S&P Global
Ratings

Environmental, Social, And Governance Evaluation

Gruppo Hera SpA

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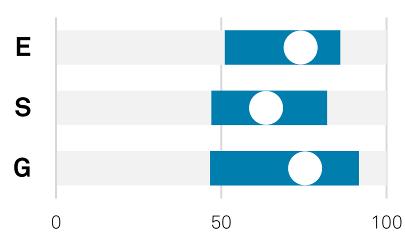
Summary

Gruppo Hera SpA (Hera) is a multi-utility company that provides gas (33% of 2020 EBITDA), water (24%), waste-management services (23%), electricity (17%) and other services (3%), including public lighting and telecommunications, across five regions of northern and central Italy. Hera's shareholding structure includes 111 municipalities that it serves along with other public shareholders (46% stake). The remaining 54% publicly trades on the Milan Stock Exchange and other indices. Headquartered in Bologna, Italy, Hera has around 8,900 employees and serves about 4.2 million customers in more than 300 Italian municipalities. In 2020, Hera generated €7.08 billion in revenue and €1.12 billion of EBITDA.

The ESG evaluation of 81 for Hera reflects our view that the company has strong preparedness to execute its strategy of creating shared value while navigating potential disruptions from regulatory changes related to the transition to a circular, low-carbon economy. Hera's governance structure is solid, with high levels of board independence, supported by good transparency and disclosure. The company's workforce is more diverse than peers', with a high share of women in managerial (non-board) positions. The company has a small but increasing proportion of employees under the age of 30. Hera shows strong commitment to the communities it serves, and engages with them through tailored initiatives, pioneering multi-stakeholder groups that foster dialogue to integrate communities' views. We expect its material greenhouse gas (GHG) emissions (Scope 3 from the use of sold products, natural gas, and generation of purchased electricity) will continue to decline. Hera has quickly capitalized on circular economy principles to become a leading multi-utility company that outperforms its peers. It continues to leverage technology and innovation to reduce its environmental footprint, including through plastics recycling and generating energy from waste. Its strong preparedness supports the resilience of its well-diversified business.

ESG Profile Score

71 /100



Company-specific attainable and actual scores

Preparedness Opinion (Scoring Impact)

Strong (+ 10)

ESG Evaluation

81 /100

A higher score indicates better sustainability

Component Scores

Environmental Profile

Sector/Region Score	36/50
Greenhouse gas emissions	Strong
Waste and pollution	Strong
Water use	Strong
Land use and biodiversity	Good
General factors (optional)	None
Entity-Specific Score	**38/50**
E-Profile (30%)	**74/100**

Social Profile

Sector/Region Score	32/50
Workforce and diversity	Good
Safety management	Good
Customer engagement	Good
Communities	Strong
General factors (optional)	None
Entity-Specific Score	**32/50**
S-Profile (30%)	**64/100**

Governance Profile

Sector/Region Score	27/35
Structure and oversight	Strong
Code and values	Strong
Transparency and reporting	Good
Financial and operational risks	Neutral
General factors (optional)	None
Entity-Specific Score	**49/65**
G-Profile (40%)	**75/100**

ESG Profile (including any adjustments) **71/100**

Preparedness Summary

Hera is well prepared for a world in which sustainable development and the circular economy are increasingly valued by stakeholders, thanks to its ability to anticipate headwinds, track record in setting and meeting targets, and to its well-diversified business. The company's long-term sustainability strategy, Creating Shared Value (CSV), seeks to generate tangible growth aligned with global sustainable development goals (SDGs)--including those related to responsible consumption and production (SDG 12) and climate action (SDG 13) among others--and the needs of local communities. It has good foresight on risks and assessment of emerging trends, including potential business disruptions from changing regulation associated with circular economy goals. Hera's culture is fostered through its focus on innovation, training, and sustainability-aligned incentive structure that supports its long-term strategy.

Capabilities	
Awareness	Good
Assessment	Good
Action plan	Excellent
Embeddedness	
Culture	Excellent
Decision-making	Excellent

Preparedness Opinion (Scoring Impact) **Strong (+ 10)**

ESG Evaluation **81/100**

Note: Figures are subject to rounding.

Environmental Profile

74/100

Sector/Region Score (36/50)

Gas- and electricity-related activities are exposed to risks linked to the transition to a low-carbon economy. Toughening climate-related regulations expose multi-utilities to significant costs and operational impacts. Multi-utilities involved in waste recycling and recovery face regulatory risks linked to European circular economy goals. Furthermore, multi-utilities' operational activities can have an impact on endangered species and sensitive natural environments, while multi-utilities' water use may exacerbate water stress in affected regions.

Entity-Specific Score (38/50)

Note: Figures are subject to rounding.

Greenhouse gas emissions	Waste and pollution	Water use	Land use and biodiversity	General factors
Strong	**Strong**	**Strong**	**Good**	**None**

Hera's material emissions occur when suppliers generate power for its electricity services and customers use the gas it provides. These emissions are declining thanks to company efforts. Hera stands out among peers as having an ambitious target of reducing Scope 3 emissions by 37% by 2030 (compared with 2019), which we view as realistic given that the company achieved a 7% reduction in 2020 (verified by the Science Based Target initiative). Hera deploys artificial intelligence to reduce gas leaks, with leak detection reporting up 46% in 2019 compared with the previous year. Its gas strategy centers on network optimization, readiness for the hydrogen transition, and increasing the sale of natural gas sold with certified carbon credits (20% or more targeted by 2030, compared with 4.4% in 2020).

Hera has rapidly adopted circular economy principles and outperforms its peers. We view favorably the company's low use of landfills (3.4% in 2020) which is significantly below most peers (22%), and comfortably ahead of the EU's Circular Economy Action Plan goal of 10% by 2030. Hera has set further targets, including reducing landfill waste to below 2% by 2030 and a 150% increase (compared to 2017) in plastic recycled by its subsidiary Aliplast over the same period, which we believe will support this trend. The average recycling and recovery rate of customers' waste was 92% in 2019, placing Hera ahead of peers, and has remained at or above 92% since 2015. We view favorably the company's water-management strategy that includes monitoring systems (focused on purification, distribution, and treatment) and control of the waste treatment chain (including waste-to-energy plants and landfills) to ensure strict compliance with regulations.

Hera uses technology and targets further reducing water stress risks, despite lower exposure. The company has no plants located in water-stressed areas (those exceeding 1,700m^3 per person annually). Its water-management project started in 2018. By 2020, it resulted in a 12% drop in the company's water consumption compared with 2017, with further targets to reduce it by 17% and 25% by 2024 and 2030, respectively.

Hera's management of biodiversity risks meets local regulations and is aligned with that of peers. For example, Hera has assets located in protected areas that require specific management and toxicity testing at its purification plants, both are required by law. Furthermore, design and planning assessments of the plants are carried out in adherence to local legislation.

Social Profile

64/100

Sector/Region Score (32/50)

Material exposures to social risks come from the sector’s relatively older, male talent pool, network reliability and affordability, reputation, and the community impacts of Hera’s activities. Occupational safety risks are typically well-managed within the sector (given stringent safety standards) but can at times expose companies to material damage. Furthermore, the energy transition requires upgrading and expanding network infrastructure, which can be disruptive to local communities.

Entity-Specific Score (32/50)

Note: Figures are subject to rounding.

Workforce and diversity	Safety management	Customer engagement	Communities	General factors
Good	**Good**	**Good**	**Strong**	**None**

Hera’s workforce management is aligned with peers', but has stronger gender diversity. The age demographic is representative of the sector but the proportion of under 30s has increased (6% in 2020, up from 4% in 2018) with plans to achieve 7.5% by 2023. Typical for the sector, Hera’s workforce is largely male, but female participation increased to 27% in 2020 from 25% in 2018. The company stands out for its high share of women in managerial positions (33% in 2020). Hera also has its own corporate university, partners with local institutions to attract and retain talent, and offers more training hours than many peers (26 hours per employee in 2020). Hera’s turnover rate (at 6.2% in 2020) is in line with the average for sector peers (8%).

Hera's customer engagement practices aligned with peers'. We view favorably the company’s support of customers experiencing financial hardship and efforts to raise awareness of energy consumption. The customer satisfaction index shows an improving trend (73 in 2020, up from 71 in 2016), within the sector average. Complaints increased since 2017, however average response times have improved, and a betterment plan is in place. Hera invests in innovation and digitalization (16% of capital expenditure to 2024) and targets 44% of customers using its digital services in 2024, in line with the sector.

Hera’s safety-management procedures are in line with those of the sector. The company’s accident frequency index in 2020 (14.2 accidents per million hours worked) dropped 17% compared with 2017, but remains above the sector average (2.6 accidents per million hours worked). The supplier accident frequency rate (22.3 in 2020) is lower than Hera’s own blue-collar workers. Subcontractors are screened against safety management criteria and awarded additional points in public tender processes where safety training hours are above those required nationally. Hera had two fatalities in 2020, which is lower than the sector average.

Hera’s tailored initiatives for community engagement are effective, enabling high support among stakeholders. Since 2013, Hera has pioneered multi-stakeholder dialogue groups (HeraLAB) led by local communities to integrate their needs and concerns into its planning and strategy. This initiative is unrivalled among Hera’s Italian peers. Hera also partners with NGOs and educational institutions to promote sustainability concepts.

Governance Profile

75/100

Sector/Region Score (27/35)

Hera is headquartered and operates in Italy whose institutional effectiveness somewhat lags similarly developed European countries. While a strong rule of law exists, perception of corruption is higher.

Entity-Specific Score (49/65)

Note: Figures are subject to rounding.

Structure and oversight	Code and values	Transparency and reporting	Financial and operational risks	General factors
Strong	**Strong**	**Good**	**Neutral**	**None**

Hera's board shows diverse composition, high levels of independence, and good governance practices that align with international best practice. The board comprises 15 members (the largest among global peers), including two executives (the CEO and executive chairman) and 13 independent directors (best among peers). Hera's diversified business model requires different industry skillsets. As such, the company benefits from its large board, despite its potential to complicate effectiveness. The board's skillset also reflects Hera's needs (23% of members have industry expertise) and, while average tenure exceeds that of peers (eight years), appointments are limited to three fiscal years. We view that directors' origins reflect the company's operational territory. Gender diversity (40% women in 2020) meets the Italian legal requirement, and board attendance is high (96% median attendance in 2020). Hera's governance structure is effective with no unexplained departures. Key-person risk is not material despite absence of a succession plan. The company's decentralized ownership model (with 46% ownership by 111 municipalities and public shareholders) reinforces its operational effectiveness.

Hera has established a comprehensive code and values framework across its value chain that meets global standards. Hera leverages its core values, partly developed by employees and key stakeholders, including sustainability and shared value, innovation, transparency and collaboration, to support its strategic objectives. Corruption risk is well managed, with management and shareholders acting independently and strong procedures in place, including frequent training and updates of the company's code of ethics (every two-to-three years), as well as anti-bribery certification (ISO 37001). Hera's policy framework is comprehensive, publicly available, and applies to all subsidiaries and suppliers (100% of Hera's subsidiaries have been covered by the code of conduct since 2016), which we view favorably. We view executives' remuneration (up to 46% annual bonus of fixed pay), and long-term incentives (three years with 33% vesting on an annual basis) as in line with that of peers.

Disclosure and reporting practices are better than many global peers' and cover a range of financial and nonfinancial metrics, policies, and governance topics. We view favorably Hera's granularity of reporting, which captures shared value generated by region, and reporting of indicators that measure investments' environmental benefits. However, environmental and social data is not reported by business segment, which makes data analysis challenging given the diversified business model. Hera comprehensively discloses tax liabilities, which we view favorably among global peers. Hera will gradually comply with the Task Force on Climate-related Financial Disclosure and align its reporting in due course, which we view favorably.

Preparedness Opinion

Strong
(+ 10)

Preparedness	Low	Emerging	Adequate	Strong	Best in class

Hera is well prepared for a world in which sustainable development and the circular economy are increasingly valued by stakeholders, thanks to its ability to anticipate headwinds and well-diversified business. The company's Creating Shared Value (CSV) strategy fully integrates sustainability and seeks to generate tangible long-term growth aligned with global sustainable development goals and the needs of local communities. This will be achieved through pursuing carbon neutrality of its gas and electricity distribution businesses; implementing circular economy initiatives in its waste activities (including introducing power-to-methane technology for electrical energy storage); and network digitalization (including smart dumpsters). In 2020, Hera's externally audited CSV-linked EBITDA reached €420 million (37% of the group's total EBITDA, up 7 percentage points from 2019), with a growth target of 50% by 2024, which we believe will support Hera's ambition to generate tangible sustainable long-term growth.

Hera foresees and assesses emerging trends and potential business disruptions. The company is exposed to numerous risks and opportunities, including climate change (asset damage and disruption) and associated regulatory changes and legislation. Risks are identified from the top-down and bottom-up through scenario analyses, stress testing, and what-if analyses, and include targeted measures (such as water network leak detection and the planned construction of interconnections between water networks) that serve to increase resilience to physical impacts of climate change. Hera has leveraged secular industry trends, such as energy production from waste (e.g., by upping its biomethane production from organic waste to 7.8 million/m^3 in 2020 from 6.5 million/m^3 in 2019) and plastic recycling, including its strategic acquisition of plastic waste recycling company Aliplast in 2017. Hera performs an annual assessment of risks and opportunities and sensitivity analysis that examines to long-term changes in gas demand from energy efficiency investments, electricity intensity, legislation, and infrastructure investment. These result in the identification of investments and management actions (such as hardening of its electricity distribution network against acute weather events and increasing its presence in electricity distribution).

Hera fosters its culture through innovation, training, and a sustainability-aligned incentive structure that supports its long-term strategy. Since 2006 CSV factors have contributed to management and executive bonuses, with performance against long-term sustainability targets accounting for upward of 35% of variable remuneration (15% in 2007). In 2020, 35% of managers' variable remuneration was linked to sustainability objectives, including projects promoting smart energy, resource efficiency, and innovation; such focus led Hera to invest in waste recycling ahead of peers. In 2021, CSV-linked EBITDA will be incorporated in remuneration calculation. Hera approaches innovation collaboratively, fostering ideas from internal and external stakeholders to identify priorities. This reinforces its strategic objectives and focus on innovation. Under its CSV strategy, Hera invested €86 million (up 10% from 2019) in innovation in 2020, including in Heureka+ (where employees submit and vote on innovative ideas) and HeraLAB (a social innovation initiative to improve dialogue with local communities). The latter launched in 2013 and resulted in 55 funded projects, raising customers' awareness of energy consumption and recycling. Strategic partnerships with global networks like the Ellen MacArthur Foundation also support Hera's objectives, along with its focus on sustainable financing. Hera was the first Italian company to issue a green bond (2014), and has since issued another to finance investments in support of its long-term strategy (2019).

Sector And Region Risk

Primary sector(s)	Utility Networks
Primary operating region(s)	Italy

Sector Risk Summary

Environmental exposure

The regulated utility network sector's exposure to environmental risks stems from its infrastructure assets and exposure to the environmental characteristics of entities across value chains. These networks are generally viewed as having high responsibility for ensuring clean water and air, and helping to transition to a lower-carbon economy. While electric, gas, and water networks each have unique environmental risk drivers, the most material environmental risks facing these subsectors are the physical effects of climate change and mitigation policies. Each subsector also faces some land-use risk; as they grow they risk encroaching on habitable or undeveloped lands that are more exposed to biodiversity issues in some parts of the world. Electric and gas utilities are exposed to significant energy transition risks, indirectly, through their upstream partners. These risks to networks are moderated, at least financially, by the regulatory support they enjoy and their ability to absorb costs through rate increases. However, less direct reputational effects can be significant given utilities' strong brand recognition. For electric transmission and distribution networks, the physical effects of climate change, including more frequent and severe wildfires, storms, hurricanes, and tornadoes, have the potential to disrupt the functioning of critical equipment and processes. Battery storage has its own set of environmental risks, stemming from mining and end-of-life disposals of materials used in battery units. For natural gas networks, we focus on gas explosions and leaks that emit highly potent greenhouse gases and may adversely affect local biodiversity, leading to costly penalties and reputational damage. For water networks, environmental risks are mainly water quality and availability, sometimes because of inefficient and aging infrastructure. Both water quality and availability--essential for this sector--can be impaired by climate-related factors, including droughts and floods.

Social exposure

The regulated utility network sector plays a crucial community role by providing essential services that must remain affordable and reliable to ensure conciliatory regulatory and customer relationships. This is the essence of utilities' social license to operate. However, as infrastructure ages, utilities must also ensure safety as leaks, explosions and fires can yield very material financial and reputational consequences. Water utilities may also face public health risks if they are unable to avoid drinking water contamination or stop wastewater from polluting supplies. Governments and regulators focusing increasingly on affordability, which we believe could create barriers to regulated networks' cost recovery. This is especially so in areas facing upward cost pressures from ongoing high investments in renewables and grid strengthening. Longer term, increased costs and improved solar and battery technology could result in some downstream residential, commercial, and industrial customers partially defecting from electric utilities. Utilities also face significant workforce issues. Amid an unrelenting energy transition, electric utilities, specifically, must develop employee bases with appropriate skills to operate the grid of the future, as well as retain employees. Given the sector's high unionization, companies have to focus on labor-relations management to avoid labor disruptions and related costs. Given that utilities are local in nature, they play a prominent role in communities and have large numbers of local employees. This can often result in regulatory support, but also carries a responsibility to contribute to the community and support low income customers, as well as tactfully mitigating disputes around land use as they expand. Finally, given the social responsibility of providing continuous electricity, gas, and water supply, preventing any risk that could lead to a power blackout or water shortage is an important consideration. Cyber-attacks are therefore increased threats for the sector, more so than in many other sectors.

Regional Risk Summary

Italy

Italian institutions' effectiveness somewhat lags behind similarly developed European countries. The perception of corruption is also higher than the European average (the country ranks 51 out of 180 on the Transparency International 2019 Corruption Perceptions Index). The Italian Code of Corporate Governance is the reference document for best practices and follows a comply-or-explain principle. The new version of the Code issued in January 2020 focuses on four key areas: shareholder engagement, proportionality, simplification, and long-term sustainability. The code became effective after Dec. 31, 2020. Companies of over 500 employees are implementing the EU Non-Financial Reporting Directive's recommendations, which mandates disclosing ESG (including diversity) risks. Ownership is concentrated because many Italian companies continue to be tightly controlled through cross-holdings and pyramidal ownership, often to the detriment of minority shareholder rights. The government also maintains sizeable shareholdings in large publicly listed companies. Italy fares well on female participation on boards thanks to a reform establishing legislated quotas to ensure gender balance on corporate boards. However, boards often lack international expertise.

Related Research

- The ESG Risk Atlas: Sector And Regional Rationales And Scores, July 22, 2020
- Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide, July 22, 2020
- Environmental, Social, And Governance Evaluation: Analytical Approach, Dec. 15, 2020
- How We Apply Our ESG Evaluation Analytical Approach: Part 2, June 17, 2020

This report does not constitute a rating action.