STANDARD & POOR'S
RATINGS SERVICES
McGRAW HILL FINANCIAL

Research

Summary:
Hera SpA

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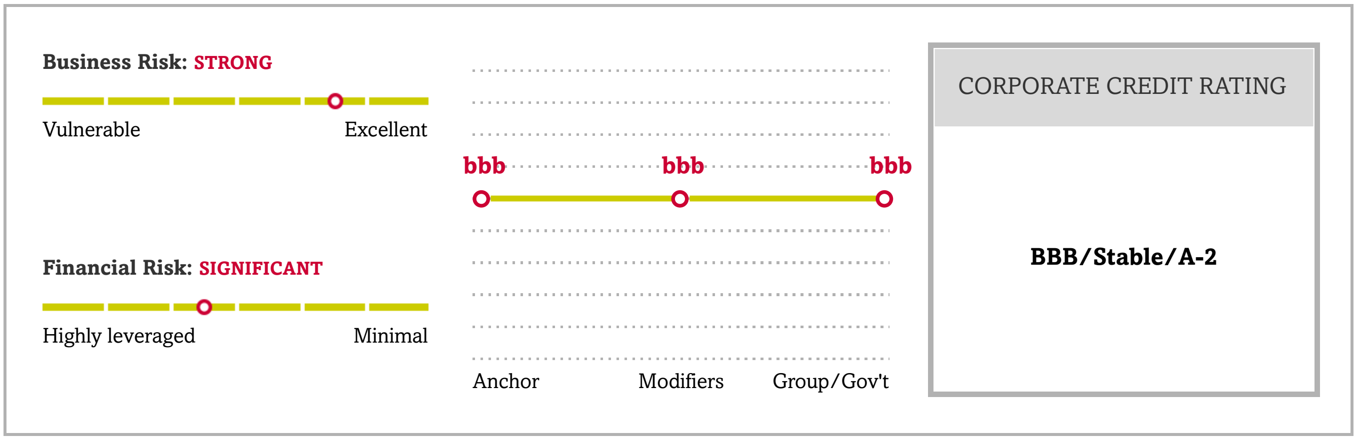
Summary:

Hera SpA



Rationale

Business Risk: Strong	Financial Risk: Significant
• Well-balanced portfolio of utility services with the share of low-risk regulated activities exceeding 50% of EBITDA. • Dominant regional position in waste and water management, and a leading position among gas suppliers in Italy. • Service provider to prosperous Italian regions. • Exposure to the depressed economic environment in Italy. • Highly acquisitive growth strategy with a minor impact on debt.	• Aggressive dividend distributions. • Slowly improving credit metrics. • Our anticipation of neutral cash flow after capital expenditures and dividends.

Outlook: Stable

The stable outlook on Italian multi-utility Hera SpA reflects Standard & Poor's Ratings Services' expectation that the company will achieve and sustain adjusted funds from operations (FFO) to adjusted debt of 18%, which we consider commensurate with Hera's "significant" financial risk profile.

Downside scenario

We could lower the rating if we considered that Hera could struggle to achieve and maintain adjusted FFO to debt of approximately 18% over the next 24 months. This could occur if Italy's market and industry conditions do not recover, jeopardizing Hera's commitment to maintaining neutral cash flow generation after capital expenditures and dividends. We would also lower our ratings on Hera as a result of aggressive acquisitive strategies that might further delay the recovery of its credit metrics.

Upside scenario

We could raise the rating if we were convinced that Hera would achieve and sustain adjusted FFO to debt above 23%, assuming no further change in our assessment of Hera's business risk.

Standard & Poor's Base-Case Scenario

Assumptions

- Full consolidation of Amga Udine into Hera's 2014 credit metrics;
- Capital expenditures of €1.2 billion over 2014-2016, including resources to retender existing gas concessions;
- A slightly diminishing tax rate in 2014 of 41%, down from 42.8% in 2013;
- An average of €130 million disbursed for dividend payments annually; and
- An average debt cost of 4.3%.

Key Metrics

	2014e	2015e	2016e
Adjusted FFO to debt (%)*	16-17	17-18	19-20
Debt to EBITDA (x)	3.8	3.7	3.5

FFO--Funds from operations. e--Estimate.

Financial Risk: Significant

Our assessment of Hera's financial risk profile as "significant" reflects our view of its aggressive dividend policy, combined with relatively weak credit metrics, namely adjusted FFO to debt of 16.5% and debt to EBITDA of 4.1x at year-end 2013. Hera's strategy is to improve its credit metrics by increasing operating cash flows over the medium term.

In our base-case scenario, however, we forecast that Hera will post neutral cash flow after capital expenditures and dividends over the next two to three years. In our view, this means that Hera has little room to maneuver, and less ability to reduce debt in a gloomy economic and industry environment.

However, prudent debt management, good access to the bond market, strong liquidity, and a good degree of cash flow predictability, determined by the high and potentially increasing share of regulated business in Hera's portfolio, partly mitigate these risks, in our view.

Other Modifiers

The modifiers have no impact on the ratings.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/A-2

Business risk: Strong

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

Financial risk: Significant

- **Cash flow/Leverage:** Significant

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)

Related Criteria And Research

- Key Credit Factors For The Unregulated Power and Gas Industry, March 28, 2014
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

	Financial Risk Profile					
Business 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-

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