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Directors' Report

984,6

million
Ebitda

266,8

million
Net profit

396,2

million
Investments

ROE 9,9 %

Return
on Equity

ROI 9,2 %

Return
on Investment

2,56 x

Net debt/Ebitda
ratio

1.01.01

Operating and financial results

The Hera Group closed the 2017 financial year with operating indicators and results increasing compared to the previous year: it consolidated its EBITDA, which reached 984.6 million euro, up 7.4%; EBIT amounted to 479.3 million, up 4.9%; net income came to 266.8 million euro, up 21.1%. From a financial point of view as well, positive results were seen: net financial debt, coming to 2,523 million euro, dropped by 1.4% and the net debt/EBITDA ratio settled at 2.56, also showing a clear improvement compared to the previous year. These results confirm the Hera Group as one of the main operators in its sector, thanks to a consolidated multi-business strategy that guarantees a dynamic balance in its operating and financial activities, combining regulated and free market activities.

**Constant growth
in all indicators**

In 2017, objectives in development were pursued through both internal and external growth. The main levers used were efficiency and innovation, as can be seen, for example, in public lighting with the use of led street lights, investments moving towards smart cities and company digitalisation. Other levers used included agility and excellence, understood as the offer of an outstanding level of service in all businesses, with the aim of surpassing the qualitative standards set by the Regulating authority for energy, networks and the environment (Arera; hereinafter the Authority). The Group's solidity in equity and financing, instead, provided the key element for development through external lines. Accompanying these strategic levers for growth, a constant role in strategy was played by sustainability and circularity.

The main corporate and business operations having an effect on 2017 can be described as follows:

In September 2016, Hera Comm was awarded the Friuli Venezia-Giulia and Emilia Romagna portion of the last resort gas supply service (FUI) for the period between 1 October 2016 and 30 September 2018, along with 5 portions of the default service in gas distribution between 1 October 2016 and 30 September 2018.

In November 2016, in the national tender held by the Single Purchaser for 2017-18 safeguarded services, Hera Comm was awarded six portions covering eleven regions of Italy.

On 1 February 2017, Waste Recycling Spa acquired the "plants" corporate branch of the Pisa company Teseco, a leading figure in industrial waste treatment and recovery.

In January 2017 Herambiente Spa signed a binding deal with Aligroup Srl for the acquisition of the Aliplast Group, a leading operator in the segment of plastic waste collection and recycling with subsequent regeneration, using an integrated process that transforms all waste into products ready to be reused. The operation was closed on 3 April 2017 following the fulfilment of the main conditions precedent. As of 1 January 2017, all companies of the Aliplast Group were thus entirely consolidated within the Hera Group. In December 2017, Herambiente Spa's acquisition of a further 40% of Aliplast Spa's shares was completed. With this operation, the amount of Aliplast Spa shares held by the Group rose to 80%. The remaining 20% of these shares, as stipulated in the agreement signed in January 2017, will be acquired within June 2022.

On 6 July 2017, Hera Comm Marche Srl acquired a full holding of the company Verducci Servizi Srl, which is active in the natural gas and electricity supply market.

Since 1 January 2017, Heratech, a company that manages works requested by customers (new connections, technical opinions, urbanisation, etc.), has been operational for all network services managed by the Group. It furthermore deals with planning and implementing plants and networks and other highly specialised technical activities, for both the Group and third parties. The company is 100% controlled by Hera S.p.A.

This consolidated income statement reflects the application of accounting principle IFRIC12 "Service concession arrangements". The effect of applying this principle, which leaves the results unchanged, is that investments made in goods granted under concession, only including network services, are acknowledged in the income statement.

During 2017, the Group chose to adopt in advance accounting principle Ifrs 15 “Revenue from contracts with customers”, which only has an impact in electricity sales in particular regulated market segments. For further details, see chapter 2.02.02 of the consolidated income statement.

Following resolution 268/2015/R/eel of 4 June 2015, with which the Authority adopted the Standard grid code for electricity transmission, and, later, directive 13/2016 – Dmeg of 5 August 2016, as of the 2017 financial year revenues and costs amounting to € 657.9 million have been recorded in the income statement for a reclassification of general system charges, from financial accounts to operating accounts of the sales companies. In order to be more easily compared, the amounts recorded in December 2016 have been adjusted, inserting system charges within operating accounts, similarly to 2017. At 31 December 2016, this adjustment, which leaves the results unchanged, introduced higher revenues coming to € 697.9 million and an identical rise in costs.

Note that in order to be more easily compared, the 2016 financial year has been adjusted to reflect the reclassification among “Other operating revenues” of feed-in-premium contributions, formerly green certificates, originally included among “Revenues”. The value of this reclassification, which has no effect on results, amounts to € 26.8 million.

The following table shows operating results at 31 December 2017 and 2016:

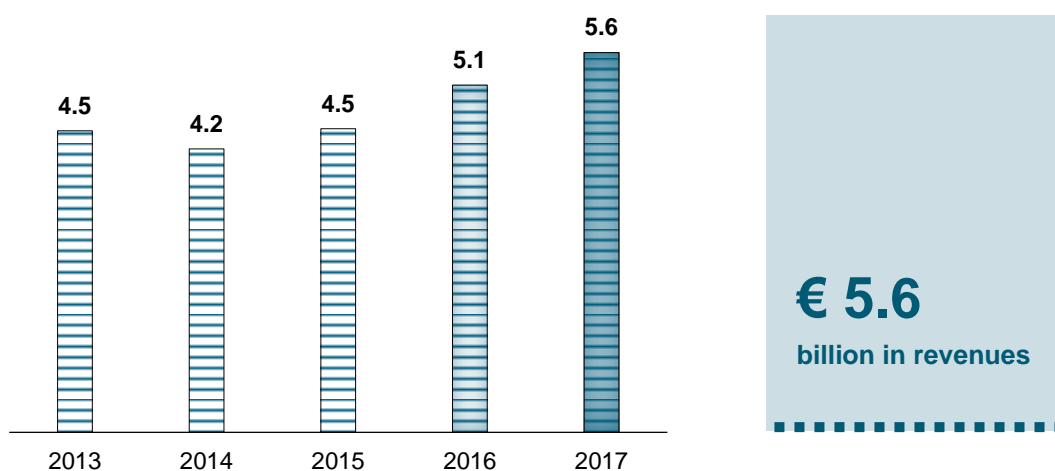
Income statement (mn€)	Dec 17	% Inc.	Dec 16 Adj	% Inc.	Abs. change	% Change
Revenues	5,612.1		5,131.3		+480.8	+9.4%
Other operating revenues	524.8	9.4%	430.2	8.4%	+94.6	+22.0%
Raw materials	(2,606.8)	-46.4%	(2,176.8)	-42.4%	+430.0	+19.8%
Service costs	(1,952.2)	-34.8%	(1,896.7)	-37.0%	+55.5	+2.9%
Other operating costs	(84.6)	-1.5%	(75.0)	-1.5%	+9.6	+12.8%
Personnel costs	(551.6)	-9.8%	(524.1)	-10.2%	+27.5	+5.2%
Capitalised costs	43.0	0.8%	27.8	0.5%	+15.2	+54.7%
EBITDA	984.6	17.5%	916.6	17.9%	+68.0	+7.4%
Amortisation, depreciation and provisions	(505.3)	-9.0%	(459.6)	-9.0%	+45.7	+9.9%
EBIT	479.3	8.5%	457.1	8.9%	+22.2	+4.9%
Financial operations	(101.5)	-1.8%	(117.4)	-2.3%	-15.9	-13.5%
Pre-tax profit	377.8	6.7%	339.7	6.6%	+38.1	+11.2%
Taxes	(111.8)	-2.0%	(119.3)	-2.3%	-7.5	-6.3%
Net result	266.0	4.7%	220.4	4.3%	+45.6	+20.7%
Result from special items	0.8	0.0%	-	0.0%	+0.8	+100.0%
Net profit of the period	266.8	4.8%	220.4	4.3%	+46.4	+21.1%
Attributable to:						
Shareholders of the Parent Company	251.5	4.5%	207.3	4.0%	+44.2	+21.3%
Non-controlling interests	15.3	0.3%	13.1	0.3%	+2.3	+17.4%

Constant and increasing growth

Revenues for 2017 came to € 5,612.1 million, up € 480.8 million or 9.4% compared to the € 5,131.3 million seen in 2016. The 2017 financial year benefitted from the entrance of the Aliplast Group, which contributed with € 109 million, and Verducci Servizi Srl, with 1.8 million. Not including these changes in the Group's scope of operations, growth in revenues amounted to € 370.0 million, mainly owing to an increase in trading, coming to roughly € 300 million, higher revenues in gas and electricity sales, due to a rise in the price of commodities, amounting to € 60 million, greater volumes of gas and electricity sold, coming to roughly € 75 million and higher regulated revenues in the water services, reaching € 22 million. The reduction in revenues offsetting the growth described above was due to the effect of the sale of green certificates during the past year, amounting to roughly € 24 million (with an equal effect on costs), the application of accounting principle Ifrs 15, coming to € 19.1 million, and lower revenues for system charges, reaching € 40 million.

For further details, see the analyses of each single business area.

Revenues (bn€)



Note: the trend seen from 2013 to 2015 does not reflect the adjustment of system charges, which came to € 697.9 million in 2016 and € 657.9 million in 2017.

Other operating revenues increased over the previous year by € 94.6 million or 22.0%. This growth is mainly due to higher Ifric 12 revenues coming to € 45.0 million and higher revenues from energy efficiency certificates amounting to € 33.5 million for their higher value per unit, changes in the scope of operations coming to roughly € 4.0 million and a higher recovery of insurance and reimbursements amounting to roughly € 4.0 million.

Costs for raw and other materials rose by € 430.0 million over 2016, up 19.8%; this increase, not including the change in scope of operations following the entrance of the Aliplast Group and Verducci Servizi Srl amounting to roughly € 60.0 million and the € 24 million classification of environmental certificates, is due to an increase in trading, a higher price for electricity as a raw material, greater volumes of gas and electricity sold and the higher cost per unit of energy efficiency certificates.

Other operating costs, not including the change in scope of operations following the entrance of the Aliplast Group and Verducci Servizi Srl coming to roughly € 17.8 million, increased by € 47.3 million overall (€ 38.5 million in higher costs for services and € 8.8 million in higher operating expenses). Mention must also go to roughly € 60 million in higher Ifric 12 commissions per circa 60 million, € 7.0 million in commissions and works between Group companies, higher costs in the water cycle largely involving an increase in quick response activities owing to the drought in 2017 and higher costs in the waste area tied to maintenance works on a few waste treatment plants. The higher costs mentioned above were only partially offset by lower costs for system charges, amounting to € 40 million.

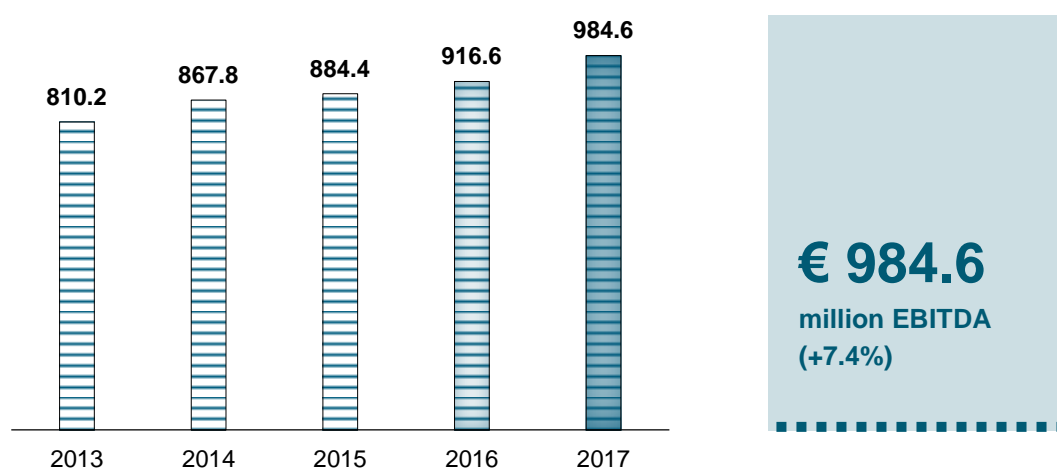
Personnel costs, excluding changes in the scope of operations, rose by € 10.5 million or 2.0%. This increase was mainly due to the higher retribution foreseen by the national labour contract and was only partially offset by a lower average presence. The changes in the scope of operations mentioned above amounted to € 17.0 million overall, the most significant of which involved the waste area with the entrance of the Aliplast Group and the corporate branch of Teseco Srl.

Capitalised costs rose by € 15.2 million or 54.7% in 2017 compared to the previous year, for greater works on plants and work on assets belonging to the Group.

EBITDA settled at € 984.6 million, rising by € 68.0 million or 7.4% over 2016. This growth can be attributed to the good performance shown by all business areas. The energy areas rose by € 50.3 million, driven by the electricity business with a higher income on free market and safeguarded sales activities and a higher income from electricity production. The waste area also made a significant contribution, with € 15.3 million coming from the reinforced organisational structure owing to the acquisition of the Aliplast Group. Results were positive for the integrated water cycle and the other services area as well.

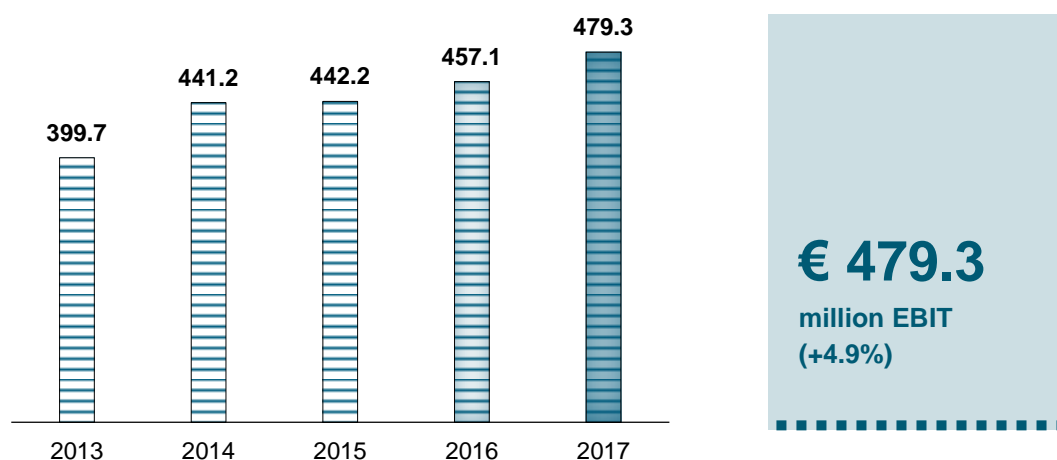
For further details, see the analysis of each single business area.

EBITDA (mn€)



Amortisation and provisions rose by € 45.7 million or 9.9%, going from the € 459.6 million seen in the previous year to € 505.3 million. Amortisations increased due to new investments in operations and the change in scope due to the Aliplast Group and the sales companies. Provisions for doubtful debts rose, in particular in the sales company Hera Comm Srl, owing to the new scope of operations in managing for safeguarded services.

EBIT reached € 479.3 million at the end of 2017, increasing by € 22.2 million or 4.9% compared to the € 457.1 million seen in 2016.

Ebit (mn€)

The results of financial management at the end of 2017 came to € 101.5 million, improving by € 15.9 million or 13.5% compared to 31 December 2016. The good performances can be attributed to a more efficient and flexible financial structure, partially obtained through the liability management operations introduced in 2016, and the higher income due to default indemnities applied to the late payment of safeguarded customer credits. Also note the improved results obtained by related companies and joint ventures.

Good performance in financial management

Pre-tax profits grew by € 38.1 million, going from € 339.7 million in 2016 to € 377.8 million in 2017.

Income taxes went from € 119.3 million in 2016 to € 111.8 million in 2017. The tax rate showed a clear improvement, settling at 29.6% rather than the 35.1% seen in 2016. This improvement was mainly due to a decrease in the nominal Ires rate, which fell to 24%, but also benefitted from the patent box, ace, tax credits for research and development, large and extremely large amortisations (the latter concerning the consistent investments made in instrumental goods serving a technological and digital transformation along the lines of "Industry 4.0") that the Group proved able to take advantage of over the year.

Improved tax rate

Net results rose by 20.7%, corresponding to € 45.6 million, going from € 220.4 million in 2016 to € 266.0 million in 2017.

2017 results increased thanks to special items amounting to € 0.8 million, made up of: (i) goodwill write-downs coming to 12.4 million; (ii) other provisions for risks, coming to 6.0 million; (iii) positive tax effects, amounting to 19.2 million, linked to discharge transactions, through the payment of the substitute tax, relating to the controlling interest in Aliplast Spa, coming to 10.6 million, and the discharge of goodwill recorded in Inrete Distribuzione Energia Spa, coming to 8.6 million. For the tax rate derived from the financial statements, see note 11 of paragraph 2.02.06.

Net profits thus rose by 21.1% or € 46.4 million, going from € 220.4 million in 2016 to € 266.8 million in 2017.

+21.1% Net profits

Group net profits came to € 251.5 million, up € 44.2 million compared to the amount seen at 31 December 2016.

Net profits post minorities (mn€)

