



Moody's Investors Service

Rating Action: **Moody's downgrades Hera's rating to A2; outlook negative**

Global Credit Research - 22 Jul 2009

Approximately EUR500 million of rated debt affected

London, 22 July 2009 -- Moody's Investors Service has today downgraded to A2 from A1 the long-term senior unsecured issuer and debt ratings of Hera S.p.A. ("Hera"). The outlook assigned to the ratings is negative. The rating action concludes the review initiated on 20 May 2009.

The downgrade reflects Moody's view that the implementation of the company's investment programme for 2009-11, in conjunction with relatively high projected dividend payments, will result in a projected credit profile inconsistent with the previous A1 rating.

Hera's investment plan for 2009-11 includes more than EUR1 billion of capex, of which approximately 43% is related to development initiatives and 57% to maintenance. The bulk of projected expenditures are concentrated on the waste segment (28%), where Hera aims to complete waste-to-energy ("WTE") projects under development and expand the special waste business segment, and water activities (35%), with capex aimed at optimising sourcing and expanding the network. As part of its plan, Hera also intends to strengthen its energy activities, with the strategic objective of increasing upstream integration, enlarging its customer base and expanding its district heating network.

Whilst Hera has indicated that funding of the investment programme for 2009-11 is expected to be fully covered by internally generated operating cash flows, Moody's believes that the combination of the planned capex and the relatively high projected dividend payments will continue to weigh on the company's financial profile. Thus, Moody's has downgraded the company's rating to A2.

Going forward, Moody's would expect Hera to exhibit an FFO Interest Coverage ratio of at least 4.5x, FFO/Net Debt above 20% and RCF/Net Debt at least in the mid teens on a sustainable basis to support the current ratings. These ratios guidance recognise the company's business risk positioning, underpinned by Hera's continued presence in the low risk regulated businesses.

Whilst acknowledging the projected boost to Hera's earnings over the medium term, Moody's notes that cash generation associated with a portion of the current envisaged level of investments will be relatively limited in the short-term, potentially resulting in a weak positioning of the company within the current rating category. Therefore, to reflect the limited flexibility at the current rating levels, Moody's has assigned a negative outlook to Hera's rating.

In light of Hera's 15% ownership by the City of Bologna, the company falls under Moody's methodology for Government Related Issuers ("GRIs"), although its rating does not receive any uplift from potential government support. As a reflection of the considerations discussed above, Moody's has revised downward one of Hera's GRI rating inputs -- the Baseline Credit Assessment ("BCA"), which represents the company's stand-alone credit quality -- from 5 to 6, which, on a scale of 1-21, is equivalent to the A2 rating category. The other GRI inputs for Hera remain unchanged, namely; (1) the Aa2/stable outlook rating of the City of Bologna; (2) Moody's assessment of low default dependence between the City of Bologna and Hera; and (3) the agency's assessment of low probability of support.

The previous rating action on Hera was implemented on 20 May 2009, when Moody's placed the company's long-term senior unsecured issuer and debt ratings under review for possible downgrade.

The principal methodology used in rating Hera was "The Application of Joint Default Analysis to Government Related Issuers" published in April 2005, which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating Hera can also be found in the Credit Policy & Methodologies directory.

Hera is one of the largest integrated multi-utilities in Italy, with 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 three months ended 31 March 2009, Hera recorded a turnover of approximately EUR1.3 billion.

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