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Italian Utilities: A Weak Economy And A Fragmented Market Dim Profit Prospects

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Italian Utilities: A Weak Economy And A Fragmented Market Dim Profit Prospects

The surge in renewable energy generation and subdued demand for power amid weak economic conditions has cut power prices and, in turn, the profitability of large rated utility companies throughout Europe. Yet, Italian utilities are hit particularly hard. The country's economic prospects remain gloomy amid the harshest recession it has experienced since World War II. Electricity prices have fallen by 15% in 2014 year to date on last year. Gas prices are additionally suffering volatility due to geopolitical risks, given that Italian imports of natural gas from Russia transit through Ukraine. We now predict that power and gas demand in Italy will not recover its 2008 levels before 2020. Consequently, we believe Italian utilities will struggle to keep adjusted returns on capital in the 7% and 10% range they achieved over 2009-2013.

Overview

- Weak economic conditions in Italy and an industry shift toward renewable energy generation is depressing Italian utilities' profitability.
- We expect margins of companies operating in liberalized segments of Italy's energy industry will suffer the greatest margin erosion, not least as customers become increasingly price-sensitive.
- We consider prospects for companies in the regulated gas and power transmission and distribution segment more stable because they are less exposed to weak market fundamentals.
- Consolidation of Italy's fragmented utilities' landscape will help companies defend their profitability, in our view, although entrenched local authority reforms and low appetite for M&A are holding it back.

Companies exclusively or highly exposed to liberalized sectors of the energy industry in Italy, such as power and gas supply, will likely face additional competitive pressures, and ultimately greater erosion of margins than companies operating on regulated markets, in our view. Earnings potential from service offerings in areas such as energy efficiency could at best offset the negative impact on revenues from lower volumes. Companies operating in regulated business areas have more stable prospects in the currently weak market conditions. The profitability of purely regulated players in the power and gas grid transmission and distribution sector tends not to be correlated to macroeconomic indicators, making these players better sheltered against unfavorable market conditions. They nevertheless face risks related to changes in regulated revenues (regulatory reset risk), particularly in an environment of very low interest rates and deflationary trends.

Growth potential for Italian utilities is further limited by the highly fragmented market landscape. Apart from a few large players, a multitude of municipal shareholders are still pre-eminent among local utilities, and are keen to preserve their local stakes. We believe consolidation in the sector may help to defend profitability. Yet, while this topic is at the top of the political agenda, it is entrenched with the reform of local public services in Italy. Concentration has only materialized in areas where public shareholders were individually diluted and had limited influence on management's growth strategy. What's more, for power suppliers, in particular, the depressed economic environment and ensuing risk of deteriorating counterparty risk is also likely to deter them from expensive acquisitions.

Low interest rates are increasingly encouraging Italian utilities to tap the capital markets to manage their liabilities and optimize costs. However, rising geopolitical risks could increase their borrowing rates, in our view.

Among the three main business segments in Italy's power and gas industry, we believe prospects are overall negative in conventional power generation and in the supply of power and gas. We consider the outlook for the gas and power transmission and distribution segment to be stable, mainly because it is less exposed to weak market fundamentals, although vulnerable to a decline of regulated revenues in a low interest rate environment.

Standard & Poor's rates eight Italian utilities. They comprise:

- Companies operating in purely regulated segments (SNAM SpA, Terna SpA, and 2i Rete Gas);
- Integrated utilities along the power and/or gas value chain (Enel SpA, Edison SpA, and A2A SpA); and
- Multiutilities (Hera SpA and Acea SpA). Multiutilities have no operations in the upstream business and a portfolio of both liberalized (power and gas supply, waste treatment) and regulated (power, gas, and water distribution) businesses.

Conventional Power Generation: The Surge of Renewables And Weak Demand Clouds Credit Prospects

Falling power prices, due to subdued economic demand as well as the fast rise in the production of renewable power will continue to depress profitability in conventional power generation in Italy over the next few years, in our view. Price declines were particularly evident in the first half of 2014 in Italy--down 18% year on year (see chart 1 and 2). Based on current market signals, we predict that profitability will hit a record low in 2015-2016 although this depends to a certain extent on generators' production hedging policies.

Chart 1

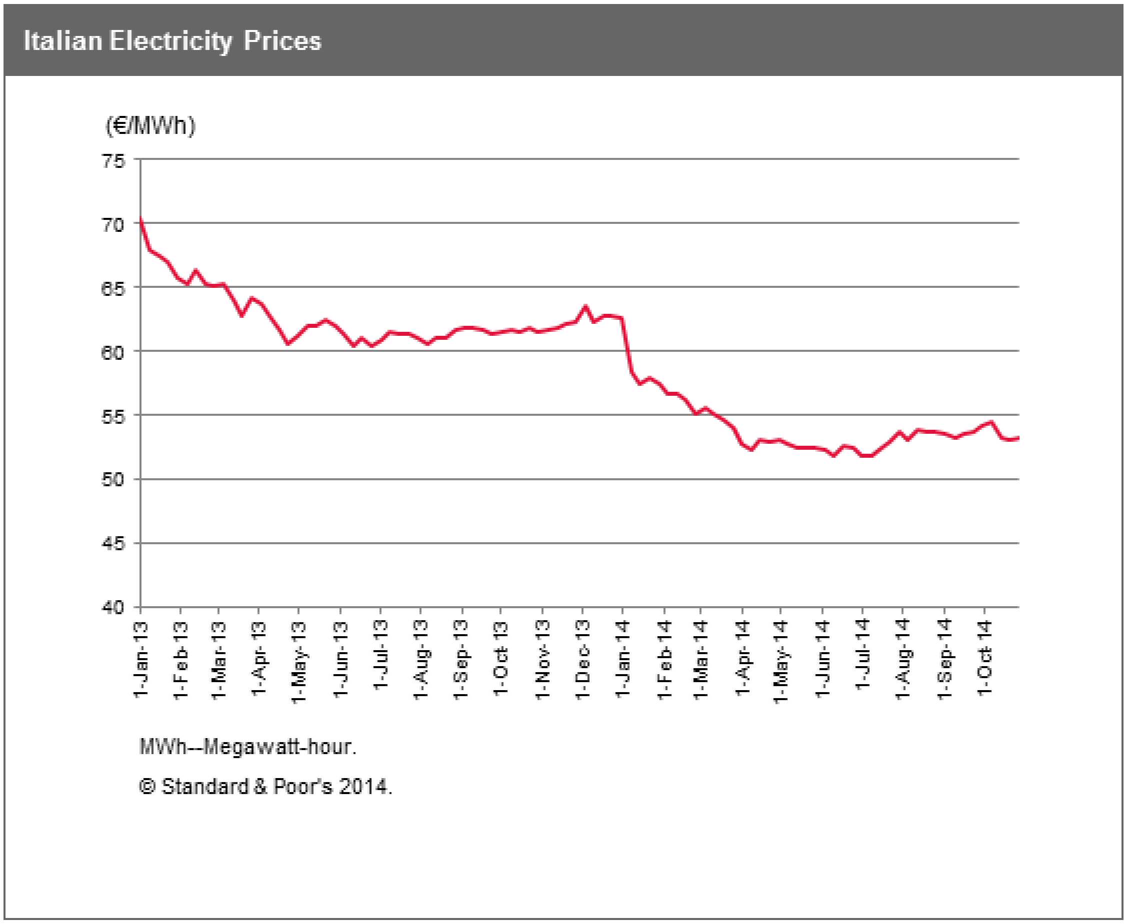
Italian Electricity Prices
(€/MWh)
75
70
65
60
55
50
45
40
1-Jan-13
1-Feb-13
1-Mar-13
1-Apr-13
1-May-13
1-Jun-13
1-Jul-13
1-Aug-13
1-Sep-13
1-Oct-13
1-Nov-13
1-Dec-13
1-Jan-14
1-Feb-14
1-Mar-14
1-Apr-14
1-May-14
1-Jun-14
1-Jul-14
1-Aug-14
1-Sep-14
1-Oct-14
MWh--Megawatt-hour.
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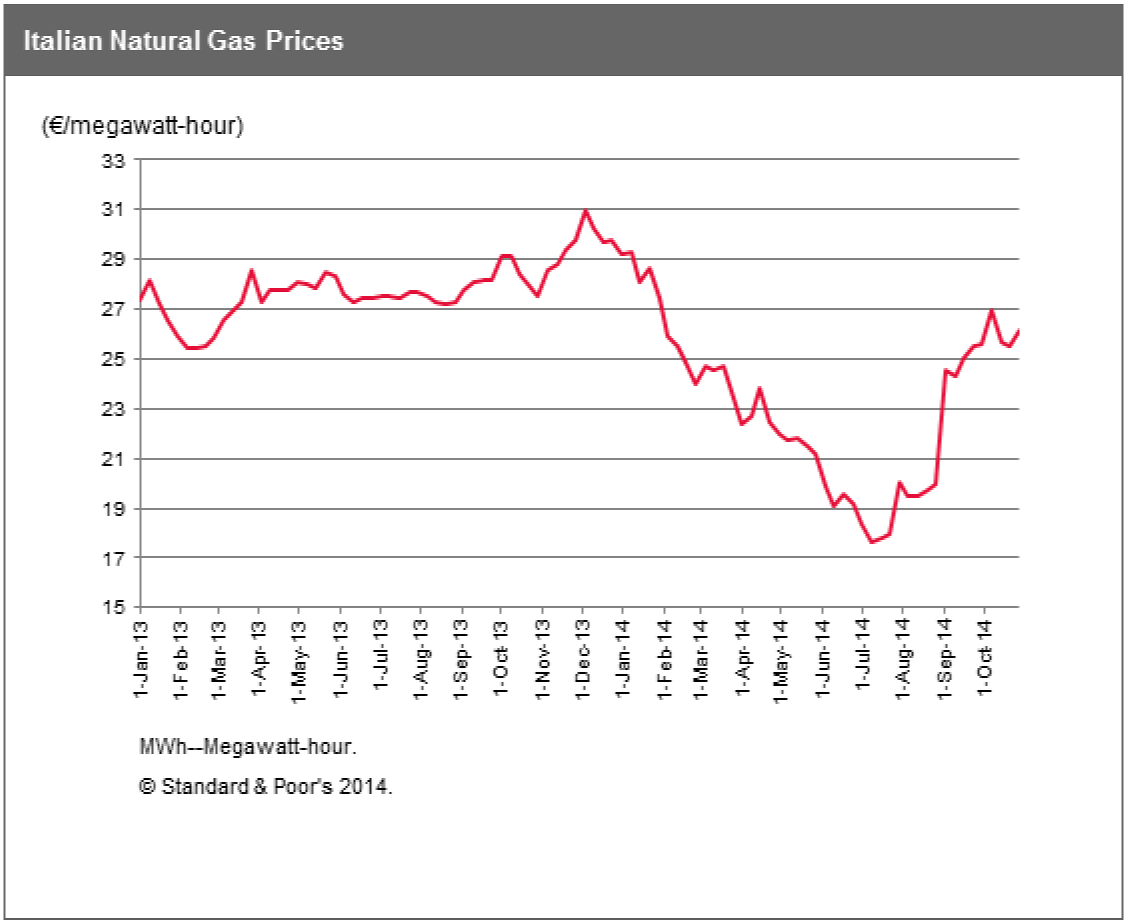
Chart 2



The market is particularly difficult for generators with a high share of thermal production in their portfolio of assets, in particular gas-fired power production by combined cycle gas turbines (CCGTs), because the utilization rate is so low that companies cannot recover fixed costs. This has led many of the main generation companies to shut down or mothball existing capacity. In 2013, 12 thermal production units with a capacity of two gigawatts (GW) in total exited the market. Enel is currently considering mothballing capacity for 11GW in Italy. A2A has already mothballed 20% of its installed CCGT capacity this year. Meanwhile, E.ON's retreat from the Italian market is currently under way.

Thermal production declined by 10% over the first nine months of 2014 on the equivalent period of last year, while power demand as a whole fell by 3% over this period, according to Terna, Italy's independent electricity transmission grid operator. As a result, the contribution of conventional generation to national power production has fallen over the past two years (see table 1).

Table 1

Contribution Of Generators To National Production (% Of Total)

(%)	2012	2013
Enel	25.1	25.2
ENI	9.4	8.5
Edison	7.1	6.0

Table 1

Contribution Of Generators To National Production (% Of Total) (cont.)		
A2A (incl. Edipower)	6.9	5.3
E.ON	4.3	4.6
ERG	2.8	3.1
IREN	2.2	3.1
GSF SUEZ	3.5	2.9
Sorgenia	1.9	2.1
Others	36.8	39.2

Source: annual report AEEGSI, 2014.

Proposed "capacity payments" will provide very limited compensation to conventional generators

In light of the swift rise in renewables' production and the need to manage intermittent power sources, the government recently approved payments, known as "capacity payments" for utilities' to remunerate non-subsidized power generation. However, we believe these payments will far from compensate generators for the investments they have made in flexible and efficient gas-fired generation capacity between 2000 and 2010.

The proposed capacity payment mechanism will introduce specific remuneration only for a certain subset of generation plants based on specific technical features, above all their capacity to load up and down quickly. Terna will organize the tender process and identify eligible plants. Terna will also forecast the flexibility needs of the Italian power system over a number of years in conjunction with the planned development and upgrade of the power transmission infrastructure. The tenders should give owners of eligible plants greater visibility over a number of years on the minimum coverage of costs by offering a fixed premium expressed in terms of available efficient capacity (euros per megawatt). At present, remuneration for these plants is relatively uncertain because it relies on the day-to-day participation of those plants to the "Mercato servizi di dispacciamento" (MSD), the market on which Terna buys and sells power to maintain the security of the transmission grid. Remuneration of ancillary services on the MSD has been rising materially in 2013 (see table 2), providing CCGTs with a much higher remuneration than that available at baseload prices, despite declining utilization rates. The MSD does not discriminate between efficient and non-efficient capacity.

Table 2

Remuneration Of Ancillary Services In Italian Power Market Show Costs Are Rising

	2009	2010	2011	2012	2013
Million €	1,165	1,147	1,148	1,299	1,723
Euros per megawatt hour	3.82	3.76	3.76	4.26	5.64

Source: AEEGSI.

The capacity payments will be funded through consumers' electricity bills, so providing little room for increasing overall resources to the electricity operators. This leads us to believe that remuneration of efficient flexible capacity will come at the detriment of remuneration of ancillary services with probably no substantial economic impact for a subset of highly efficient plants and a potential loss of remuneration for those plants able to offer capacity reserve with lower efficiency standards. Furthermore, we understand that flexible hydro plants will also be eligible for capacity payments, thereby reducing the share of remuneration potentially available to gas-fired plants.

In these circumstances, only those thermal generators with highly efficient plants will marginally benefit from the reallocation of the remuneration, leading to greater visibility over remuneration of capacity. This leads us to conclude that a substantial recovery of profitability for highly efficient generation plants is relatively unlikely under current market conditions, dominated by weak pricing and demand. We therefore believe that the proposed capacity payment mechanism will have little impact on the rating of power generators in Italy.

Supply Of Power And Gas: Market Liberalization Is Unlikely To Improve Profitability Sustainably

Profit margins in the power and gas supply business segment increased considerably in 2013 with the accelerated transition of customers to the liberalized market. (Liberalization of the gas market started in 2003 and of the power market in 2007). However, we don't believe this higher profitability will be sustainable over the longer term because we expect that customers will become increasingly price-sensititve.

Although prices on the two markets are not directly comparable, we understand that on the fully liberalized "mercato libero", where pricing is contractually and bilaterally based, prices remain higher than on the regulated "mercato tutelato", where pricing is determined by a formula of the Italian authority AEGGSI ("Autorità per l'energia elettrica il gas e il sistema idrico). Suppliers' margins increased considerably in 2013 as customers have increasingly migrated to the liberalized market. However, we believe the supply market in Europe is becoming ever more complex as it moves from a commodity to a service-based business. In particular, we expect that success drivers in this market will increasingly be the quality of services, product offerings, and pricing, rather than brand visibility.

We therefore consider that the higher profitability recently observed in the supply segment in Italy will be hard to defend over the next three to four years. Above all, we believe profits will be constrained by decreasing volumes of power and gas sold, as a result of energy efficiency, customers' higher sensitivity to prices and services, and higher costs for suppliers to serve the customer.

Supply churn rates are low in power supply

Despite the full liberalization of power supply in 2007, it remains heavily concentrated on the incumbent, Enel (see table 3). Churn rates have been historically low among retail consumers but picked up in 2013 (see table 4), which we believe is because customers are becoming increasingly price-sensitive.

Table 3

Market Share Of Power Suppliers 2013 (Per Volumes Sold)		
	Gigawatt-hours	**%**
Enel	89,884.00	34.9
Edison	18,709.00	7.3
ENI	10,441.00	4.1
Acea	9,940.00	3.9
Hera	8,415.00	3.3
Green Network Luce & Gas	7,706.00	3.0

Table 3

Market Share Of Power Suppliers 2013 (Per Volumes Sold) (cont.)		
A2A	6,879.00	2.7
Sorgenia	6,821.00	2.6
E.On	5,885.00	2.3
Axpo Group	5,818.00	2.3
Gala	5,602.00	2.2
Iren	4,892.00	1.9
Others	76,473.00	29.7
Total customers	257,465.00	100.0

Source: AEEGSI Annual report 2014.

Table 4

Percentage Of Clients Changing Power Supplier In Italy

	2012	2013
Retail	6.4	7.4
Others	12	15.3
Total	7.6	9

Source: AEEGSI annual report 2014.

Geopolitical tensions could make gas supply margins more volatile

Profitability in the gas supply sector is largely driven by gas procurement policies and volumes. Companies' procurement policies vary substantially. The largest players importing gas under oil-indexed long-term contracts ("take or pay"), which are renegotiated steadily toward higher flexibility of the "take" obligations and a greater share of gas-linked hub prices in the pricing formula. Smaller operators have a more flexible procurement policy because they purchase gas annually at hub-linked prices and are potentially exposed to price volatility observed in connection with the Russian-Ukrainian conflict. In the context of the current geopolitical tensions, we see a risk of potentially higher price volatility more than a physical shortage of gas. This could affect the stability of operating margins, in our view. As in power supply, churn rates in the gas supply sector have increased substantially over 2013 together with the accelerated liberation of the market (see table 6).

Table 5

Market Share Of Gas Suppliers (Per Volumes Sold)

(%)	2012	2013
ENI	27.1	25.9
Edison	11.6	11.9
Enel	10.5	9.2
GDF Suez	5.4	5.0
E.ON	4.1	3.9
Iren	4.1	3.9
Hera	3.6	3.4
Royal Dutch Shell	2.6	2.8
A2A	2.6	2.5

Table 5

Market Share Of Gas Suppliers (Per Volumes Sold) (cont.)		
Sorgenia	0.7	2.2
Ascopiave	1.7	1.4
E.S.T.R.A.	1.3	1.2
Others	24.7	26.7

Source : AEEGSI annual report 2014.

Table 6

Percentage Of Clients Changing Gas Supplier

	2012	2013
Retail	4.5	5.5
Public Services	7.7	15.2
Others	8.2	9.9
Total	4.7	5.9

Source: AEEGSI annual report 2014.

Transportation And Distribution Of Power And Gas: Increasing Reset Risk

The credit outlook for operators in power and gas transportation and distribution (grid networks) is more favorable than the other two sectors because it is regulated, giving companies a certain level of tariff visibility. The main credit risk in this business segment is linked to our assessment of regulatory advantage and on the allowed revenues at various intervals (regulatory reset risk). We believe that the regulatory environment will remain benign for regulated issuers in Italy because of the material need for upgrading existing infrastructure. Investments in the gas transportation sector will focus on the development of gas reverse flow and the increase of storage capacity. In power transportation, the removal of existing congestions in the national grid and improvement of interconnection capacity at national borders remain priorities. The bulk of upgrades in power and gas distribution will focus on the transition to smart grids.

Given their advantage of operating in a solid and transparent regulated system, we assess the business profiles of gas and power transportation and distribution companies at the stronger end of our scale. We consider the Italian regulatory framework as stable, having not changed substantially since its first introduction. Tariff-setting procedures are transparent, and the system has a track record of ensuring the financial stability of regulated players and attracting investors. The Italian authority AEEGSI, which has been operative since 1997 and is responsible for the regulation in the gas, electricity, and water sector, operates independently. In our view, regulatory independence has in recent years been crucial to mitigating potential government interference over tariffs and preserving the credit quality of players in this business segment amid difficult political and economic conditions in Italy.

Remuneration under the regulatory framework is linked to the regulated asset base (see tables 7 and 8). The authority establishes allowed revenues at the beginning of each regulatory period. Tariffs are based on a revenue cap mechanism. The regulatory framework provides a variety of incentives in the form of additional remuneration to the base weighted average cost of capital (WACC) for specific categories of investments the regulator perceives as having a strategic impact for the energy system. The recognition of investments in the regulated asset base occurs with a lag of two years in the transportation of power and gas. The regulatory lag is compensated though an additional forfeit remuneration on the base WACC, which improves the cost recovery of investments.

Table 7

Italian Electricity Regulatory Framework

	Transportation	Distribution
Expiry	Dec-2015	Dec-2015
Length of regulatory period	4 years	4 years
WACC real pre-tax (updated) (%)	6.3	6.4
Regulatory WACC lag recognition (%)	1.0	1.0
Efficiency x-factor - opex (%)	3.0	2.8

WACC--Weighted average cost of capital. Opex--Operating costs. Source: AEEGSI.

Table 8

Italian Regulatory Framework - Gas

	Transportation	Distribution	Storage	Regasification
Expiry Date	Dec-2017	Dec-2019	Dec-2018	Dec-2017
Length of regulatory period	4 years	6 years	4 years	4 years
RAB methodology	Revalued historical cost	Revalued historical cost	Revalued historical cost	Revalued historical cost
WACC real pre-tax (%)	6.3	6.9	6.0	7.3
Regulatory WACC lag recognition (%)	1.0	--	--	1.0
Incentives on new investments	Yes	Yes	Yes	Yes
Efficiency x-factor - opex (%)	2.4	1.7	0.6	--

WACC--Weighted average cost of capital. Opex—operating costs. Source: AEEGSI.

The system insulates operators from price, volume, and counterparty risks, which supports cash-flow stability throughout the economic cycle. Historically, profitability at purely regulated power and gas transmission operators Terna and SNAM have not been correlated to macroeconomic indicators. This supports our view that the Italian regulatory framework mitigates difficult local economic conditions.

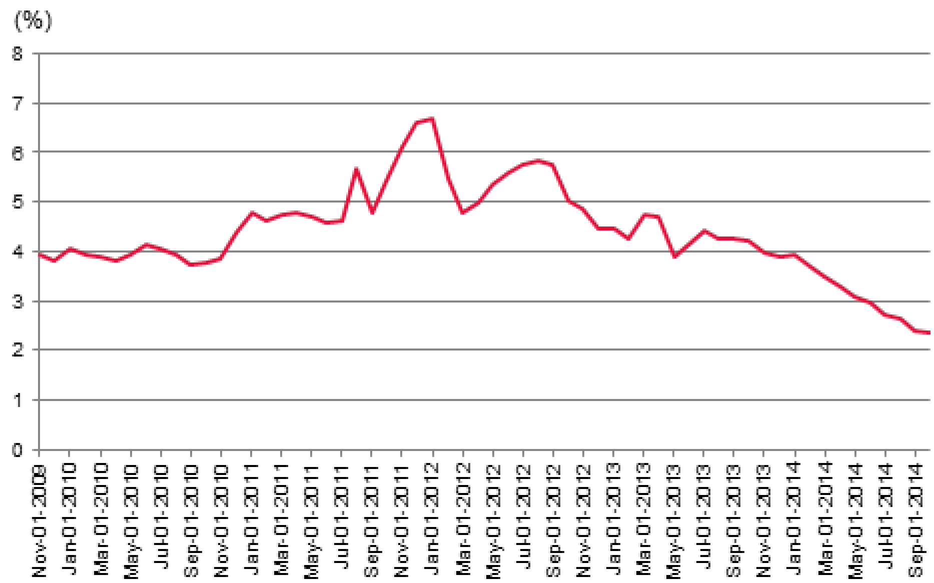
Despite the fair visibility we have on the performance of regulated issuers we do believe reset risk is higher in the currently low interest rate environment. The risk-free rate, which feeds in to the WACC formula, is reset every 24 months to prevent a misalignment between remuneration of the asset base and the cost of debt. The risk-free rate tracks the 12-month average of the Italian 10-year government bond. A decreasing 10-year government bond yield (see chart 3) lowers the WACC and has a negative impact on allowed revenues. The next reset will have an impact on 2016 allowed revenues, and we expect the risk-free rate will potentially decline by 150-200 basis points (bps). Regulated issuers' business plans are based on a risk-free rate that exceeds 4%, while the Italian government 10-year bond rate is currently hovering at around 2.5%. The downside risk on revenues is material, and could therefore affect companies' credit metrics.

In a low inflationary environment (see chart 4), the impact on allowed revenues of a lower risk free rate in the WACC formula, could be partially mitigated by the reset of a lower inflationary parameter. At the same time, however, a restatement of inflation would also lead to lower regulated revenues, caused by lower allowed operating costs and a lower revalued regulated asset base.

In these circumstances, credit metrics of regulated players that we rate could potentially deteriorate in 2016, although the net effect would depend on the benefits of a low interest rate environment on the cost of debt and on the mix of measures that the issuer may implement to protect cash flows.

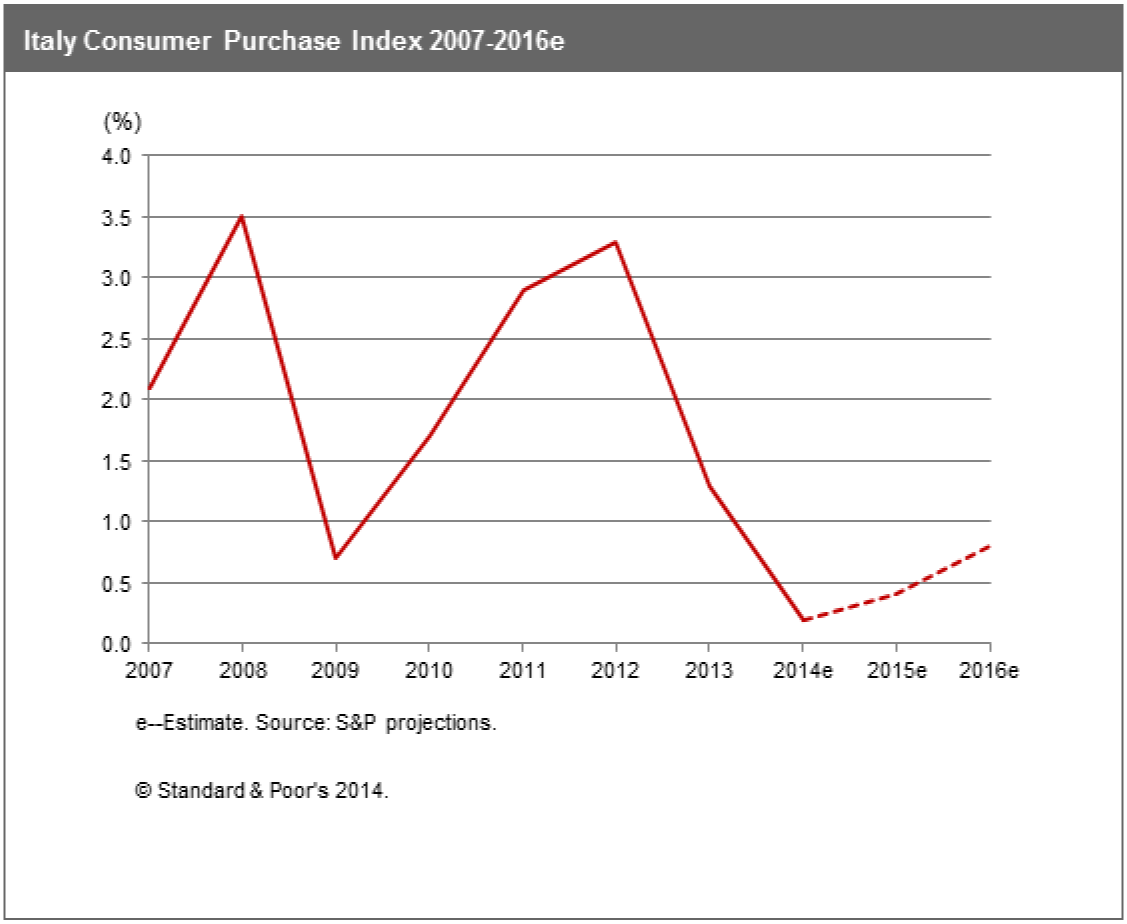
Chart 3

Italian Government Bond 10-Year Rate



Source: Capital IQ.

Chart 4



Retendering of gas distribution concessions significantly affects the regulated business

The reform of gas distribution in Italy started with legislative decree No. 164 in 2000, which prescribed that concessions should be awarded through competitive bids over a 12-year horizon. However, this process has been at a political standstill for more than a decade. We now expect tenders to start in 2015.

Most existing gas distribution concessions have matured, but continue to be operated by the existing concessionaire so far as tenders are executed. The Italian market is being structured into 177 catchment areas ("ATEM- Ambiti Territoriali Minimi"). For each area, a 12-year concession is assigned through public tender.

The calendar for concession tenders established by the Ministry of Economic Development has been delayed by a variety of issues spanning from divergent interpretations by market players on the valuation of the concessions (linked to regulated asset base versus replacement value), to the eligible asset value retained for the calculation of allowed revenues for a new concessionaire, and more simply to administrative delays. We do expect tenders to start in 2015 in Northern and Central Italy.

In our view, this tendering risk has implications for issuers' business and financial risk profiles. Nevertheless, in the event of the loss of a gas distribution tender, the capacity to meet financial obligations would be protected to some extent by the payment of a redemption value owed to the exiting concessionaire. Tender risk is potentially higher for issuers with a blended mix of regulated and nonregulated activities in the portfolio.

Utilities Are Tapping Capital Markets

Italian utilities have issued bonds more frequently on the financial markets over the past three years to actively manage their liabilities and optimize costs. While the large €6 billion bond issue by Snam in 2012 boosted overall issuance in that year (see chart 5), we note that utilities of all sizes have a growing appetite to tap the capital markets.

While the currently low interest rate environment favors capital market issuance, rising geopolitical risk could lead investors to demand higher country risk premiums for Italian debt. This could potentially have a negative impact on the benefits utilities can expect from active liability management policies.

We estimate refinancing needs for rated Italian utilities will be substantial over the next four years, with just under €30 billion of bonds approaching maturity in the years 2015-2018 (see chart 6). This will provide utilities with the opportunity to engage in active liability management in a low interest rate environment as observed in 2014, barring any turbulence on financial markets linked to rising geopolitical risks.

Chart 5

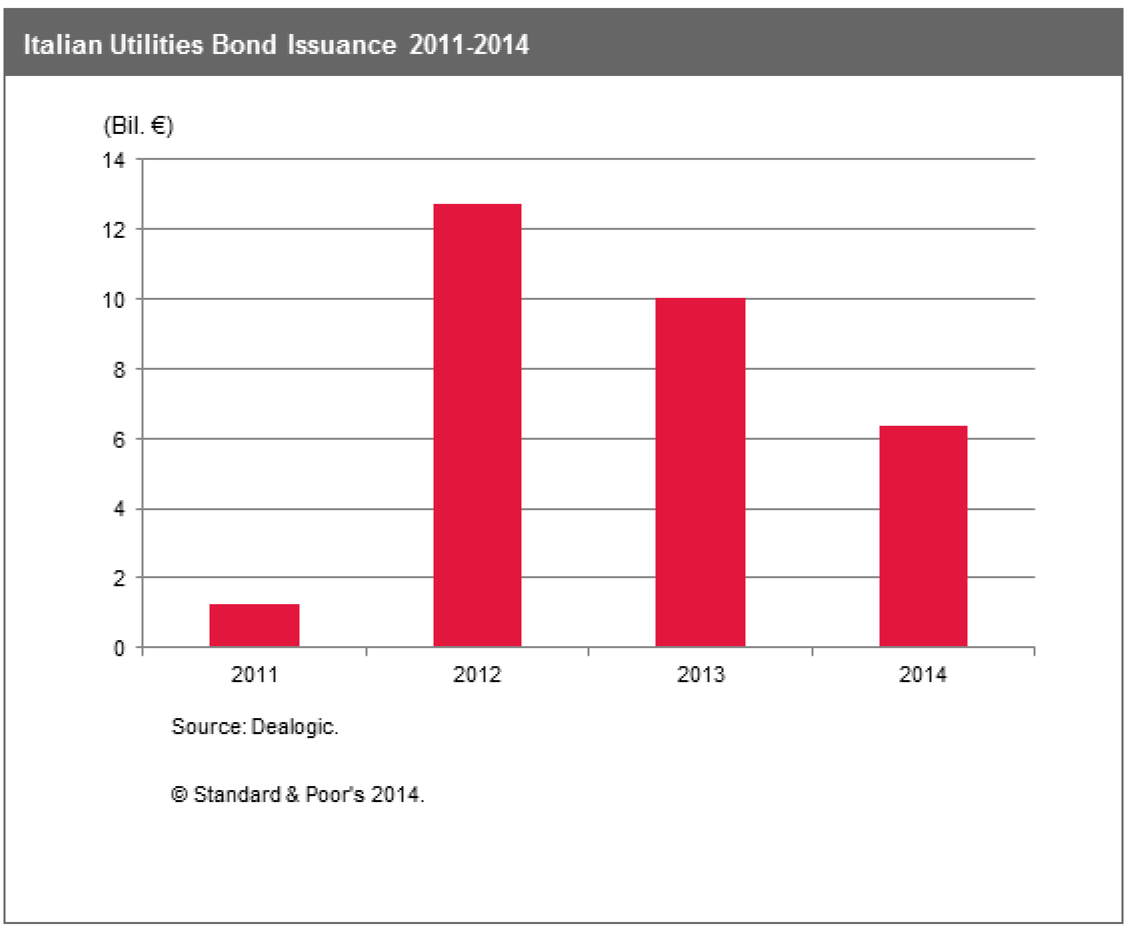
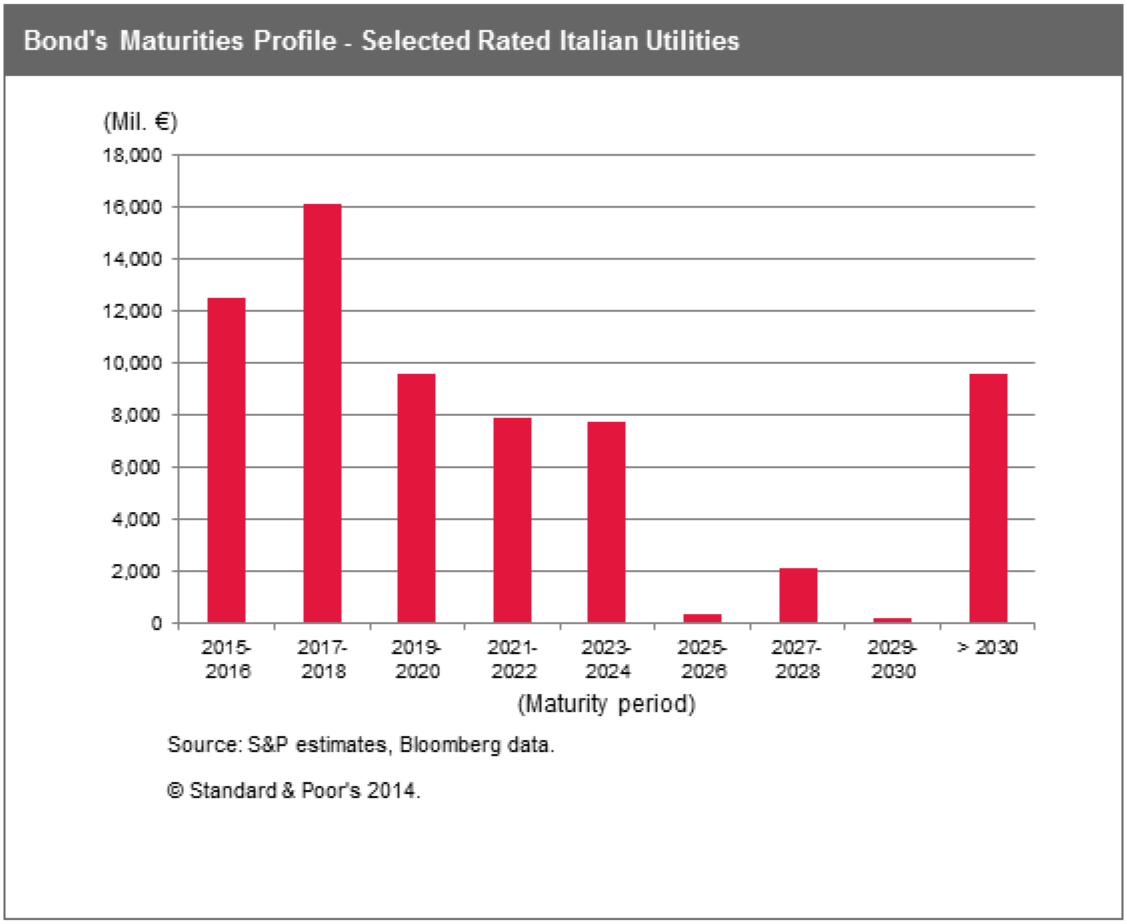


Chart 6



Factors Blocking Consolidation In The Industry

In the difficult economic environment, utilities in Italy, as in the rest of Europe are adopting defensive strategies of cost rationalization and asset sales. We believe that consolidation in Italy through mergers and acquisitions could support cost synergies and lead to a more efficient allocation of resources and costs.

The Italian utility sector is very heterogeneous and highly fragmented. Besides a few large issuers, such as Enel and Edison, the power and gas sector in Italy consists of a multitude of smaller regional players with varying levels of integration along the energy value chain. The bulk of these companies emerged from mergers of municipal utilities with operations not just in gas and power but also in related public services such as integrated water services, district heating, and waste collection and treatment. The degree of industrial integration among these entities varies substantially, and not all of these multiutilities have a streamlined corporate structure organized along businesses lines. We believe this will limit the potential of cost synergies and potential value added in the event of mergers and acquisitions.

While consolidation is high on the political agenda, we believe it is constrained by the overwhelming presence of municipal stakeholders in the industry, which want to maintain independent representation in their local territory. Furthermore, municipal stakeholders, unlike in other European countries, have a relatively limited track record of providing exceptional support in the form of equity financing, but have maintained pressure on dividend policies.

The most notable example of non-debt-financed external growth is that of multiutility Hera, which has integrated neighboring multiutilities in the north eastern area of the Italian peninsula with a similar business mix. This has enabled Hera to increase its market share both in unregulated businesses, particularly waste operations, and regulated businesses, typically gas distribution. We believe Hera's growth strategy was supported by the fragmented mix of municipal shareholders that it integrated, which have limited individual influence on the company's strategy.

We also believe that consolidation is unlikely to flourish in the currently weak market conditions. Even the liberalized and more competitive power supply business segment, on which more than 300 suppliers operate, is unlikely to consolidate as present. This is because Italian utilities face persistent difficulties managing counterparty risk. Bad debt is a greater concern for Italian utilities than for their European peers. Italian suppliers are engaging in ongoing sales of receivables to the financial system to manage their credit risk and improve working capital management. We consider this a way of financing working capital through debt. In a persistently depressed economic environment, we see a risk of deteriorating counterparty risk for Italian suppliers. This is likely to deter them from expensive acquisitions.

In the gas distribution segment, where there were 229 operators as of end-2013 even though Italgas (SNAM) and 2i Rete Gas together hold just under 50% of the market, we expect to see some concentration by the end of 2019. However, we believe it will take longer to see a significant consolidation in this sector. For this to happen, existing operators with ambitions to expand their market shares will have to invest considerable resources to compensate exiting concessionaires. However, we understand that large national players would rather consolidate their positions within concessions operated up to now in partnership with other players, potentially leading to an increase in their already high market shares measured on redelivery points (number of gas distribution points). We believe smaller gas distributors and multiutilities are focusing on improving their positions in their existing concession areas. However, we believe they are unlikely to be able to leverage substantially and bid aggressively in other concession areas, given the potential size of investments and the relatively short life of the new concessions (12 years). We therefore consider consolidation prospects in this sector, as a result of tenders, to be limited. We think an aggressive concentration scenario unlikely to materialize in the current regulatory period (up until 2019).

Credit Quality Among Rated Italian Utilities Is Declining

Standard & Poor's rates eight utilities in Italy. They fall into three categories: Purely regulated businesses, such as network operations; vertically integrated utilities, with operations ranging from upstream to downstream along the power; and multiutilities, which have other utility related businesses in their portfolio, in water, district heating, and waste disposal and treatment (see table 9).

Table 9

Rated Italian Utilities					
--Network--		--Integrated Utilities--		--Multiutilities--	
Company	**Rating**	**Company**	**Rating**	**Company**	**Rating**
2i Rete Gas	BBB/Stable/A-2	A2A SpA	BBB/Negative/A-2	Acea SpA	BBB-/Stable/A-3
SNAM SpA	BBB+/Negative/A-2	Edison SpA	A-/Negative/A-2	Hera SpA	BBB/Stable/A-2
Terna SpA	BBB+/Negative/A-2	Enel SpA	BBB/Stable/A-2		

*Ratings as of Nov. 5, 2014.

With a few exceptions--notably 2i Rete Gas, Edison, and Hera--most rated utilities are government-related entities (GREs), directly or indirectly linked to the Republic of Italy or to local governments. Under our criteria, ratings on utilities could be rated one or two notches above the sovereign rating, depending on their exposure to the Italian jurisdiction, if we considered them potentially resilient to an hypothetical sovereign stress default scenario. We rate network operators SNAM, Terna and vertically integrated Edison above the sovereign rating on Italy (unsolicited BBB/Negative/A-2). The rating on Edison benefits from our assessment of support from being a highly strategic subsidiary of the larger French utility Electricite de France S.A. (A+/Stable/A-1).

Downgrades have outnumbered upgrades over the past five years (see chart 7), reflecting declines in the sovereign rating and deteriorating market conditions on Italian utilities' relatively tight credit metrics. Ratings are solidly positioned in a 'BBB' category and compare fairly well with the rating distribution of utilities in EMEA as a whole (see chart 8). The majority of stable outlooks reflects mainly the capacity of Italian utilities to achieve a modest strengthening of credit metrics in what we believe remains a challenging environment (see chart 9).

Chart 7

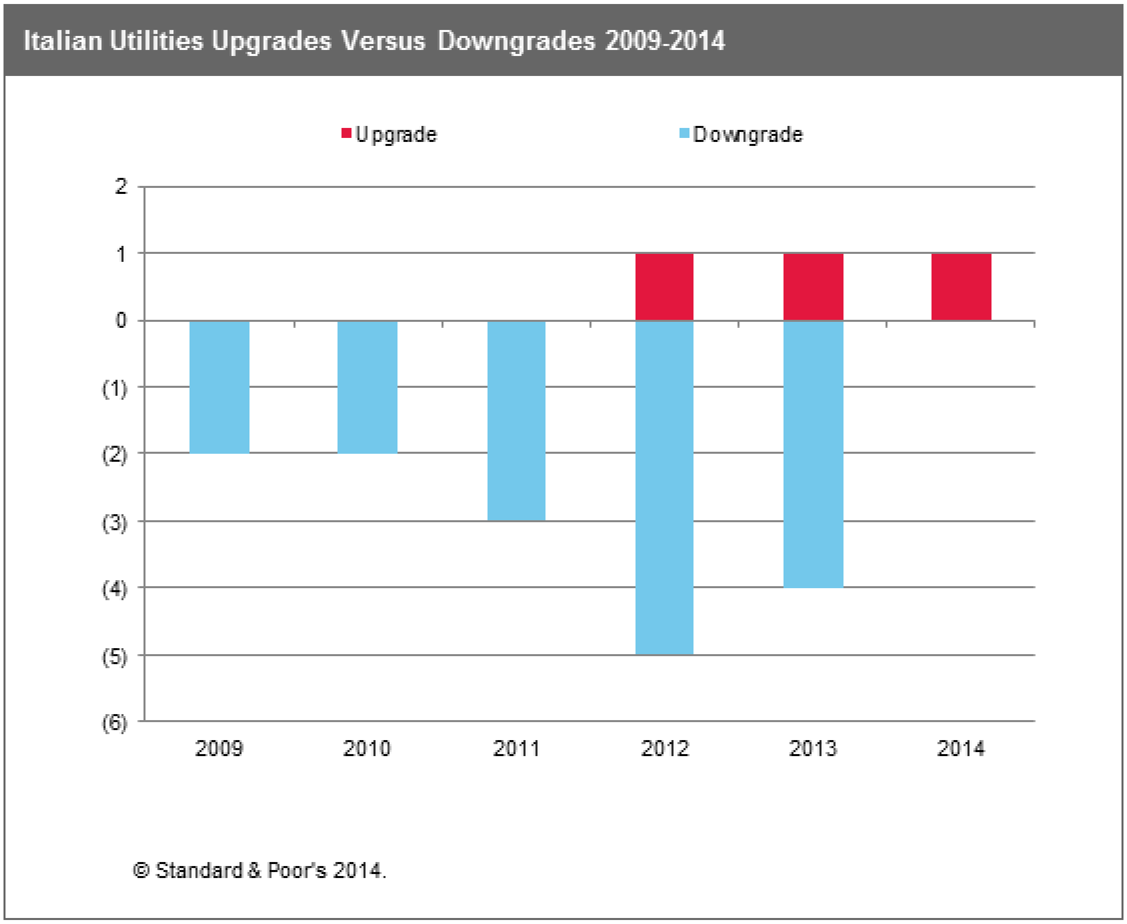

Italian Utilities Upgrades Versus Downgrades 2009-2014
Upgrade
Downgrade
2
1
0
(1)
(2)
(3)
(4)
(5)
(6)
2009
2010
2011
2012
2013
2014
© Standard & Poor's 2014.

Chart 8

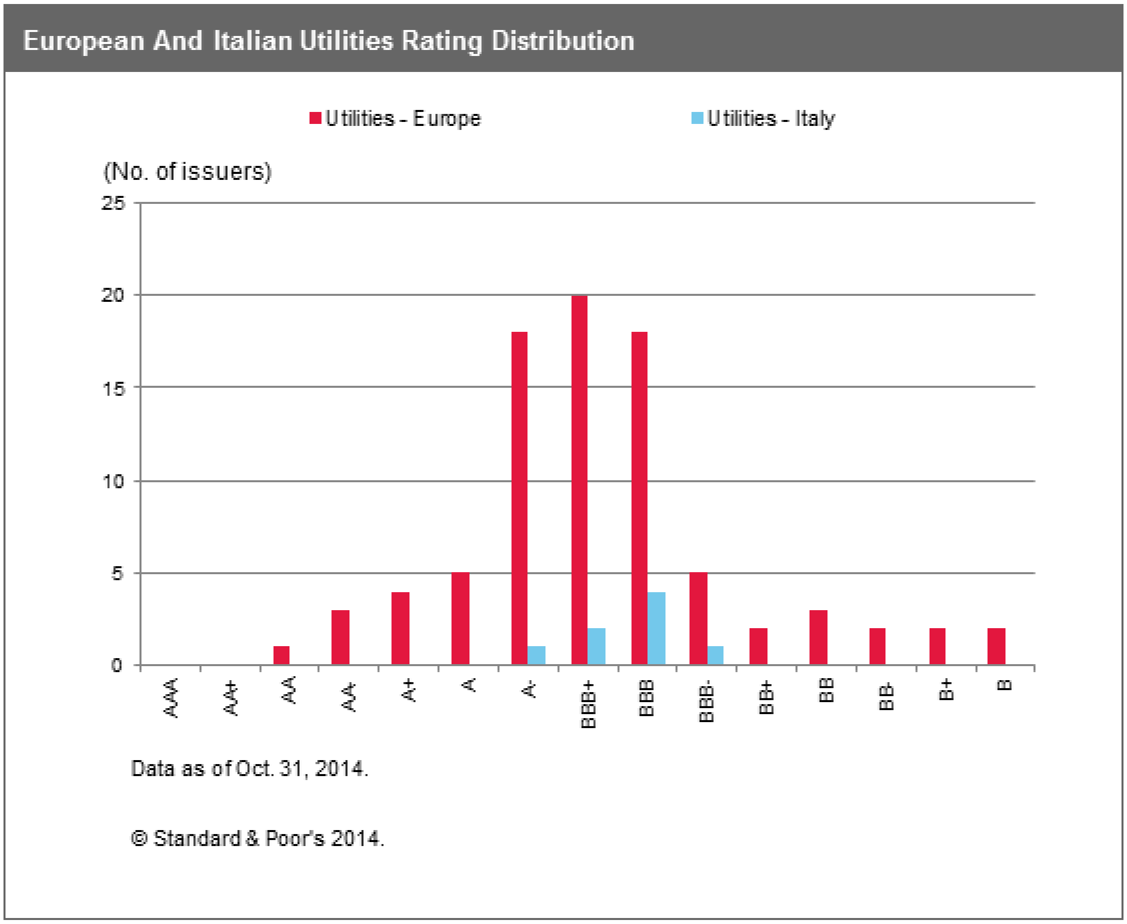

European And Italian Utilities Rating Distribution
Utilities - Europe
Utilities - Italy
(No. of issuers)
25
20
15
10
5
0
AAA
AA+
AA
AA-
A+
A
A-
BBB+
BBB
BBB-
BB+
BB
BB-
B+
B
Data as of Oct. 31, 2014.
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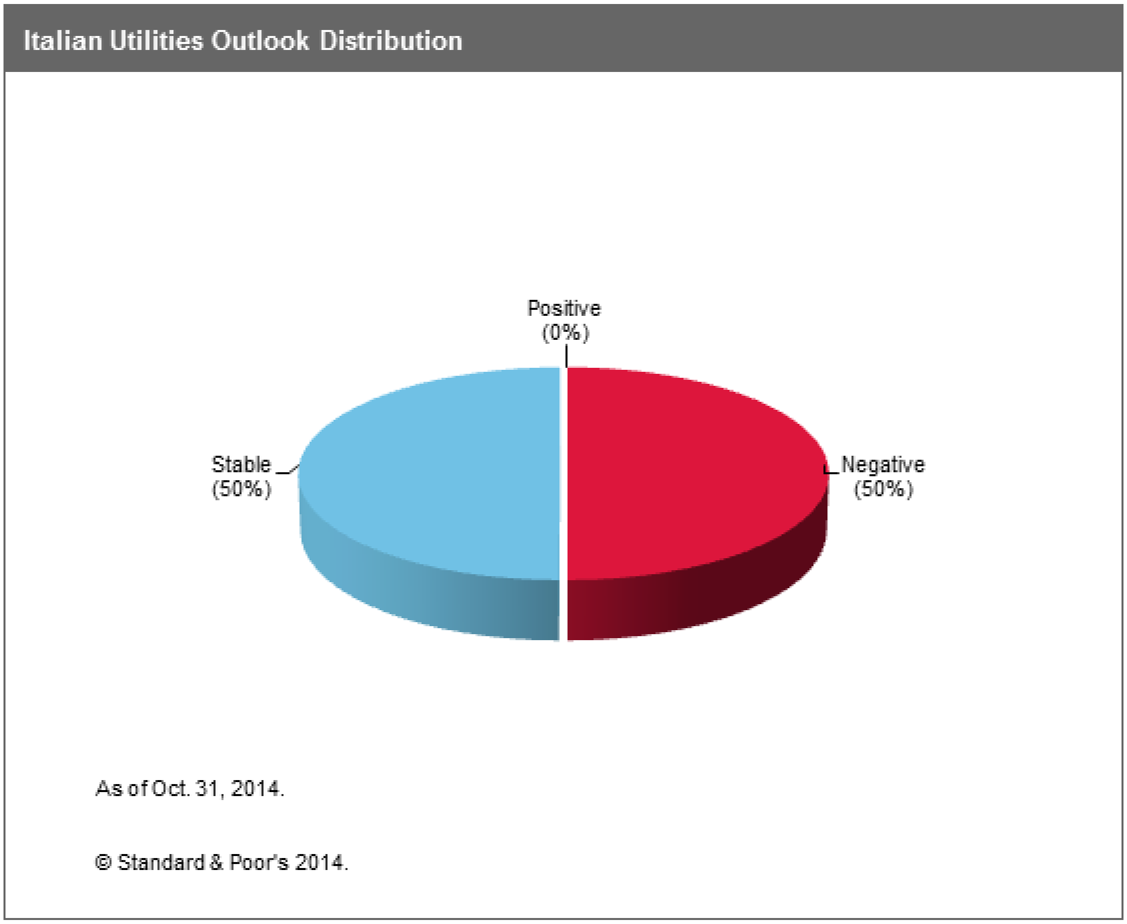
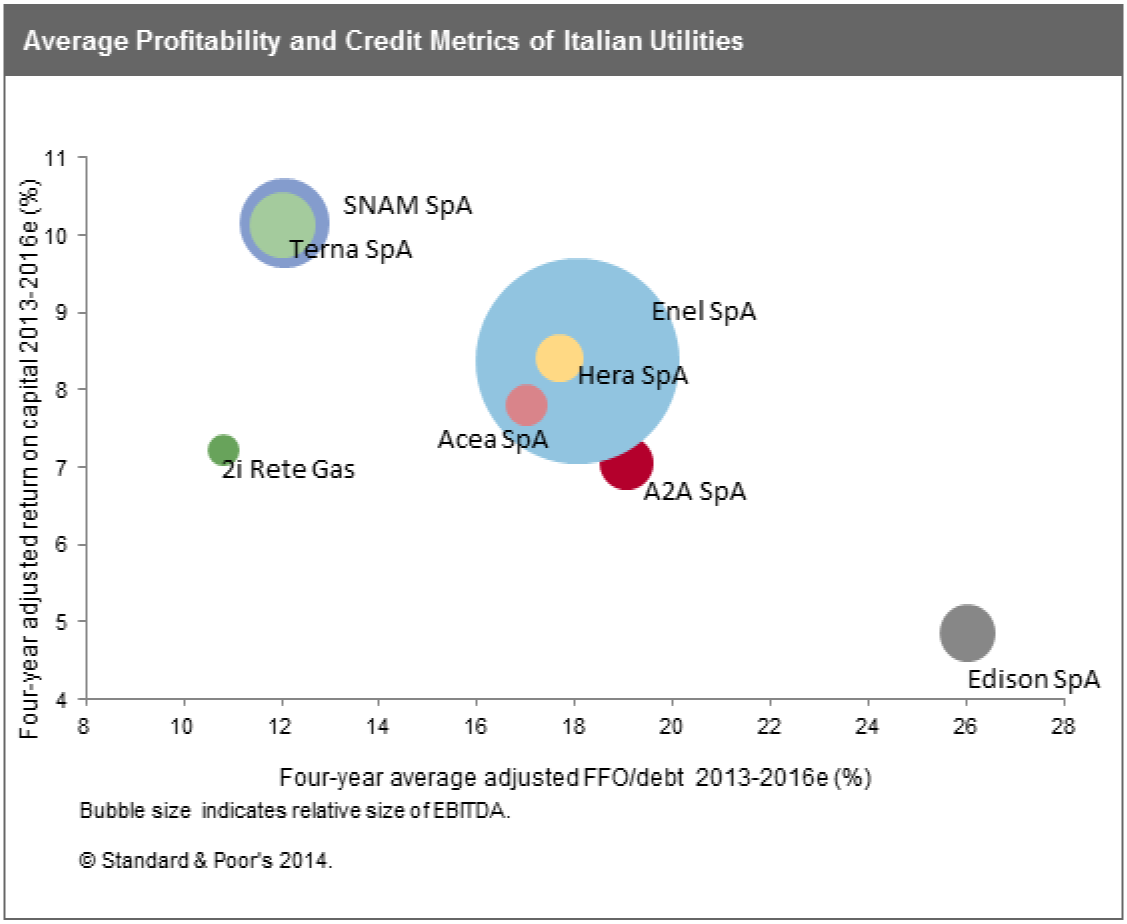
Chart 9



Network operators have higher profitability and are relatively more leveraged than integrated utilities or multiutilities (see chart 10). This is because their operations are regulated, making their cash flows more predictable. The lower adjusted return on capital for 2i Rete Gas versus other pure regulated players reflects, in our view, the impact of the successive transformation of this pure gas distribution player over recent years. Integrated utilities Enel and A2A and multiutilities Hera and ACEA compare well both in terms of credit metrics and profitability.

Chart 10



Under Standard & Poor's policies, only a Rating Committee can determine a Credit Rating Action (including a Credit Rating change, affirmation or withdrawal, Rating Outlook change, or CreditWatch action). This commentary and its subject matter have not been the subject of Rating Committee action and should not be interpreted as a change to, or affirmation of, a Credit Rating or Rating Outlook.

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