

Rating Action: Moody's downgrades Hera to Baa1; negative outlook

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London, 26 January 2012 -- Moody's Investors Service has today downgraded to Baa1 from A3 the long-term issuer and senior unsecured ratings of Hera S.p.A. (Hera). The outlook assigned to the ratings is negative.

RATINGS RATIONALE

Today's rating action reflects Moody's view that, as a result of the implementation of Hera's investment programme for 2011-15 and the relatively high expected dividend payments, the company's projected financial profile will likely be inconsistent with the previous A3 rating.

Hera's investment plan for 2011-15 includes more than EUR1.8 billion of capital expenditure (capex), of which more than 60% is related to development initiatives and the remainder to maintenance. The bulk of Hera's projected expenditures are concentrated on its networks business (67% of the total). Here, the company plans to increase its presence in the gas distribution segment through the potential award of new concessions and to expand its water, gas and electricity networks. In the waste segment (representing 28% of capex), Hera aims to complete waste-to-energy projects under development and increase the amount of waste it treats. As part of its plan, the company also intends to strengthen its energy activities, with the objective of enlarging its customer base.

The negative outlook on the ratings reflects that, in the context of its planned investments, Hera's performance could be negatively affected by (i) the greater uncertainty and general pressures that the company is facing as a result of the current sovereign and macroeconomic environment in Italy; and (ii) Moody's expectation of more volatile and expensive funding conditions associated with this environment. In light of Hera's material presence in the water, gas distribution and waste collection segments, the negative outlook also reflects (i) the uncertainties characterising the Italian water regulatory framework and associated parameters related to the remuneration of capital invested; and (ii) the short- and long-term renewal risks characterising Hera's gas distribution and waste collection concessions, which the rating agency expects will be tendered over the short to medium term.

In order to support the current Baa1 rating, Hera would need to exhibit ratios of (i) funds from operations (FFO)/net debt at least in the mid-teens in percentage terms; (ii) retained cash flow (RCF)/net debt at least in the low double digits in percentage terms; and (iii) FFO interest coverage of at least 3.5x.

Because of Hera's majority ownership by a number of Italian municipalities, of which the largest is the City of Bologna with a stake of approximately 14%, the company falls under Moody's methodology for government-related issuers (GRIs). As a reflection of the considerations discussed above, Moody's has revised downwards Hera's baseline credit assessment (BCA) -- which represents the company's standalone credit quality -- to 8 from 7, which, on a scale of 1-21, is equivalent to the Baa1 rating category. Moody's assesses the other GRI inputs as being (i) the credit quality of Hera's municipal shareholder (the City of Bologna, not rated); (ii) the moderate level of default dependence between the City of Bologna and Hera; and (iii) the low probability that the City of Bologna will provide the company with support in the event of need. As a result of these inputs, particularly the low-probability-of-support assumption, Hera's rating does not currently receive any uplift under Moody's GRI methodology.

WHAT COULD CHANGE THE RATING UP/DOWN

Given the current negative outlook, Moody's does not expect upward rating pressure in the intermediate

term.

The outlook could return to stable if the pressures linked to the current sovereign and macroeconomic environment in Italy were to ease, supported by Hera's continued presence in regulated activities and a comfortable positioning of key credit metrics within the guidance discussed above. In addition, the rating outlook could be stabilised following the resolution of the current regulatory uncertainties characterising Hera's water activities.

Further negative pressure on the ratings could develop in the event of (i) a material weakening of the sovereign and macroeconomic environment in Italy; (ii) a deterioration in Hera's financial profile to a level that is inconsistent with the guidance discussed above; and/or (iii) a deteriorating business risk profile, as a consequence of regulatory uncertainties and/or a shift from low-risk regulated activities in favour of higher-risk unregulated activities.

PRINCIPAL METHODOLOGY

The principal methodology used in rating Hera was "Government-Related Issuers: Methodology Update", published July 2010. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Hera is one of the largest integrated multi-utilities in Italy, with a particular focus on the region of Emilia Romagna, one of the wealthiest in the country. The company provides a variety of public services, including the sale and distribution of gas and electricity, the provision of integrated water services and urban and special waste collection and disposal services, as well as ancillary activities, such as district heating and public lighting. In the financial year ended 31 December 2010, the company recorded a turnover of approximately EUR3.7 billion.

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