Research Update:

Italian Multi-Utility Hera Outlook Revised To Negative On Delayed Credit Metric Recovery; 'BBB+/A-2' Ratings Affirmed

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Overview

- We believe adverse economic and market conditions in Italy will delay the recovery of Italian multi-utility Hera SpA's credit metrics.
- We are revising downward our forecast for Hera's net cash flow over 2013-2014.
- We are revising our outlook on Hera to negative from stable and affirming our 'BBB+/A-2' ratings.
- The negative outlook reflects our opinion that Hera could struggle to improve its credit metrics to be commensurate with a 'BBB+' rating in 2013-2014.

Rating Action

On April 26, 2013, Standard & Poor's Ratings Services revised its outlook on Italy-based multi-utility Hera SpA to negative. The 'BBB+/A-2' long- and short-term corporate credit ratings were affirmed.

Rationale

The negative outlook reflects our view that the worsening economic and market conditions in Italy for utilities will weigh on Hera's operations. We now believe Hera will struggle to strengthen its ratio of funds from operations (FFO) to debt, as adjusted by Standard & Poor's, to our previous forecast of about 20% by 2013-2014. Although management says it aims to achieve this ratio, Hera is a shareholder-friendly group, and we note the absence of a clear alternative plan to deleverage in case of a weaker-than-expected market environment.

Although Hera's credit metrics are recovering more slowly than we previously forecast, we still believe the group can improve its weak credit metrics over the next few years. However, we believe Hera's delayed recovery is unlikely to be commensurate with our 'BBB+' rating over 2013-2014.

We understand that Hera's management will rely exclusively on increasing operating cash flow to improve its credit metrics over 2013-2014. However, we now forecast that the group will post negative cash flow after capital expenditures and dividends over the next two years. In our view, this means Hera has very little room to strengthen its credit metrics should economic and industry conditions deteriorate further. Although approximately 50% of Hera's EBITDA comes from low-risk regulated activities, we see downside risk, mainly due to the weak operating environment.

As a result, we believe Hera will maintain adjusted FFO to debt at 16%-18% in 2013-2014 unless the company commits to alternative actions to reduce debt.

Hera has a "high" exposure to Italian country risk, in our view. This is based on its domestic earnings profile and our view of the utility sector's high sensitivity to country risk. Hera's waste segment, the group's historical growth factor, is sensitive to local economic conditions.

Liquidity

We assess Hera's liquidity as "strong" according to our criteria. In our view, the company will cover its planned cash outlays--mainly capital expenditures, debt service, and dividends--with available cash, committed credit lines, and FFO, by more than 2.0x over 12 months following Dec. 31, 2012.

Our assessment is underpinned by:
- Access to unrestricted cash of more than €524 million, mainly held at the parent company level;
- Available committed credit lines of €170 million in December 2012, with a maturity longer than 12 months;
- Our forecast that Hera will generate annual adjusted FFO of about €500 million over the next 12 months; and
- €700 million of proceeds from the bond issue in January 2013.

This compares with our forecast that over the next 12 months, Hera faces:
- €360 million of capital expenditures;
- Dividend outflows of approximately €120 million; and
- Debt maturities below €300 million.

We see as supportive that Hera managed to renegotiate its bonds with put options so they no longer weigh on short-term refinancing needs. In addition, we understand the company intends to extend committed credit facilities of about €250 million that mature in less than 12 months. At the same time, under our base-case scenario, we anticipate that Hera will post negative discretionary cash flow after capital expenditures and dividends over the next two years.

Outlook

The negative outlook reflects our view that Hera could struggle to improve its weak credit metrics to be commensurate with a 'BBB+' rating over the next 12-24 months. We base our opinion on the weak economic and operating environment in Italy and the group's shareholder-friendly dividend strategy.

We could lower ratings if we believed Hera could only marginally improve its currently below-average credit metrics for the ratings in 2013-2014. This could be the result of either a weaker operating performance than we currently expect or the maintenance of an aggressive dividend strategy. A weaker operating performance could also lead us to revise our opinion on the resilience of Hera's business risk profile to the deteriorating economic environment.

We could also lower the rating on Hera if we lowered the sovereign rating on the Republic of Italy (BBB+/Negative/A-2, unsolicited) by two notches or more, owing to our view of Hera's high exposure to Italian country risk. This is because we associate a deterioration of sovereign-related risks with increasing adverse market conditions for corporates operating in Italy, in particular utilities.

We could revise the outlook to stable if we believed Hera was committed to, and presented a plan for more aggressive deleveraging that would result in healthy positive cash flow after capital expenditure and dividends over the near to medium term. This would, in our view, support the recovery of Hera's credit metrics, including an FFO-to-debt ratio of about 20% or higher by the end of 2014.

Related Criteria And Research

- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology: Short-Term/Long-Term Ratings Linkage Criteria For Corporate And Sovereign Issuers, May 15, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Understanding Standard & Poor's Rating Definitions, June 3, 2009
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Hera SpA		
Corporate Credit Rating	BBB+/Negative/A-2	BBB+/Stable/A-2
Senior Unsecured	BBB+	

Additional Contact:
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Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.