

Company Name: Hera
Company Ticker: HER IM
Date: 2018-05-10
Event Description: Q1 2018 Earnings Call

Market Cap: 4,435.85
Current PX: 2.978
YTD Change(\$): +.068
YTD Change(%): +2.337

Bloomberg Estimates - EPS
Current Quarter: N.A.
Current Year: 0.171
Bloomberg Estimates - Sales
Current Quarter: N.A.
Current Year: 5553.500

Q1 2018 Earnings Call

Company Participants

- Tomaso Tommasi di Vignano
- Stefano Venier
- Luca Moroni

Other Participants

- Javier Suarez Hernandez
- Roberto Letizia
- Enrico Bartoli

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. This is the Chorus Call operator. Welcome to the presentation of the Financial Results as of March 31, 2018 for Hera Group. All participants are in listen-only mode. Following the initial presentation, there will be a Q&A session. [Operator Instructions]

I'd now like to give the floor to Mr. Tomaso Tommasi di Vignano, Executive Chairman of Hera Group. Mr. Tomaso di Vignano, you have the floor.

Tomaso Tommasi di Vignano

Thank you, and good morning to all of you. We have just concluded our board meeting, during which we also approved the Q1 results. This time we didn't even have time for lunch because we wanted to be here at – in a timely fashion given all of your commitments and therefore with my colleagues, I'd like to give you an overview of our results, which aren't complicated in fact given the fact that they include a certain element of straightforwardness, which is also accompanied by the positive results as underlined by the board a few minutes ago. As you may have already seen from our press release we have had a significant growth in EBITDA posting plus 5.2% at €322 million, which also given the good result, which accompanied the EBITDA results as seen in terms of our net profit growth where we closed the quarter with a €120.5 million posting plus 9.6% compared to the same period last year.

Therefore over the past three months, over the first three months of the year we worked on the quality of our figures also as far as our EBITDA is concerned, but also in the following lines in the P&L, which is something we've been working on over the past few quarters and these results in fact are the outcome of a good trend as far as our operational results are concerned based on our constant search for growth and efficiency as usual. As I mentioned our net profit is marked by a 10% growth with a pace, which was faster compared to the past. And another further positive development is that in terms of our financial debt, we fine-tuned at the financial debt, which is something we had already done in the previous quarters and therefore we are at €2.5 billion, slightly below what we had already achieved in the fourth quarter of 2017.

So this is a summary of our figures and then we will be going into the business-by-business breakdown as usual. As far as our profit is concerned, as our revenues are concerned we had a good expansion in trading also marked by the recovery as far as the season was concerned. In the previous years we had a tougher time in the month of January,

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whereas this year, we were able to recover the results both in February and in March. Furthermore you will also be hearing how we worked on expanding our energy customer base, with a 28,000 increase in our customer base in Q1, which also includes a number of operations as far as M&A is concerned in the specific sector.

We also did well in waste, and as thus far as waste treatment is concerned, that was a sector which allowed us to post a higher impact despite the divestment from this sector in the Forlì province, and we'll be seeing the figures related to this sector. And moving on to EBITDA, I already mentioned what our growth rate was, and the important thing to note is that even as far as EBIT is concerned we grew by 5.5%. We grew almost 10% on the pre-tax level and 10% is the net profit post tax, which means that the year was off to a good start with a contribution focused for the most part on organic growth. In other words of the €16 million in growth, \$15.2 million stem from organic growth and we'll be seeing which sectors that relates to.

Within the result, we also took into account the conclusion of an incentive [indiscernible] (00:06:14) and it was the energy plant worth €1.3 million and we also contributed with the further €2 million to EBITDA through M&A activities. Now going back to the way in which organic growth was achieved. As far as energy is concerned, I mentioned the fact that a major part of the €7.3 million stems from the increase in our customer base with some 28,000 customers through transactions that had already been announced to you in the Gorizia area and in the Abruzzo region which allowed us to go beyond the 2.4 million energy customers in line with the trend we had given ourselves also in a very ambitious way as included in the business plan we presented to you.

The sales volumes increased both in gas and in electricity and also in the trading activities which had a very positive trend with a growth equal to 75% in terms of volumes. As far as the networks are concerned, their growth was worth €5.5 million and it benefited from efficiency and innovation projects, which were started in the sectors which belong to the networks sector. As far as waste is concerned, I mentioned the fact that the overall result for the strategic waste area is worth approximately €2.5 million. And as far as waste treatment is concerned €4.9 million were brought about by waste treatment activities, including the contribution from the Aliplast company which was fully operational within our perimeter in this quarter.

As far as waste collection is concerned, there was a €2.5 million decrease, entirely related to the exit of the Forlì activities from our group's perimeter. And finally, as far as the results of the others are concerned, which include public lighting and TLC even here if we consider the size of that business area we posted a good result in the quarter worth of €1.7 million in terms of EBITDA. This is a summary of the results, which is very straightforward, which is exactly what characterize the quarter.

Now, I'll give the floor to Stefano to go into business-by-business breakdown.

Stefano Venier

Thank you, and good morning. Well, beginning as usual with the Waste business we posted a growth worth were some €2.5 million over the quarter. The more sizable part of the growth was linked to organic growth. Now the organic growth components, which had the biggest impact are prices, which is what we underlined also over the past two quarters in 2017. The prices which, all-in-all posted a growth in the first quarter, last year, which was worth some €3 million. This is a figure which stems from the growth of prices which hovered between 10%, 15%, and 20% depending on the various sectors. Another component compared to last year, which posted a positive contribution is the change in perimeter, which affected our activities in this business. And besides Forlì which was mentioned a number of times, which is underlying [indiscernible] (00:10:27), even the revenues from the sale of energy of electricity compared to last year post a minus €1 million to €1.2 million due to the fact that as you may remember Q1 last year posted a very high PUN value especially AT the month of January given the French situation.

And this year despite having values which are above average and above our budget, in the comparison it will have a slightly negative figure. Among the other business news the more relevant refers to the new bio-methane plant, which we have already illustrated on previous occasions and on the slide here you have a synthesis of our upcoming deadlines. We're now in the final construction phase. We expect to upload the very first part of the waste beginning in

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July and it will be followed by three months testing period and it will be fully operational over the last quarter this year. The key figures in this project, which as you may remember, is worth 135,000 tons of which 100,000 tons refer to organic waste and 35,000 tons refer to other types of biomass especially greenery which will bring about 7.5 million cubic meters of methane, which in our case we chose to inject directly into these [indiscernible] (00:12:19) network.

The [indiscernible] (00:12:20) high-pressure network, so that it can then be used in the connection points with a special focus on transportation. In terms of underlying business trends are concerned, I mentioned the prices, I mentioned electricity we're still missing the volumes. As far as urban waste is concerned we're facing a stable situation the volumes which are entirely similar to Q1 last year. As far industrial waste is concerned demand is quite high as seen by the price dynamics and as far as we're concerned our volumes were in line with Q1 last year or slightly below those figures. These are the essential elements in the waste sector. Moving on now to the networks area on page 5; as usual here we have collected all of the activities, which pertain to the regulated distribution business, which includes water, gas, electricity and district heating.

In this case we were facing some positive dynamics with results which grew by some €5 million with different components. The water sector grew by €2.3 million benefited slightly from some greater revenues due to the effects of the investments made at the end of last year and also due to increased efficiencies, which brought about roughly 50% of the result that you can see. As far as gas distribution and district heating are concerned, certainly district heating contributed with greater volumes compared to last year thanks to a thermal quarter, which was a slightly colder. In the gas distribution sector, we have some further revenues linked to premiums on service and the positive contribution, which I wish to mention since it is something we seldom do, although I think at this times it deserves to be mentioned.

And I'm referring to the activities we have in Bulgaria referring to gas distribution and sale, which accounts for 14,000 customers, a country in which we rank number two in the country. 14,000 customers, which means that it is a sector which compared to the Italian context would be quite modest whereas in Bulgaria it is a sizable presence, which is growing with some 2,000 customers, to 3,000 customers per year. In electricity distribution, we also posted positive results worth €1.1 million linked to premiums and higher revenues also given the investments made. I'll go to a typical question I amassed which is how the €139 million of EBITDA are split up for 2018.

These stem in the following way: €57.4 million from gas distribution, €55.5 million from water services, €10 million referred to electricity distribution and the remaining amount refers to district heating. The final business area is energy supply therefore. As I already mentioned a few minutes ago, generally speaking the quarter was slightly colder compared to last year, during which we sold some 22 million cubic meters more compared to last year on the residential market, which is where some – a further 2%. It was a strange quarter, because as you may remember January was mild and then it was very cold between the end of February and mid-March.

This obviously brought about a certain degree of discontinuity even in the gas procurement sector and gas trading therefore, allowing us to obtain some positive benefits, which in turn contributed to the €6 million growth, which you can see in the left hand graph. Allow me to mention the fact that this result also has to take into account two negative phenomena. The first refers to the divestment from the activities we had in the City of Sassari and Sardinia, which we sold to the Itau Gas Group in early-April, which means that that activity was deconsolidated in Q1 this year. This was a business which had an overall year-over-year result were €3.5 million and therefore Q1 has a minus €1.2 million, plus we also had the fact that in the first three months of the year we'll have the same situation in the second three months, given the fact that it will be up and running in the first few days of June.

We had the most important power plant with a Hera stake, which is a Teverola plant, which is down for maintenance. It is a plant which gives us the highest contribution in terms of production and in terms of dispatchment and the fact that this asset was not available had an impact compared to the previous year for some €4 million, which means that we absorbed negative impacts worth some €5 million and despite that we posted a €6 million growth. The final element, which supports this result, is of course our customer base, which is now up to €2.4 million. I had already commented during the yearly results conference call that at the end of February we had gone beyond the 1 million customers in electricity. And to those we have to add 1.4 million gas customers which increased to a grand total of 2.4 million. Now the electricity market, which is now – which now has a further 60,000 to 70,000 customers over the past 12 months is

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also partly reflected in the electricity volumes sold, which were equal to 3 terawatts per hour in the first quarter with a growth equal to 500 gigawatts per hour, which includes 300 gigawatts per hour in the business retails sector.

And this is the general result. And I'll the give phone to Mr. Moroni to comment the good performance in our financial cost, in the tax rate and in the cash flows, which as the Chairman was saying is another positive note as far as this quarter is concerned.

Luca Moroni

Good morning, everyone. The net result for Q1 is positive with a plus 10%, with a positive contribution also from our financial management, through which we continue to fine-tune a number of items linked to the cost of debt, although the major contribution this time stems from interest charges, which we apply to the safeguard of the customers, which have a certain system. Tax rate is at 30% much like the first quarter of last year with a continuous benefits stemming from all of the fiscal optimization measures that we have already implemented as of the end of the last year, and even beyond that in the previous exercise, which will continue to bring about positive results throughout the year.

If we look to the cash flows, as you can see the free cash flow is at around €40 million, brought about by an operational cash flow equal to €226 million, and brought about by a €69 million variation in net working capital, and one of your possible questions maybe on the shift, which is a volume effect for the most part, both in terms of energy certificate that we will be cashing in in the upcoming weeks and months and also due to the normal seasonality of the first quarter, which was marked by an increase in volumes due to the Salvaguardia market these were figures which have been entirely included in our yearly targets.

Then we have the typical differences between funds and fair tax and financial burdens and CapEx were €75 million. With this €40 million I mentioned we also completed a number of minor M&A transactions. And we also had a buyback which was worth some €10 million, which means that the total cash flow is at a little over €20 million, which as I mentioned allow us to fine tune our net financial positions at €2.5 billion, which on a rolling EBIT basis allows us to have a lever equal to 2.5 times, which means that we are doing quite well in terms of cash flows, which continue to be quite a sizable allowing us to have the opportunity to maintain the financial flexibility that we already mentioned as we were commenting the year end results for 2017.

Tomaso Tommasi di Vignano

Thank you Mr. Moroni and I think the conclusions are quite easy today. I mentioned the fact that the results were good and straight forward and all of the things we have highlighted are consistent with that. Following the shareholders' assembly we are proceeding with the very first announced variation as far as a dividend is concerned, which will be worth a €0.095 per share and during the assembly we also confirmed our dividend plan for the other years included in the business plan according to the elements that you are already familiar with, which means that we are fully in line with our expectations.

I'd now like to give you the floor for any possible questions you may have.

Q&A

Operator

This is the Chorus Call operator. We can now begin our Q&A session. [Operator Instructions] The first question is from the Italian conference call, Javier Suarez, Mediobanca.

<Q - **Javier Suarez Hernandez**>: Yes. Good morning and thank you for your time. I have two or three questions for you. The first is on the energy business, slide number 6. Looking at my figures I think the real surprise refers to the Gas

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business. Could you give us some more granularity as to the evolution of EBITDA in the Energy business, in terms of volumes in terms of the number of clients and your trading activities, in other words how much do these three components benefit positively? Can you give us some further details in fact to understand what the underlying dynamics are?

The second question is on the waste business, slide number 4. Even here you posted growth and I'm interested in understanding what is the growth posted by Aliplast. You've referred to stable volumes and a major growth in the underlying prices. Is this interpretation correct? And we are referring to a double-digit growth of – in the underlying prices for a special waste treatment and my final question refers to the fact that, the cash flow statement you mentioned the negative effect of the working capital. This minus €69 million on slide 8, how much should this be by year-end? Should that number be assumed to be zero by year-end or is it otherwise?

<A>: I'll begin with the underlying developments on energy. As I mentioned we sold 22 million cubic meters more and this of course gives us a further margin compared to last year somewhere between €1.5 million and €2 million. Plus to this result we also have to consider a contribution from trading activities given the fact that the volatility of the volume prices in Q1 gave us a number of opportunities on our positions and this can be worth another €2 million. Of course this is less recurring compared to the previous item I mentioned. Also as far as the gas sector is concerned, there is a component within the volumes, which we posted further figure compared to the end of 2017, which is worth some €3 million.

We then have the contribution from electricity. In the electricity supply business the result posted was related to some further volumes and the result was worth €1 million approximately. What is the underlying customer dynamics? Well in volumes we sold more because we had slightly increased sales in the Maggior Tutela market worth 200 gigawatts per hour [indiscernible] (00:28:21) business and retail sector we had some further 300 gigawatts per hour. Compared to a further 90,000 customers added to our customer base compared to 12 months ago, the electricity customers went from 911,000 to 1.07 million. In the gas sector, customers grew by 15,000 moving from 1.385 million to 1.4 million, which means that in the gas sector the dynamics on volume which brought about those changes is essentially linked to the different thermal season of it or the different thermal characteristics in Q1 compared to last year and not so much due to the customer base whereas the higher volumes in electricity are also partly linked to the plus 90,000 customers.

In the waste business, you had a question on the Aliplast contribution compared to last year in Q1 that is worth plus €3 million on the overall total. Whereas regarding prices, it is true that we have certain products which compared to Q1 last year had double-digit increases. And this is especially linked to the dry materials, which have different destinations, by dry material I mean dry waste, which grew significantly. Another significant increase, a double-digit increase was the growth in hazardous industrial waste or complex industrial waste. And these types of waste increased even above 20%, but in this case we're only referring to a few thousand tons nothing major and therefore. In total the waste managed in Q1 was worth – was 20,000 tons below Q1 last year. 50% of that is urban waste and 50% of that is industrial waste. Your third question was on the working capital, Luca.

<A - Luca Moroni>: Yes, as far as working capital is concerned our yearend forecast is in that range. We are at around €80 million, an €80 million difference year-on-year.

Operator

The next question is by Robert Letizia, Equita SIM.

<Q - Roberto Letizia>: Good morning. I have a first general question on the political environment. We've been reading of a possible agreement between the Five Star Movement and the League. With this positive – possible new government, will there be any negative or positive impacts on your businesses? As far as the waste prices which you referred to, can you give us an idea as to how much of this shift is structural? Is this price dynamic due to the crisis on the availability to treat waste and therefore can we expect similar scenarios for second half of 2018 and 2019? Or is it simply something pertaining for the first part of a year, which will then be reabsorbed? Then I have a couple of more questions on figures. Can you give us a breakdown of your D&A to understand the effects of provisions and bad debt?

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And I also wanted to know, whether there will be an impact from IFRS on your figures this year? And if so, how much of that will have an impact on Q1 and on the entire year?

<A>: I'll begin with your last question. D&A as far as the accruals and depreciation compared to the previous year concerned we had an overall growth were €7 million, most of which is linked to amortization for the delta investments and the delta perimeter for Aliplast which contributed to over 50% of this shift. As far as the procurement for the [indiscernible] (00:33:24) credit funds this is also linked to the first effects of IFRS 9. There is a difference between last year worth some €9 million, which is a first indication as to the effect of the implementation of this accounting principle. Overall, the accruals in the first Q was worth €23 million, and on the entire year because this was the first quarter of it being applied, on a yearly basis, this is a €2 million contraction will be prolonged or replicated rather even in the following quarters. But it may perhaps even be improved slightly. As far as the waste sector is concerned under the geopolitical environment, I'll leave the floor to the Chairman.

<A - Tomaso Tommasi di Vignano>: As far as prices are concerned, in the waste sector, I don't think this is a short-term situation. For a number of quarters now, we have been seeing an increase in prices, which is the direct outcome of the short coming as far as waste treatment assets are concerned throughout the country, as recognized by everyone, explicitly, even in the recent days, also by those – and this brings me back to your first question, who – those movements who oppose waste energy plant. So, either we do something about this both in terms of the quality of governance, as far as the authorization are concerned.

And also as far as the amount of assets available to deal with the waste sector or based on our vision, these prices will not be [indiscernible] (00:35:31) sort of in the short term. In fact there is still room to increase the prices, given the asset shortcomings. And I'm sure, we all read the papers, and to a few days ago, we were reading articles about one-third of the country facing an emergency as far as waste is concerned. But I don't have the real situation in each city of course. But I'm sure that the green book published by [indiscernible] (00:36:01) Italia expresses its concern, given the shortcomings the country has, in terms of waste disposal assets.

Therefore, the answer to your question on prices is quite clear and consistent. More generally speaking, speaking of the future government, typically, I tried to study the situation, and I prefer to refrain from offering a point of view, given the fact that we still have no clear idea, as to who the government is going to be made up of, and we only have pre-electoral documents, which show the position on individual topics. Therefore, before we become concerned or worried, I think it's better to wait and see. And in one of your notes, I read some possible on crisis points, and it seems to me that, there are no real certainties in fact. If we look at the situation in the water sector as far as infrastructure is concerned prior to the reforms, you can certainly understand the difference there was or the difference in the country three years ago.

And I'm sure that the situation will be considered very carefully and the same goes for waste disposal plants. Whether we like them or not, I think there are a number of cities in Italy, which truly have the need to have waste disposal assets, although they may not admit to having this need. And the same goes for possible aggregations or possible consolidation, if we want to push all of Italy to look to in-house solutions we can go in that direction of course. But the real industrial game changer came about in those parts of the country where a focus on the industry was made. Therefore I would prefer to refrain from expressing views until we see the positions that the new government will have.

<Q - Roberto Letizia>: Thank you.

Operator

The next question is from Enrico Bartoli, Mainfirst.

<Q - Enrico Bartoli>: Good afternoon, I also have some questions. I have a question on electricity. Can you give us an idea of the Teverola plant impact? Also in terms of full year, can you comment the trend regarding sales margin from electricity customers in the quarter and what you expect in the upcoming quarter. As far as waste is concerned have a general question, given the reduction of recycled material from China, do you expect an impact on prices of

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intermediate material? And as far as interests are concerned, the interest from the Salvaguardia customers, can you give us some figures and what can we expect for the entire year?

<A>: As far as an electricity market is concerned, the impact in Q1 for the Teverola plant we just start for maintenance was worth €4 million as I mentioned. In Q2 this will be replicated, but the figure will be lower. Last year in fact we had – in month of January [indiscernible] (00:40:22) familiar with and its benefits and then in the months of April and May, which are the less active months in MSD and therefore in that case there was no production. We'll start again in June, but is also an intermediate long-term which is quite slow in fact, but Q2 will roughly be half of what we had in Q1 and for then on, that should account for the entire effects of the thermal production plants for the year. And then during the year of course we'll be seeing how the activity will go concerning the new provisions. On the electricity margins I don't have anything new to say vis-à-vis the two previous quarters.

If you look at the retail sector, nothing much has changed. And if I look at the business sector, we're simply seeing the effects of the contracts closed in Q4 2017, which had a slight fine-tuning compared to the previous year. But that doesn't imply any major figures. The topic of China is pretty complex because it also relates to the value of the primary and secondary materials we have in the country through the consortia. To-date, we still haven't seen any effects on urban paper and plastic. We haven't seen any major effects on the valorization of this material through consortia. But were the closure of the Chinese market to be prolonged and if I remember correctly the price of a paper has had less than €20 per ton.

As far as plastic the supply is far above demand. Therefore if this situation were to continue for the remaining months in 2018 even the stability of the consortia's pricing, it would be subject to a review although it's hard to give you a forecast. As far as the valorization of this material from the industrial standpoint is concerned, while from a certain point of view, I think, we chose wisely when we decided to focus on Aliplast because we can look to turn production, which is otherwise be of a lower value and the quantities of plastic, which is not treated by Aliplast. It refers to what we were saying earlier. We're suffering a bit and then in fact that is the only material in the waste cycle, which is posting lower prices compared to all of the other parts of the business, although the negative effect stemming from this was already included in the positive €3 million I mentioned earlier.

On the interest for the safeguarded customers the positive effects we had on the financial management, it was slightly above €5 million. €1.5 million to €1.8 million of this is an extraordinary event which stems from a dividend which is distributed from a minority share we have and therefore we have to look at €4 million. This includes €1.5 million to €2.8 million, which refer to pure financial management. The remaining part refers to the delta between the delay interest and if we take a €4 million and multiply them for the four quarters, that would be the figure we expect to have by the end of the year some €8 million to €9 million

Operator

[Operator Instructions] The next question is a follow-up by Enrico Bartoli, MainFirst.

<Q - Enrico Bartoli>: I have a further question can you give us your impression on a delay of the opening up of the residential electricity customers and what impacts that may imply compared to your business plan forecast?

<A>: It's far too early, I hope that provisions will be complied with Italy that is a provision which expects that market to be opened up within a certain amount of months, so otherwise it will become a self-confirming prophecy. The market has to be opened up and we're going to continue as we always have.

Operator

[Operator Instructions] Mr. Tommasi di Vignano, gentlemen for the time being there are no further questions.

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Tomaso Tommasi di Vignano

Well, thank you very much. And we will go back to work hoping that things will continue as they have so far. Thank you.

Operator

This is the Chorus Call operator. The conference call is now over. You can disconnect your telephones. Thank you.

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