MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Hera´s Baa2 rating; outlook stable

25 Jun 2019

Madrid, June 25, 2019 -- Moody's Investors Service ("Moody's") has today affirmed the Baa2 long-term issuer rating and senior unsecured ratings of Hera S.p.A. (Hera) following the company´s announcement on 17 June 2019 that it will enter into a partnership with Ascopiave S.p.A. (Ascopiave) to develop a major operator in the gas and electricity supply business in the North-East of Italy. Moody´s has also affirmed the (P)Baa2 rating on Hera´s EMTN programme. The outlook remains stable.

RATINGS RATIONALE

The affirmation of Hera´s ratings reflects the moderate impact of the announced partnership on Hera´s business and financial profiles. The addition of Ascopiave´s gas and electricity sales business, through the consolidation of a joint venture named EstEnergy S.p.A. (EstEnergy), is in line with Hera´s strategic plan to expand its client base in the energy segment to 3 million customers by end of 2022; whereas the financial impact of the transaction is mitigated by the partial funding through shares and an asset swap.

The partnership agreement foresees an upsizing of the existing EstEnergy, which is currently jointly controlled by Hera and Ascopiave, to include the companies´ broader gas and electricity sale operations in the Veneto, Friuli Venezia Giulia and Lombardia regions of Italy. EstEnergy's total combined client base post-merger is estimated at 1.069 million customers, of which about 800,000 are current Ascopiave clients. The transaction will be mainly funded through an exchange of shares and assets between the two companies. Hera will retain control (52% ownership) of EstEnergy in exchange for the disposal to Ascopiave of part of its local gas distribution network (which generated 1.6% of its consolidated EBITDA in 2018 and has an estimated value of EUR171 million) and a minority shareholding of 3.6% in Hera Comm, the Hera Group´s sales company. The transaction also includes the acquisition by Hera Comm of Amgas Blu, a sales company entirely owned by Ascopiave and operating in the province of Foggia with about 50,000 gas supply customers.

The implied enterprise value assigned to Ascopiave´s clients under this transaction is EUR587 million, which is equivalent to EUR790 per client. Although this is above the sector average in Europe, Moody´s understands that Hera´s management is expecting to benefit from material synergies thanks to cross-selling activities and operational improvements, which will in turn sustain the joint venture´s growth ahead of the full liberalization of the retail energy supply market in Italy. The latter is currently planned for 2020. In Moody´s view, the greater exposure to the unregulated gas and electricity supply business stemming from the consolidation of an additional EUR40 million of EBITDA combined with the simultaneous reduction of the contribution from regulated networks (from 43% of EBITDA to 41% on a pro forma basis) is not material in the context of Hera´s well-diversified business mix and total reported EBITDA in excess of EUR1 billion.

At the same time, under the shareholder agreement that will govern the relationship between EstEnergy's shareholders, Ascopiave will be granted a transfer option concerning its future minority shareholding. This right may be exercised, wholly or in part, up to the seventh year from the closing date (estimated to take place in December 2019), at a price set at the higher between (1) the fair market value of the shareholding at the exercise date and (2) the value of the shareholding, revised by applying a 4% annual interest rate, net of the amount of dividends received. Such right will be also extended to Ascopiave´s shareholding in Hera Comm, and will result in a corresponding liability of around EUR475 million on Hera's balance sheet. Moody´s considers this put option as a debt-like obligation in line with the rating agency´s practice, and will calculate Hera´s credit metrics accordingly. Nevertheless, Moody´s expects that the company will continue to exhibit financial metrics that are commensurate with the current rating level. In particular, adjusted Funds From Operations (FFO) to net debt and retained cash flow (RCF) to net debt ratios are estimated at 20% and 16%, respectively, post-closing , which remains well above Moody´s guidance for the Baa2 rating of FFO/Net Debt in the mid-teens and RCF/Net Debt in the low double digits, both in percentage terms.

Finally, today's rating action also reflects that Hera´s Baa2 rating continues to factor in the company's (1) diversified business mix; (2) portfolio of low-risk domestic regulated activities (which will continue to generate more than 40% of EBITDA following the transaction) with limited exposure to volumes and underpinned by supportive and transparent regulatory frameworks; (3) strategy of growth through small and medium-scale acquisitions funded with exchange of shares; and (4) solid liquidity and financial profiles. These positives are balanced by (1) the exposure to potential changes in 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 waste management and energy supply businesses; and (3) the exposure, although limited, of Hera's power generation and waste businesses to volatile power prices in Italy.

Given Hera's 47.9% public shareholder base, Moody's considers the company to be a government-related issuer. However, the Baa2 rating does not incorporates any uplift from Hera's standalone credit quality, expressed as a baseline credit assessment (BCA) of baa2, based on Moody's assessment of low support and moderate dependence. Moody's assumption of low support takes account of the limited capacity of Hera's public shareholders to provide support to the company in a scenario of financial distress.

OUTLOOK

The stable outlook is in line with the stable outlook on the Government of Italy's rating, reflecting the company's links with the sovereign, which constrain Hera's ratings at Baa2. The stable outlook also reflects Moody's expectation that Hera will maintain its current solid financial and liquidity profiles.

WHAT COULD CHANGE THE RATING UP

Any potential upgrade of Hera's ratings would be contingent on (1) an upgrade of the Government of Italy's rating; and (2) Hera maintaining its current underlying credit profile, reflected in adjusted FFO/net debt above the high teens and RCF/net debt above the low teens, both in percentage terms, and a good liquidity position.

WHAT COULD CHANGE THE RATING DOWN

Negative pressure on Hera´s ratings could arise following (1) a downgrade of the Government of Italy's rating; (2) 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; or (3) a deterioration in Hera's business risk profile as a result of its growth strategy, with no offsetting strengthening in its credit metrics.

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in May 2017, and Government-Related Issuers published in June 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

Headquartered in Bologna, Hera S.p.A. is one of the largest multi-utilities in Italy. At the end of 2018 the company reported revenues of EUR6.1 billion.

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