thanks to the flexibility of Hera's public shareholders (see chart 4 above). Even after the recent announcement of a dividend per share increase, following strong 2020 results, the dividend pay-out remains at 53%, which is a controllable level in our opinion. Furthermore, we believe that Hera's management would be ready to take remedial credit actions to preserve the rating, should the growth embedded in the current plan be hampered by negative events, for instance by refraining from some of the discretional capex.

**Chart 6**

**RAB Evolution In The New Strategic Plan**
2019-2024




f--Forecast. Source: S&P Global Ratings.



## Financial summary

**Table 2**

| Hera SpA -- Financial Summary* | | | | | |
|---|---|---|---|---|---|
| **Industry sector: Energy** | | | | | |
| | **--Fiscal year ended Dec. 31--** | | | | |
| | **2020** | **2019** | **2018** | **2017** | **2016** |
| **(Mil. €)** | | | | | |
| Revenue | 7,079.0 | 6,912.8 | 6,134.4 | 5,612.1 | 4,460.2 |
| EBITDA | 1,038.9 | 1,027.2 | 984.9 | 924.7 | 869.6 |
| Funds from operations (FFO) | 790.0 | 833.1 | 715.5 | 681.9 | 573.7 |
| Interest expense | 103.3 | 114.1 | 121.7 | 121.0 | 129.7 |
| Cash interest paid | 64.3 | 71.0 | 92.8 | 95.3 | 158.0 |
| Cash flow from operations | 929.6 | 737.6 | 624.5 | 778.8 | 691.0 |
| Capital expenditure | 511.7 | 538.5 | 469.7 | 445.8 | 389.7 |
| Free operating cash flow (FOCF) | 417.9 | 199.1 | 154.8 | 333.0 | 301.3 |
| Discretionary cash flow (DCF) | 199.8 | 35.4 | (19.7) | 192.1 | 155.9 |
| Cash and short-term investments | 987.2 | 364.0 | 535.5 | 450.5 | 351.5 |
| Gross available cash | 987.2 | 364.0 | 535.5 | 450.5 | 351.5 |
| Debt | 3,441.6 | 3,580.3 | 3,132.2 | 3,089.2 | 3,055.7 |
| Equity | 3,155.3 | 3,010.0 | 2,846.7 | 2,706.0 | 2,562.1 |
| **Adjusted ratios** | | | | | |
| EBITDA margin (%) | 14.7 | 14.9 | 16.1 | 16.5 | 19.5 |
| Return on capital (%) | 9.2 | 9.9 | 9.6 | 9.4 | 8.8 |

**Table 2**

## Hera SpA -- Financial Summary* (cont.)

**Industry sector: Energy**

| | --Fiscal year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| | **2020** | **2019** | **2018** | **2017** | **2016** |
| EBITDA interest coverage (x) | 10.1 | 9.0 | 8.1 | 7.6 | 6.7 |
| FFO cash interest coverage (x) | 13.3 | 12.7 | 8.7 | 8.2 | 4.6 |
| Debt/EBITDA (x) | 3.3 | 3.5 | 3.2 | 3.3 | 3.5 |
| FFO/debt (%) | 23.0 | 23.3 | 22.8 | 22.1 | 18.8 |
| Cash flow from operations/debt (%) | 27.0 | 20.6 | 19.9 | 25.2 | 22.6 |
| FOCF/debt (%) | 12.1 | 5.6 | 4.9 | 10.8 | 9.9 |
| DCF/debt (%) | 5.8 | 1.0 | (0.6) | 6.2 | 5.1 |

*Figures are S&P Global Ratings' adjusted.

## Reconciliation

**Table 3**

## Hera SpA -- Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

| | --Fiscal year ended Dec. 31, 2020-- | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Hera SpA reported amounts** | | | | | | | | |
| | **Debt** | **Shareholders' equity** | **EBITDA** | **Operating income** | **Interest expense** | **S&P Global Ratings' adjusted EBITDA** | **Cash flow from operations** | **Capital expenditure** |
| Reported | 3,599.0 | 2,960.8 | 1,018.6 | 551.3 | 82.3 | 1,038.9 | 891.4 | 506.4 |
| **S&P Global Ratings' adjustments** | | | | | | | | |
| Cash taxes paid | -- | -- | -- | -- | -- | (184.6) | -- | -- |
| Cash interest paid | -- | -- | -- | -- | -- | (81.9) | -- | -- |
| Cash interest paid: Other | -- | -- | -- | -- | -- | 18.5 | -- | -- |
| Trade receivables securitizations | 33.7 | -- | -- | -- | -- | -- | 32.9 | -- |
| Reported lease liabilities | 93.6 | -- | -- | -- | -- | -- | -- | -- |
| Postretirement benefit obligations/deferred compensation | 113.8 | -- | -- | -- | 0.3 | -- | -- | -- |
| Accessible cash and liquid investments | (987.2) | -- | -- | -- | -- | -- | -- | -- |
| Dividends received from equity investments | -- | -- | 10.1 | -- | -- | -- | -- | -- |
| Power purchase agreements | 25.0 | -- | 6.2 | 0.9 | 0.9 | (0.9) | 5.3 | 5.3 |
| Asset-retirement obligations | 137.4 | -- | -- | -- | 19.8 | -- | -- | -- |
| Nonoperating income (expense) | -- | -- | -- | 48.9 | -- | -- | -- | -- |
| Noncontrolling interest/minority interest | -- | 194.5 | -- | -- | -- | -- | -- | -- |
| Debt: Guarantees | 0.4 | -- | -- | -- | -- | -- | -- | -- |

**Table 3**

| Hera SpA -- Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Debt: Contingent considerations | 24.1 | -- | -- | -- | -- | -- | -- | -- |
| Debt: Put options on minority stakes | 401.9 | -- | -- | -- | -- | -- | -- | -- |
| EBITDA: Gain/(loss) on disposals of PP&E | -- | -- | 6.0 | 6.0 | -- | -- | -- | -- |
| EBITDA: Other income/(expense) | -- | -- | (2.0) | (2.0) | -- | -- | -- | -- |
| Depreciation and amortization: Other | -- | -- | -- | 2.0 | -- | -- | -- | -- |
| Total adjustments | (157.4) | 194.5 | 20.3 | 55.8 | 21.0 | (248.9) | 38.2 | 5.3 |
| **S&P Global Ratings' adjusted amounts** | | | | | | | | |
| | **Debt** | **Equity** | **EBITDA** | **EBIT** | **Interest expense** | **Funds from operations** | **Cash flow from operations** | **Capital expenditure** |
| Adjusted | 3,441.6 | 3,155.3 | 1,038.9 | 607.1 | 103.3 | 790.0 | 929.6 | 511.7 |

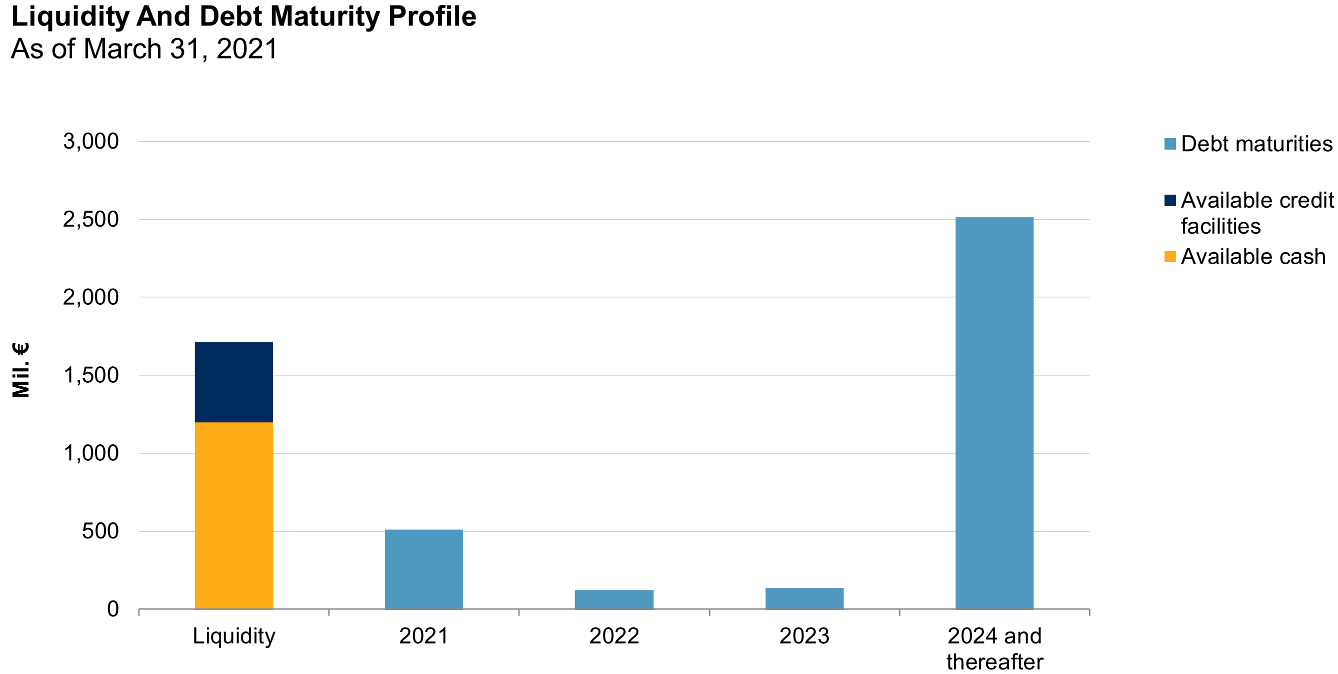
## Liquidity: Strong

Hera's liquidity is strong. In our view, as of March 31, 2021, the company's planned available cash and committed credit lines cover cash outlays--mainly capex, debt service, and dividends--by about 1.8x over the next 12 months and by well above 1.5x over the following 12 months. Furthermore, Hera has a high credit standing in the capital markets, strong relationships with banks, and solid and prudent risk management.

| Principal liquidity sources | Principal liquidity uses |
|---|---|
| • Our estimate of about €1.2 billion of cash and liquid investments fully available for use;<br>• Available undrawn committed credit lines of €500 million maturing beyond 12 months, which reduce to about €450 million over the following 12 months; and<br>• Our forecast of about €745 million of cash FFO over the next 12 months. | • Debt maturities of about €560 million over the next 12 months and about €65 million over the subsequent 12 months;<br>• Working capital outflows of €22 million over the next 12 months;<br>• Capex of about €615 million over the next 12 months; and<br>• More than €195 million paid in dividends, including dividends to minorities. |

### Debt maturities

**Chart 7**




Source: S&P Global Ratings.



## Environmental, Social, And Governance

We believe Hera is well positioned to benefit from the accelerated energy transition in Europe, mainly through its investments to foster circular economy.

We view favorably Hera's commitment to reduce Scope 3 emissions by 33% by 2030, compared with the levels in 2019.

Most of its carbon footprint relates to its the waste-to-energy segment, since it has no other direct exposure to power generation activities. We note Hera was the first company in Italy to issue a green bond, in June 2014, and remains active in green bond financing, issuing its second green bond in 2019.

About 24% of Hera's 2020 EBITDA came from regulated water distribution activities. The company consistently fully meets regulatory requirements when it comes to leakage reduction and water consumption reduction. Furthermore, it targets a 17% reduction in water intensity in 2024 versus 2019.

## Issue Ratings - Subordination Risk Analysis

### Capital structure

At year-end 2020, Hera's capital structure comprised about €3 billion of gross debt, almost all of which was unsecured.

### Analytical conclusions

We rate Hera's senior unsecured debt 'BBB+', the same as the long-term issuer credit rating, since there are no significant elements of subordination risk in the capital structure.

## Ratings Score Snapshot

### Issuer Credit Rating

BBB+/Stable/A-2

### Business risk: Strong

- **Country risk:** Moderately high
- **Industry risk:** Low
- **Competitive position:** Strong

### Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

### Anchor: bbb+

### Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

### Stand-alone credit profile : bbb+

- **Group credit profile:** bbb+

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

## Related Research

- Italian Multi-Utility Hera SpA Upgraded To 'BBB+' On Improved Credit Metrics; Outlook Stable; May 7, 2021
- Italian Multi-Utility A2A SpA Affirmed At ‘BBB/A-2’ On Announced Strategic Plan Through 2030; Outlook Stable, Feb 8, 2021
- The Energy Transition And What It Means For European Power Prices And Producers: January 2021 Update, Jan. 27, 2021
- Italian Electricity And Gas Transmission And Distribution Frameworks: Supportive, Jan. 20, 2021
- Italian Multi-Utility Hera's EBITDA Growth Should Offset Debt Increase In Ambitious New Strategic Plan To 2024, Jan. 14, 2021
- Hera SpA, June 26, 2020
- The Energy Transition And What It Means For European Power Prices And Producers: Midyear 2020 Update, June 8, 2020
- A2A SpA, June 1, 2020

## Business And Financial Risk Matrix

| Business Risk Profile | Financial Risk Profile | | | | | |
|---|---|---|---|---|---|---|
| | Minimal | Modest | **Intermediate** | Significant | Aggressive | Highly leveraged |
| Excellent | aaa/aa+ | aa | a+/a | a- | bbb | bbb-/bb+ |
| **Strong** | aa/aa- | a+/a | **a-/bbb+** | bbb | bb+ | bb |
| Satisfactory | a/a- | bbb+ | bbb/bbb- | bbb-/bb+ | bb | b+ |
| Fair | bbb/bbb- | bbb- | bb+ | bb | bb- | b |
| Weak | bb+ | bb+ | bb | bb- | b+ | b/b- |
| Vulnerable | bb- | bb- | bb-/b+ | b+ | b | b- |

## Ratings Detail (As Of June 30, 2021)*

| | |
|---|---|
| **Hera SpA** | |
| Issuer Credit Rating | BBB+/Stable/A-2 |
| Senior Unsecured | BBB+ |
| **Issuer Credit Ratings History** | |
| 07-May-2021 | BBB+/Stable/A-2 |
| 13-Mar-2018 | BBB/Positive/A-2 |
| 12-Jul-2013 | BBB/Stable/A-2 |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.