

# 1

## 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

# Reference scenario and Group strategy

According to the latest Top Utility report drafted by Althesys, the public utilities sector plays a leading role within the Italian economy, accounting for approximately 7% of the country's Gross domestic product (GDP). This result, however, represents levels of service and efficiency that differ greatly across the country on account of the high level of fragmentation among operators. The most recent census, carried out by the government in 2014, counted no less than 1,500 of the latter, a figure which is quite distant from the standards seen in other European Union countries. With the goal of improving the efficiency and transparency seen in these services, the government and the national Authority have therefore pursued actions aimed at rationalising the sector.

**The utility sector and the Authority,**

rationalising the industry and liberalising the market

In gas distribution, for example, tenders for renewing grants are foreseen within the next five years across the entire country. These competitive procedures have been designed to promote greater consolidation among operators, while at the same time favouring the more efficient ones and those able to sustain more wide-reaching investment plans. The areas concerned by the tenders have in fact been geographically widened, now covering provinces instead of municipalities, as was previously the case. It follows that, according to estimates made by sector professionals, a reduction should be seen in the number of companies, from over 200 to roughly twenty.

In late 2017, the government also established that regulations for the waste management sector were to pass over to the Authority for electricity, gas and the water service, which was thus renamed as the Regulatory authority for energy, networks and the environment (Arera, Autorità di regolazione per energia reti e ambiente). With this reform, the executive branch expects a higher degree of uniformity to be reached in tariffs and service quality nationwide, for example by defining the mechanisms used in tenders for granting concessions for street cleaning and urban waste collection. Thanks to this change, similar to the one introduced for water services, the government aims at achieving, over the medium term, a rationalisation of this sector, which is currently the only one lacking modern and rational regulations.

In liberalised businesses, the government's objective is to promote a higher level of market competition, to the advantage of end consumers. To this intent, a prediction for the complete liberalisation of the electricity market as of 1 July 2019 was included in the 2017 Competition Bill. At present, roughly 20 million users have not yet chosen a free market energy supplier. Launching this process thus represents an opportunity to stimulate competition and give space to companies with the best service levels and the largest scale economies.

In this context, marked in all sectors by various factors encouraging the consolidation of smaller operators, Hera operates with a development model that is geared towards making the most of scale economies and synergies (internal growth) and expanding the geographical extent of its own operations (external growth), by integrating sector enterprises. Since its establishment, 25 companies in bordering regions have been merged, allowing Hera to achieve nationally significant market positions and quintupling its EBITDA. This process has been favoured among other things by an amply

**Hera's model of aggregation**

diversified corporate structure that entrusts the Group's management to a governance inspired by an industrial and managerial type of rationale.

The results for 2017 also bear the mark of this strategic approach. As regards external growth, in the year in question Hera brought to conclusion a few important acquisitions in liberalised markets. In the energy sales business, Hera Comm Srl, the Group's trading company, completed its acquisition of a few customer packages (Verducci Servizi Srl) in the Abruzzo region, an increasingly interesting area, as is witnessed by the acquisitions made over the last three years (Alento Gas Srl, Julia Servizi Più Srl, Fucino Gas Srl and Gran Sasso Srl). In early 2018 Blu Ranton Srl, a gas and electricity sales company operating in the Marche and Abruzzo regions with roughly 17,000 customers, was added to the list of purchased companies. Thanks to this transaction, the Group is now the one of the foremost operators in these regions, with approximately 225,000 customers. In the same period, a customer portfolio was purchased from Eni in the province of Gorizia, where the group already provides gas and electricity distribution services.

**Hera grows in many directions**

Two acquisitions were completed in the waste treatment sector: Aliplast Spa and Teseco Spa. The latter meets the Group's need to enhance its industrial waste recycling plant capacity, allowing it to expand in one of Tuscany's most important industrial districts, where the Group was already present as of late 2015 con Waste Recycling Spa.

Aliplast Spa instead allowed a new link to be added to the value chain in this sector: thanks to it, Hera is now in fact able to create finished products starting with recovered raw materials. This operation furthermore allows the Group to reduce its exposure to the cyclically variable price of recycled materials, to pursue cross-selling of waste treatment services on the vast customer base of the newly acquired company (present across Italy) and to evolve its activities, moving towards a circular economy.

Internal growth was pursued through extracting efficiencies and synergies from the businesses managed, in line with the track record seen over the last five years, during which roughly 90 million euro in accumulated savings were recorded. This result was partially obtained thanks to the development of a few innovative projects, such as satellite searches for leakage in the water network or the digitalisation of the process of urban waste collection (HergoAmbiente project). Continued growth was furthermore seen in free markets, where a wider customer base was obtained through commercial actions and an enlargement of the regions involved in last resort services. 2017 was in fact the first year of the two-year grants in safeguarded electricity and default gas services, which the Group had been awarded in late 2016, gaining national co-leadership.

The Group's growth strategy, effectively and continuously pursued in 2017 as well, maintained a perfect balance between regulated and liberalised activities in its core businesses. This balanced portfolio mix heralds the sustained presence of a high risk diversification.

In early January 2018 the new business plan to 2021 was presented, the fifteenth since the Group's establishment, geared towards further growth. Thanks to a macroeconomic scenario expected to improve and the development opportunities offered by the rationalisation of the sector, EBITDA is anticipated to grow by 218 million euro, reaching in 2021 the target of 1.135 billion euro, higher than the one set down in the previous plan. Relying on the Group's current market position and the availability of accumulated financial resources, growth will also be fuelled by an ambitious investment program coming to roughly 2.9 billion euro, with a sharp acceleration (+62%) compared to the investments made in the last five years. The Group's strategy, indeed, calls for an efficient allocation of capital, fully financed by the generation of cash flow and largely dedicated to networks, which will allow the Group to conserve its current low risk profile.

**The new business plan to 2021**

The objective of maintaining financial solidity was also confirmed, with a target of a 2.9 net debt to EBITDA ratio. The 17% increase in dividends per share, to be implemented progressively until 2021, in any case leaves ample room with which to finance any possible opportunities for future growth.

Confirming the content of the previous business plan, this strategy will be supported by the usual five development levers: growth, efficiency, innovation, excellence and agility. This orientation, which has already proven its validity in recent years, is at the root of all projects envisaged for the next four years,

which match the main directions in which the sector is evolving: circular economy, utility 4.0 and customer experience.

The strategy through to 2021 also proves to be in line with the idea of a circular economy, pushing sustainable management beyond simply reusing and recycling materials coming from sorted waste. The Group, that in this area has reached the targets set by supranational organisations (EU and UN) well ahead of time, will take a decisive step in the upcoming five-year period towards directly producing goods that can be relocated on the market, through the use of recycled materials.

Circular economy

The Group furthermore intends to move towards utility 4.0, through the use of digital technologies in all its business areas. Intelligent networks, big data analysis and the internet of things indeed represent opportunities to have the processes and infrastructures managed more efficient and concretely contribute to a smart development of the cities served.

Utility 4.0

A great deal of attention is expected to be given to customer experience and all related activities, which encourage customer relationship management tools to evolve. The target is an ever-increasing capacity and velocity in big data analysis in order to provide a structure for strategies aimed at improving the quality of the services offered, as well as to define the marketing offers that best meet customer requests.

Customer experience

The plan presents targets and projects that the Group wishes to pursue in a sustainable way, creating value for all stakeholders. The first to do so in Italy, in 2017 Hera reported its creation of shared value (Csv), which is inspired by the economic theory developed by Porter and Kramer in 2011. This indicator calculates the Group's EBITDA deriving from activities in line with the global objectives set out in the UN Agenda and, more specifically, those that meet the call to action of 10 of the 17 points presented, i.e.: efficient use of resources, intelligent use of resources, innovation and territorial development. In the previous financial year (2016), Csv accounted for roughly 30% of Group EBITDA, and this amount is expected to rise to 40% in 2021, considering that two thirds of the growth foreseen in the plan is related to projects in line with the UN's global Agenda.

Creation of shared value