10 November 2023 – Neuss, Germany

Rating Action / Update:

Creditreform Rating has affirmed the unsolicited corporate issuer rating of Hera S.p.A. at BBB / Stable

Analysts

Sabrina Mascher de Lima
Lead Analyst
S.Mascher@creditreform-rating.de

Christina Sauerwein
Co-Analyst
C.Sauerwein@creditreform-rating.de

Neuss, Germany

Creditreform Rating (CRA) has affirmed the unsolicited, public corporate issuer rating of Hera S.p.A. – hereafter referred to as Hera or the Company, as well as the unsolicited corporate issue rating of its long-term local currency senior unsecured notes at BBB. The initial unsolicited short-term rating was set to L3 (adequate level of liquidity). Additionally, CRA has maintained the stable outlook for the aforementioned rating objects.

Hera S.p.A., headquartered in Bologna, Italy, was founded in November 2002 following the merger of several multi-utility companies operating in Italy's northeastern region. Hera and its subsidiaries operate mainly in the distribution and sale of electricity and gas (ranked among the top five national operators), waste management (the largest operator in Italy), integrated water services, including collection, drinking water purification and water distribution (between top two national operators), and public lighting (5th largest operator). In 2022, the Company generated net revenues of EUR 20,082 million with a reported EBIT margin of 2.7%.

Current relevant factors for the rating

The following considerations were of specific relevance for the rating assessment:

- Hera has shown stable to growing operating results in 2022 and in 9M2023
- Energy prices are abating, but global economic uncertainty and high geopolitical risks remain
- Increased capex and dividend payments, coupled with prolonged economic volatility, could exert negative pressure on Hera's financial profile in the forthcoming years
- Debt levels increased substantially during 2022 due to the temporary effect of exceptionally high gas prices and the consequent higher working capital requirements
- New tariff methodic set lower remuneration for the investment in regulatory asset base (RAB), which, in times of rising interest rates, could pressure net profits downward
- New concessions continue to ensure the growth of regulated activities and the stability in future cash flows
- Comfortable liquidity position and active liability management strategy continue to be key supporting factors of the rating
- Unsolicited sovereign rating of the Italian Republic of BBB- / stable limits the corporate issuer rating of Hera S.p.A.

ESG factors are factors related to environment, social issues and, governance. For more information, please see the "Regulatory requirements". CRA generally takes ESG relevant factors into account, when assessing the rating object and discloses them when they have a significant influence on the creditworthiness of the rating object, leading to a change in the rating result or the outlook.

ESG-criteria:

CRA generally takes ESG factors (environment, social and governance) into account within its rating decisions. In the case of Hera S.p.A. we have not identified any ESG factors with significant influence.

Since the beginning of February 2022, the European Commission classified natural gas as sustainable source under certain conditions; regarding gas as an essential part of the energy mix and as a transitional technology. In the longer-term, the Company will remain susceptible to the future acceptance of natural gas as an energy source and the accelerated pace of renewable transition, facing higher costs and investments to adapt its business model to the changing economic conditions and increasingly awareness on climate neutrality.

Hera's other business segments, namely waste and water, play a key role in terms of sustainability. The Company operates the entire waste and water cycles and is taking several initiatives to transition towards a circular economy, investing in recycling activities, using waste to produce biomethane, enhancing its logistics platform to support waste storage, treatment and appropriate disposal systems and expanding reuse and recovery of water.

Currently, nearly 52% of Hera's EBITDA is generated from environmentally sustainable activities, with a target of reaching 70% by 2030. To achieve this goal, the Company has committed itself to increasing its recycling activities (plastic by +150% and packaging by +80%), rising the share of electricity sales from renewable sources from current 41% to over 50%, almost doubling its biomethane production and reducing its carbon emission (scope 1, 2 and 3) by 37%, all by 2030. Additionally, the Company is also well-positioned in terms of the S- and G-factors, showing an integrated ESG culture, partly due to its ESG-linked management compensation and the promotion of gender diversity.

A general valid description of Creditreform Rating AG, as well as a valid description of corporate ratings for understanding and assessing ESG factors in the context of the credit rating process, can be found here.

Rating result

The unsolicited corporate issuer rating of BBB attests Hera a highly satisfactory level of creditworthiness and a low-to-medium default risk. Key factors included in the rating is the Company's integrated and diversified business model as well as its strong presence in the North-Eastern Italy, a more populated and higher-income region. An additional positive consideration is the systemic relevance of Hera's activities and its stable cash flow generation, as nearly half of its operations are regulated and somewhat insulated from market volatility. Hera's industry expertise is also a supporting factor for the ratings, which has enabled it to achieve continuous operating earnings growth throughout its history, both through organic investments and M&A transactions. Hera's conservative financial policies and solid liquidity profile also weigh positively on the rating assessment.

On the other hand, negative considerations factored into the rating are Hera's geographic concentration, as all revenues are generated domestically, leaving it highly exposed to Italy's macroeconomic and political conditions. Additionally, Hera's investment needs will increase in the coming years in view of the sector's renewable transition, which could temporarily exert nega-

Please note:

The scenarios are based on information available at the time of the rating. Within the forecast horizon, circumstances may occur that could lead to a change of the rating out of the indicated range.

tive pressure on its credit metrics. Other negative factors are the still uncertain economic conditions and increased geopolitical tensions globally, which could prolong the volatility on the energy markets and overall price environment.

Finally, Hera's rating is also constrained by the unsolicited sovereign rating of the Italian Republic (CRA: BBB- / stable as of January 17, 2023). Based on Hera's standalone credit quality, the rating could exceed the sovereign rating of Italy by up to two notches; nevertheless, it ranks just one notch above given that its public shareholding base is composed of municipalities within northeastern Italy and not directly owned by the State.

Outlook

The outlook for the next 12 months is stable. This represents our view that Hera will be able to sustain its overall stable business performance despite still ongoing economic uncertainties and increased geopolitical risks. The outlook on Hera's ratings also mirrors the outlook for the unsolicited sovereign rating of the Italian Republic. Should the operational and financial performance face a significant deterioration with an unproportioned increase in debt levels, or if there is any change in the outlook of the Italian Republic, an adjustment on the Company's outlook could be considered.

Best-case scenario: BBB

In our best-case scenario for one year, we assume a rating of BBB. Such a scenario would occur if the Company's is able to sustain growth in operating results and if its leverage and liquidity profile do not deteriorate amid a higher investment phase. This scenario takes into account stability in macroeconomic and political conditions in Italy. An upgrade in the short-term is unlikely since the ratings are constrained by the sovereign rating of the Italian Republic.

Worst-case scenario: BBB-

In our worst-case scenario for one year, we assume a rating of BBB-. Such a scenario could materialize if the sovereign rating of the Italian Republic is downgraded or if the level of general business activity deteriorates due to economic slowdown and intensification of geopolitical risks globally, or if there is an unproportioned increase in debt levels in order to fund its energy transition investment plan.

Business development and outlook

Hera has operated under highly volatile industry-specific and macroeconomic conditions over the past few years, and has still shown stable to growing earnings results. In 2022, the Company was directly exposed to the risk of disruption on gas supplies from Russia, but was still fully able to run its activities by purchasing in spot markets, albeit at much higher prices. The Italian gas market faced an unprecedented reduction of 60% in the supply from Russia, which resulted in extraordinarily high prices for energy and raw materials, as well as in a rapidly rising inflation and interest rates, and exerted pressure in Hera's overall cost structure. This scenario led to significant increase in the Group's reported net revenues during 2022, to EUR 20,082 million from EUR 10,555 million one-year earlier, but also severely impacted operating costs. As a result, the Company's EBITDA generation remained fairly stable in the period, amounting to EUR 1,201 million in 2022 (2021: EUR 1,224 million), supported by the good performance in the waste management segment, as well as by energy efficiency incentives and growing offering of energy services.

Although bottlenecks in global supply chains eased and prices normalized during the first nine months of 2023, it is expected that inflation and interest rates will remain high compared to historical periods given the intensification of geopolitical tensions globally. Despite the prolonged challenging economic scenario, Hera continued to deliver solid operating results, with continuous expansion of its customer base and EBITDA growth (up by 52% in the 9M2023 yoy). Looking ahead, Hera's operating growth will be backed by the significant increase in organic investments, as well as by the continuous bolt-on business acquisitions and expansion of activities through the award of new operating licences. The Company's capex plan for 2022-2026 amounts to EUR 4.1 billion (or an average of EUR 820 million annually), an amount that is roughly 50% higher than what has been spent in the preceding five-year period. Since beginning 2022, Hera spent EUR 107 million in strategic and small sized M&A activities, most of them in the waste treatment segment, and it was awarded with 27 operating lots for the distribution of gas and electricity throughout the national territory. Accordingly, the Company expects to increase its EBITDA generation by 22% until the end of its business plan, reaching EUR 1,470 million in 2026 (compared to EUR 1,201 million in 2022).

Hera has become more reliant on external financing over the past few years in order to fund the expansion of its investments and to increase financial slack during a period of more volatile market conditions. Hence, the Company's financial gross debt increased significantly since beginning 2022, reaching EUR 6.4 billion at year-end from EUR 3.8 billion one year earlier. This has been driven by the issuance of EUR 500 million green bonds in May 2022 and the drawdown of new bank loans for EUR 1,625 million to support working capital needs in the gas segment given the highly volatile price environment. In the first half of 2023, Hera issued its second sustainability-linked bond for EUR 600 million with maturity in 10 years and repaid EUR 1,250 million of its financial debt obligations, which led to an overall reduction in debt levels at the end of September 2023 (to EUR 5.0 billion). Despite the higher debt levels, Hera's financial profile is supported by an active liability management strategy, which helps to contain the risks of interest rates increases and lengthen the maturity of payment obligations. Accordingly, borrowing costs dropped to 2.8% compared to above 3.0% prior to 2020, and average debt duration stood at higher than 5 years at the end of September 2023. On the profitability side, the Company's EBITDA generation has grown during 2022 and 9M2023, reaching EUR 1,578 million in the twelve months up to September 2023 (compared to EUR 1,224 million in 2021), which somewhat slowed down the rise in financial leverage. Still, Hera's analytical net financial leverage (as adjusted by CRA and measured by net financial debt to EBITDA) increased to 4.0x in 2022 from 2.7x in the previous year. Nevertheless, this level of leverage can still be considered adequate taking into account the capital intensive nature of the business, and also based on our expectation that this was a temporary effect due to extraordinary volatility in energy prices which are already easing and will result in an improvement in financial credit metrics in 2023.

Hera's liquidity position was relatively tight during 2022, with a strong deterioration in operating cash flows due to the much higher working capital consumption and increased debt refinancing needs. Accordingly, the ratio of cash sources-to-uses (calculated according to CRA's methodology) was slightly below 100% in 2022, comparing very differently from the Company's historical liquidity profile, in which it stood between 150-200% (reflecting a good level of liquidity), and we expect that Hera's liquidity will show a reversal trend throughout 2023 as market volatility gradually abates. Operating cash flows grew to EUR 861 million in 9M2023 compared to EUR -468 million in the previous year. At the end of September 2023, Hera's cash holdings amounted to EUR 1.2 billion and it also had EUR 1 billion of available committed credit facility (as of June 2023), which, if taken together, would be sufficient to cover all financial debt obligations and the expected EUR 820 million annual average capex (2022-2026 business plan) for the next two years. Despite the continuity of Hera's progressive dividend policy, with payment per share rising from EUR 12.00 in 2020 to EUR 14.50 in 2025, and the frequent share repurchases and M&A activities, we believe the Company has a conservative financial policy and will prudently manage cash outflows to preserve its financial strength.

In a nutshell, Hera's positive track record of operational growth has been supported by it diversified multi-utility business model and by certain stability in cash flow generation coming from the regulated segments. It remains to be seen, however, how the economic and geopolitical scenario will affect the energy market going forward as well as the Company's financial performance during the execution of its investment plan in view of the sector's sustainable transition. We believe that there will be a trend towards increasing leverage due to the growing financing need at higher debt costs at the same time that regulatory tariff methodic set a reduction in the rate of return on the regulated asset base, which could lead to a deterioration in key metrics. To compensate, the company will continue to make efforts to increase operational efficiencies and reduce costs, and will continue to have ample access to capital markets, ensuring the maintenance of its creditworthiness.

Table 1: Financials of Hera S.p.A. I Source: Hera S.p.A. Annual report 2022, standardized by CRA

Hera S.p.A. **Selected key figures of the financial statement analysis** **Basis: Annual accounts and report of 31.3. (IAS, Group)**	**CRA standardized figures[1]**	
	2021	**2022**
Sales (million EUR)	10,377.10	19,871.30
EBITDA (million EUR)	1,081.60	1,012.40
EBIT (million EUR)	611.70	533.80
EAT (million EUR)	372.70	305.30
EAT after transfer (million EUR)	333.50	255.20
Total assets (million EUR)	13,004.55	15,924.60
Equity ratio (%)	19.65	16.94
Capital lock-up period (days)	82.89	56.81
Short-term capital lock-up (%)	29.15	14.04
Net total debt / EBITDA adj. (factor)	8.77	11.15
Ratio of interest expenses to total debt (%)	2.87	1.64
Return on Investment (%)	4.54	2.76

[1] For analytical purposes, CRA adjusted the original values in the financial statements in the context of its financial ratio analysis. For example, when calculating the analytical equity ratio, deferred tax assets, goodwill (entirely or partly), and internally-generated intangible assets are subtracted from the original equity, whilst deferred tax liabilities are added. Net total debt takes all balance sheet liabilities into account. Therefore, the key financial figures shown often deviate from the original values of the company.

Table 2: Business development of Hera S.p.A. I Source: Interim Financials as of September 2023, reported information

Hera S.p.A.				
In million EUR	9M 2022	9M 2023	Δ	Δ %
Sales	14,320.10	10,955.00	-3,365.10	-23.50%
EBIT	284.90	597.60	+312.70	+9.76%
EBITDA	722.70	1,099.80	+377.10	+52.18%
EBT	195.40	457.90	+262.50	+134.33%
EAT	139.70	333.30	+193.60	+38.58%

Further ratings

Based on the long-term issuer rating and taking into account our liquidity analysis, the short-term rating of Hera S.p.A. was set at L3 (standard mapping), which corresponds to an exceptionally good liquidity assessment for one year.

The rating objects of the issue rating are exclusively long-term senior unsecured issues, denominated in euro, issued by Hera S.p.A., which are included in the list of ECB-eligible marketable assets. Hera S.p.A. is guarantor in respect of the issues that have been issued under the Euro Medium Term Note Programme (EMTN), with the last basis prospectus of 12.04.2023. We have maintained the BBB rating with a stable outlook to the long-term local currency senior unsecured notes issued by Hera S.p.A. The rating is based on the respective corporate issuer rating.

Long-term local currency senior unsecured notes issued by Hera S.p.A., which have similar conditions to the current EMTN Programme, denominated in Euro and included in the list of ECB-eligible marketable assets, generally receive the same ratings as the current LT LC senior unsecured notes issued under the EMTN Programme. Notes issued in any currency other than euro, or other types of debt instruments, have not yet been rated by CRA. For a list of all currently valid ratings and additional information, please consult the website of Creditreform Rating AG.

Table 3: Overview of CRA Ratings I Source: CRA

Rating Category	Details	
	Date of rating committee	Rating
Hera S.p.A.	10.11.2023	BBB / stable / L3
Long-term Local Currency (LC) Senior Unsecured Issues of Hera S.p.A.	10.11.2023	BBB / stable / L3
Other	--	n.r.

Appendix

Rating history

The rating history is available under https://www.creditreform-rating.de/en/ratings/published-ratings.html.

Table 4: Corporate Issuer Rating of Hera S.p.A.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	29.03.2022	31.03.2022	09.11.2023	BBB / stable

Table 9: LT LC Senior Unsecured Issues issued by Hera S.p.A.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	29.03.2022	31.03.2022	09.11.2023	BBB / stable

Table 10: Short-term issuer ratings of Hera S.p.A.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	10.11.2023	www.creditreform-rating.de	Withdrawal of the rating	L3

Regulatory requirements

The rating[2] was not endorsed by Creditreform Rating AG (Article 4 (3) of the CRA-Regulation).

The present rating is, in the regulatory sense, an unsolicited rating that is public. The analysis was carried out on a voluntary basis by Creditreform Rating AG, which was not commissioned by the Issuer or any other third party to prepare the present rating.

The rating is based on the analysis of published information and on internal evaluation methods for the assessment of companies and issues. The rating object was informed of the intention of creating or updating an unsolicited rating before the rating was determined.

The rating object participated in the creation of the rating as follows:

With Rated Entity or Related Third Party Participation	No
With access to Internal Documents	No
With Access to Management	No

[2] In these regulatory requirements the term "rating" is used in relation to all ratings issued by Creditreform Rating AG in connection to this report. This may concern several companies and their various issues.

The rating was conducted based on the following information.

List of documents
Accounting and controlling
▪ Annual Report 2022 ▪ Interim Report 9M 2023
Finance
▪ EMTN Base Prospectus April 12, 2023
Additional documents
▪ Company's presentation ▪ Sustainability report ▪ Press releases

A management meeting did not take place within the framework of the rating process.

The documents and information gathered were sufficient to meet the requirements of Creditreform Rating AG's rating methodologies.

The rating was conducted based on the following rating methodologies and the basic document.

Rating methodology	Version number	Date
Corporate Ratings	2.4	July 2022
Corporate Short-Term Ratings	1.0	June 2023
Government-related Companies	1.1	May 2023
Non-financial Corporate Issue Ratings	1.0	October 2016
Rating Criteria and Definitions	1.3	January 2018

The documents contain a description of the rating categories and a definition of default.

The rating was carried out by the following analysts:

Name	Function	Mail-Address
Sabrina Mascher de Lima	Lead-analyst	S.Mascher@creditreform-rating.de
Christina Sauerwein	Analyst	C.Sauerwein@creditreform-rating.de

The rating was approved by the following person (person approving credit ratings, PAC):

Name	Function	Mail-Address
Philip Michaelis	PAC	P.Michaelis@creditreform-rating.de

On 11 November 2023, the analysts presented the rating to the rating committee and the rating was determined. The rating result was communicated to the company on 13 November 2023. There has not been a subsequent change to the rating.

The rating will be monitored until Creditreform Rating AG withdraws the rating. The rating can be adjusted as part of the monitoring, if crucial assessment parameters change.

In 2011, Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on this registration, Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

ESG-factors

You can find out whether ESG factors were relevant to the rating in the upper section of this rating report "Relevant rating factors".

A general valid description for Creditreform Rating AG, as well as a valid description of corporate ratings for understanding and assessing ESG factors in the context of the credit rating process, can be found here.

Conflict of interests

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or in approving credit ratings and rating outlooks.

Creditreform Rating AG ensures that the provision of ancillary services does not present conflicts of interest with its credit rating activities and discloses in the final rating reports any ancillary services provided for the rated entity or any related third party. The following ancillary services were provided for the rating entity or for third parties associated with the rated entity:

1.) No ancillary services in the regulatory sense were carried out for this rating object.

For the complete list of provided rating and credit service ancillaries please refer to the Creditreform Rating AG's website: https://www.creditreform-rating.de/en/about-us/regulatory-requirements.html#non-core-business-activities .

Rules on the presentation of credit ratings and rating outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our "Rating Committee Policy", all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, Creditreform Rating AG has used following substantially material sources:

<u>Corporate issuer rating:</u>

1. Annual report

2. Website

3. Internet research

<u>Corporate issue rating:</u>

1. Corporate issuer rating incl. information used for the corporate issuer rating

2. Documents on issues / instruments

There are no other attributes and limitations of the credit rating or rating outlook other than those displayed on the Creditreform Rating AG website. Furthermore, Creditreform Rating AG considers as satisfactory the quality and extent of information available on the rated entity. With respect to the rated entity, Creditreform Rating AG regarded available historical data as sufficient.

Between the time of disclosure of the credit rating to the rated entity and the public disclosure, no amendments were made to the credit rating.

The Basic Data Information Card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In cases where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating report and indicates how the different methodologies or other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

The meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings and best-case scenario credit ratings are explained.

The date at which the credit rating was initially released for distribution and the date when it was last updated, including any rating outlooks, is indicated clearly and prominently in the Basic Data Information Card as a "rating action"; initial release is indicated as "initial rating", other updates are indicated as an "update", "upgrade" or "downgrade", "not rated", "confirmed", "selective default" or "default".

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the Basic Data Information Card.

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009, a registered or certified credit rating agency shall make available, in a central repository established by ESMA, information on its historical performance data including the rating transition frequency and information about credit ratings issued in the past and on their changes. Requested data are available at the ESMA website.

An explanatory statement of the meaning of Creditreform Rating AG's default rates are available in the credit rating methodologies disclosed on the website.

Disclaimer

Any rating performed by Creditreform Rating AG is subject to the Creditreform Rating AG Code of Conduct, which has been published on the web pages of Creditreform Rating AG. In this Code of Conduct, Creditreform Rating AG commits itself – systematically and with due diligence – to establish its independent and objective opinion as to the sustainability, risks and opportunities concerning the enterprise or the issue under review.

Future events are uncertain, and forecasts are necessarily based on assessments and assumptions. This rating is therefore no statement of fact, but an opinion. For this reason, Creditreform Rating AG cannot be held liable for the consequences of decisions made on the basis of any of their ratings. Neither should these ratings be construed as recommendations for investors, buyers or sellers. They should only be used by market participants (entrepreneurs, bankers, investors etc.) as one factor among others when arriving at corporate or investment decisions. Ratings are not meant to be used as substitutes for one's own research, inquiries and assessments.

We have assumed that the documents and information made available to us by the client are complete and accurate and that the copies provided to us represent the full and unchanged contents of the original documents. Creditreform Rating AG assumes no responsibility for the true and fair representation of the original information.

Creditreform Rating AG

Contact information

Creditreform Rating AG

Europadamm 2-6
D-41460 Neuss

Phone: +49 (0) 2131 / 109-626
Telefax: +49 (0) 2131 / 109-627

E-Mail: info@creditreform-rating.de
Web: www.creditreform-rating.de

CEO: Dr. Michael Munsch
Chairman of the Board: Michael Bruns

HR Neuss B 10522