

Rating Action: [HERA S.p.A.](#)

MOODY'S ASSIGNS A1 RATING TO HERA SpA; STABLE OUTLOOK

Approximately EUR500 Million of Long-Term Debt Instruments Rated

London, 26 January 2006 -- Moody's Investors Service has assigned an A1 long-term issuer rating to HERA S.p.A. ("Hera"), the Italian multi-utility company, and an A1 rating to the EUR500 million senior unsecured notes due [2016/2021] to be issued by Hera. The outlook on all ratings is stable. This is the first time that Moody's has assigned ratings to Hera.

Hera's A1 ratings reflect the application of Moody's rating methodology for government-related issuers ("GRIs"). For details, please refer to Moody's Special Comment "The Application of Joint Default Analysis to Government-Related Issuers", published in April 2005. In accordance with this methodology, the ratings of Hera are based on the following inputs:

- A Baseline Credit Assessment of 3 (on a scale of 1 to 6, where 1 represents the lowest credit risk)
- The Aa2 rating of the City of Bologna
- Low dependence
- Low support

Hera's Baseline Credit Assessment ("BCA") is strongly positioned in the 3 category and reflects the following positive factors: (i) the regulated or contracted nature of the majority of the group's activities under relatively supportive regulatory frameworks, which should underpin cash flow stability and predictability, (ii) the favourable economic and demographic characteristics of Hera's service area, one of Europe's wealthiest regions, (iii) the benefit of a diversified portfolio of public utility businesses and ancillary activities, which should smooth financial performance and protect market positions, (iv) Hera's good service performance, demonstrated by low water leakage and high environmental compliance, (v) management's good track record of amalgamating the municipal businesses combined into the group, (vi) some protection from event risk due to Hera's core municipal shareholder group, which is expected to retain majority control, and (vii) good financial flexibility, notwithstanding increasing indebtedness due to a sizeable capital programme.

Hera's BCA also takes into account the following negative factors: (i) the growing importance of non-regulated cash flows, given that the majority of investments are in waste-to-energy plants, gas power plants and district heating, and the potential for the risk profile of Hera's low-margin energy supply businesses to worsen as competition develops and market structures evolve, and (ii) Hera's relatively short track record and the potential for additional M&A activity if the group seeks to further expand its territorial coverage.

In assigning a low dependence to Hera, Moody's has considered that (i) the majority of the company's revenues are generated from a wider area in the Emilia Romagna region, well beyond the City of Bologna's territory, and (ii) the majority of the factors that are likely to affect Hera's business and financial performance are unlikely to impact the City of Bologna's credit quality, and vice versa. Moody's notes that only a small portion of Hera's revenues is sourced directly from the City of Bologna.

Moody's assessment of low support reflects the relatively small stake of the City of Bologna, which holds 15% of the company's share capital, and the large size of the company relative to the City's financial capacity. In total, about 59% of Hera's shares are held by over 150 different municipalities in the Emilia Romagna region, whilst the remaining 41% are owned by institutional and private investors. Under the company's by-laws and the terms of the shareholder agreement signed by Hera's municipal shareholders, at least 51% of the company's share capital must remain under municipal ownership. Similarly to the other municipal shareholders, the City of Bologna has some material interests in Hera, both as shareholder and in relation to the quality of services provided within its territory. However, Moody's believes that it is unlikely that the City would be willing or able to provide extraordinary support to Hera in the event of a financial crisis, without a concerted effort by the other shareholders. Moody's has thus concluded that the probability of timely support is low.

The stable outlook reflects Moody's expectation that Hera's investment plans and efficiency savings from the integration and rationalisation of its businesses will generate substantial cash flow growth to limit the negative

impact of an increasing debt burden on the company's credit metrics. Moody's expects that Hera will maintain ratios of Funds from Operations (FFO) and Retained Cash Flows (RCF) to Net Adjusted Debt in the region of 25% and 20%, respectively, and FFO Net Interest Cover at over 6.0x.

Moody's expects that Hera's ratings will generally move in line with any changes in the company's BCA. The ratings could be upgraded if Hera were to establish a track record of very low cash flow volatility and a strategic focus on low-risk utility activities (including disengagement from competitive businesses if their risk profile deteriorates). Furthermore, a prolonged improvement in credit metrics beyond the ratio expectations underpinning the rating, with FFO/Net Adjusted Debt above 30%, RCF/Net Adjusted Debt above 25% and FFO Net Cash Interest Cover above 8.0x, would be likely to put positive pressure on the ratings.

The ratings could be downgraded if Hera's overall business risk were to increase due to a shift from low-risk regulated to higher-risk non-regulated activities or a severe deterioration in the risk profile of certain existing non-regulated activities (e.g. energy supply). In addition, a material and persistent decrease in financial flexibility beyond the ratio expectations underpinning the rating, with FFO/Net Adjusted Debt below a percentage in the low 20s, and FFO Net Cash Interest Cover below 5.0x, or an aggressive dividend policy resulting in a ratio of RCF to Net Adjusted Debt consistently below 18%, might put negative pressure on the ratings.

The following first-time ratings were assigned to Hera:

- Issuer rating: A1, stable outlook.

- EUR500 million senior unsecured notes due [2016/2021]: A1, stable outlook.

HERA S.p.A. is a multi-utility company, headquartered in Bologna, Italy. It is one of the country's largest utility companies and operates in the Emilia Romagna region, the sixth largest of Italy's 20 regions and one of the wealthiest. The group was formed through the integration of 11 municipal utilities within this region in 2002 and was listed on the Italian stock exchange in June 2003. The group 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 2004, the company had a turnover of about EUR1.5 billion.

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