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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

Trading and procurement policy

The recovery in demand for natural gas continued in 2017, settling at 74.7 billion m³, up 6.1% compared to the 70.4 billion m³ recorded the previous year, thus confirming the turnaround seen as of 2015. More specifically, this growth in gas consumption is due to a rise in demand from thermoelectric plants, which came to 25.3 billion m³ compared to the 23.3 billion m³ seen in 2016, with an 8.6% increase recorded mainly during the first quarter of the year, and due both to lower electricity imports coming from France and a drop in hydroelectric production. The recovery was significant in household consumption, which made up over 40% of overall demand, with a 3.5% increase from 31.7 billion m³ in 2016 to 32.8 billion m³ in 2017. Lastly, a significant rise was also seen in industrial consumption, coming to 1.1% and amounting to 14.3 billion m³, confirming the solidity of the economic recovery.

Upturn in gas consumption: +6.1%

Trading operations were oriented on the one hand towards optimizing the portfolio, with a view to balancing short-term positions, and on the other towards negotiating and managing new supply contracts for the 2017/2018 thermal year.

An optimised portfolio

Going into further detail, short-term adjustments, supported by an efficient prediction of upcoming demand, were implemented through purchase or sales agreements at the Virtual exchange point (VEP-Italy), the Virtual trading point (VTP-Austria), the Title transfer facility (TTF-Holland) and Net Connect Germany (NCG-Germany). The conditions for these transactions were generally favourable and allowed objectives in terms of expected economic results to be met.

As of April, Hera Trading initiated gas procurement aimed at both filling the storage capacity purchased by auction, with roughly 0.33 billion m³, and providing gas destined to the free market for the Group's sales companies for the 2017/18 thermal year, with roughly 0.6 billion m³, sourcing it directly from the spot and futures markets.

During the month of April, as in the previous year, negotiations also took place for modulated gas intended for the protected market delivery points (so-called Remi) of the Group's sales companies. The total amount reached roughly 1.4 billion m³ for the 2017/18 thermal year, as per the supply conditions resolved by Arera beginning in October 2013. This negotiation allowed particularly favourable terms to be obtained in terms of both prices and payment conditions.

Negotiation of modulated gas coming to 1.4 billion m³

Electricity consumption returned to a phase of growth in 2017, reaching the highest amount seen since 2013. According to the preliminary data elaborated by the national network transmission company (Terna), the total amount of electricity requested in Italy in 2017 came to 320.4 billion kWh, with a 2.0% increase over 2016.

This increase did not change significantly among the country's various regions.

Domestic production accounted for 89% of the demand seen in 2017, up 1.9% over the previous year, coming to 285.1 TWh, while the foreign balance settled at 37.8 TWh (+2% over 2016). In particular, the contribution from thermoelectric plants grew to 199.5 TWh (+4.6%), as did photovoltaic production, even more significantly, coming to 24.8 TWh (+14%). Hydroelectric production, instead, dropped once again, falling by 14.3% to 24.8 TWh, while less remarkable decreases were seen in wind power, at

Electricity consumption begins to rise once again: +2.0%

17.5 TWh (-0.2%) and geothermal production, at 5.8 TWh (-1.4%). The percentage represented by renewable sources fell from 34% in 2016 to 32.3% in 2017.

Earnings coming from thermoelectric plants, in Teverola and Sparanise in particular, showed a significant increase compared to the figures seen in 2016. Contributions to this result came from both Terna's greater usage of the Dispatching services market (Msd) and the noteworthy increase in the National single price (Pun) seen over the year.

Increase in earnings from power plants

In August 2017 a fire broke out in the Sparanise plant, causing damage to one of the power station's two modules and leading the module itself to be non-operational until the repair works are completed, which is expected for the end of the first quarter of 2018. The Ortona plant's performance continues to be problematic, located as it is in an area with scarce demand on the Dispatching services market (Msd), even though results improved compared to the previous year.

During the first half-year, with resolution 300/2017 of 5 May 2017 Arera launched an initial phase of pilot projects for consumption units and non-authorized units participating in the Msd, including various forms of aggregation according to geographical parameters. The pilot projects define the forms of return for auxiliary services not currently remunerated.

Reform of the electricity market

Furthermore, with resolution 419/2017 Arera approved new transitory regulations for actual imbalances, which calls for the introduction of macro-zone no-arbitrage compensation as of 1 July 2017, the application of a new method for calculating the positive or negative zone aggregate imbalances as of 1 September 2017, and the reintroduction of "single pricing" mechanisms for dispatching points of non-authorized units, maintaining instead mixed "dual pricing" system for consumption units, in order to contrast programming strategies that are not diligent towards the system.

As regards electricity and environmental certificate trading, a drop in earnings was seen in 2017 compared to 2016 due to the circumstantial effects of the unavailability of French nuclear plants in the fourth quarter of the previous year.

Electricity trading performance

The management/optimisation of Hera Comm Srl's acquisition portfolio, through operations on the stock exchange and on over the counter (Otc) platforms, was particularly incisive.

Commodity and exchange risk management proved once again to be particularly appropriate, allowing for a unitary and efficient management of price risk, which supported commercial activities in the gas and electricity areas, in compliance with Group policies.

Price risk management

EU Directive 201/65/UE MiFID II became effective as of 3 January 2018. This directive increases interactions between the world of finance and commodity markets, extending to energy sector operators a series of obligations typical of financial instruments. In particular, the notion of financial instrument has been further enlarged to include quotas and derivatives on commodities settled physically even if negotiated in organised trading facilities (Otf). The result is that trading these goods, priorly not regulated, will be subject to the requirements concerning authorisation, governance and capitalisation foreseen by regulations for financial intermediation services.

Adaptation to MiFID II requirements

A few exemptions are however envisaged in the application of regulations on financial intermediation for subjects operating on quotas and derivatives on commodities on their own account, or providing other investment services in commodity derivatives or quotas to customers or suppliers of their main activity.

The Group companies falling within the scope of application of these regulations, and Hera Trading Srl in particular, have taken measures to adapt, in terms of instruments and procedures, in order to meet the foreseen requirements.