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Report by the independent auditor



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INDEPENDENT AUDITOR'S REPORT PURSUANT TO ARTICLE 14 OF LEGISLATIVE DECREE No. 39 OF JANUARY 27, 2010 AND ARTICLE 10 OF THE EU REGULATION 537/2014

To the Shareholders of
Hera S.p.A.

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

Opinion

We have audited the consolidated financial statements of Hera group (Group), which comprise the statement of financial position as of December 31st, 2018, the income statement, statement of comprehensive income, statement of changes in net equity, cash flows statement for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as of December 31st, 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and the requirements of national regulations issued pursuant to art. 9 of Italian Legislative Decree no. 38/05.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISA Italia). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of Hera S.p.A. (the "Company") in accordance with the ethical requirements applicable under Italian law to the audit of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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Revenue recognition – revenue earned but not yet billed

Description of the key audit matter

As disclosed in the notes to the consolidated financial statements in the paragraph addressing *"Accounting policies and consolidation principles - Revenue and cost recognition"*, revenue from sales of electricity, gas and water is recognised and accounted for when the service is rendered and includes an accrual for revenue earned but not yet billed at the reporting date. As disclosed in Note 1, this accrual, which as of December 31st, 2018 amounted to Euro 392 million, is determined, as far as electricity and gas are concerned, by estimating the daily consumption by customer, based on the customer's historical profile, adjusted to reflect the weather conditions and other factors that could impact consumption, while, as far as the integrated water network is concerned, by estimating the revenue guaranteed by the regulated reference tariff (guaranteed revenue commitment, "VRG").

We have considered the procedure used for the determination of the above accrual to be a key matter for the audit of the Group's consolidated financial statements for the year ended on December 31st, 2018 in view of: *i)* the discretionary component inherent in the estimated nature of the accrual; *ii)* the materiality of its total amount; *iii)* the high number of the Group's users; *iv)* the complexity of calculation algorithms adopted by the Group for the determination of the accrual, which made it necessary to have the support of IT specialists to perform the related audit procedures.

Audit procedures performed

The audit procedures performed by us on the accrual for revenue earned but not yet billed at the reporting date included the following:

- analysis of the IT procedures adopted by the Group for the determination of the accrual for revenue earned but not yet billed and of the related calculation algorithms, with the support of our IT specialists;
- identification and understanding of the key controls implemented by the Group to monitor the risk of an incorrect accrual and testing of the effectiveness thereof. This work was performed with the support of our IT specialists;
- testing on a sample basis to verify the completeness and accuracy of the main data used by management to determine the accrual;
- testing, based on a sample of users, of the process for the estimation of quantities consumed and the application of the correct reference tariffs;
- a comparative analysis of the key parameters pertaining to users and consumption used for the determination of the above accrual;
- verification of the correct determination of the guaranteed revenue using the regulated reference tariff;
- review of the adequacy of disclosure provided on the recognition of revenue earned but not yet billed at the reporting date.



Recognition and measurement of derivative financial instruments

Description of the key audit matter

On account of the business in which it operates and of its financial structure, the Group holds derivatives to hedge its exposure to the risk of fluctuations in interest rates, in exchange rates and in natural gas and electricity prices. As disclosed in the paragraph in the notes to the consolidated financial statements addressing "Accounting policies and consolidation principles - Derivative financial instruments", the Group enters into transactions, which, if they satisfy the requirements laid down by International Financial Reporting Standards to qualify for hedge accounting, are designated as hedging instruments and are classified as fair value hedges or as cash flow hedges; alternatively, they are classified as held for trading.

The determination of the fair value of derivatives is performed by the Group using models developed internally that include an estimation component. Moreover, the recognition methods vary based on the nature of the derivative. Lastly, the impact of the fair value measurement of derivatives is material to the results and financial position. Specifically, as disclosed in detail in Note 19 to the consolidated financial statements, the following are recognised in the consolidated financial statements for the year ended 31st December 2018: i) in the statement of financial position, assets and liabilities arising from the measurement of derivatives of Euro 157 million and Euro 104 million, respectively, and cash flow hedge reserve of Euro 17 million; ii) in the income statement, net operating income and net financial costs arising from the measurement of derivatives of Euro 5 million and Euro 3 million, respectively, as well as net operating income and net financial income realised during the year with reference to derivatives of Euro 28 million and Euro 15 million, respectively. For these reasons, we have considered the recognition and fair value measurement of derivatives to be a key matter for the audit of the Group's consolidated financial statements for the year ended on December 31st, 2018.

Audit procedures performed

The audit procedures performed by us on the recognition and measurement of derivatives included the following:

- identification and understanding of the key internal controls implemented by the Group, as well as testing to check compliance with internal policy for the determination of the fair value of derivative financial instruments, for the designation of hedging instruments, for the measurement of their prospective effectiveness and for the determination of the ineffectiveness of the hedging relationship;
- understanding of the fair value hierarchy allocation criteria, of the valuation techniques and methodologies used to verify the effectiveness of hedging relationships and for the measurement of any ineffectiveness and an analysis of the reasonableness thereof in compliance with market standards and best practices;
- analysis and verification of the sources used by the Group for the determination of market parameters and verification of the reliability of the key market inputs used;



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- verification of the consistency of the accounting treatment adopted by the Group with applicable accounting standards;
- independent determination, on a sample basis, of fair value of some derivative financial instrument, with the support of financial instrument pricing specialists;
- verification, on a sample basis, of the formal documentation for the designation and verification of the measurement of effectiveness, as well as verification of the accuracy of the effectiveness test.

Lastly, we examined the compliance of the disclosures provided in the explanatory notes with applicable accounting standards.

Responsibilities of the Directors and the Board of Statutory Auditors for the Consolidated Financial Statements

The Directors are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union and the requirements of national regulations issued pursuant to art. 9 of Italian Legislative Decree no. 38/05 and, within the terms established by law, for such internal control as the Directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they have identified the existence of the conditions for the liquidation of the Company or the termination of the business or have no realistic alternatives to such choices.

The Board of Statutory Auditors is responsible for overseeing, within the terms established by law, the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISA Italia) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with International Standards on Auditing (ISA Italia), we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



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- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance, identified at an appropriate level as required by ISA Italia, regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence applicable in Italy, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report.

Other information communicated pursuant to art. 10 of the EU Regulation 537/2014

The Shareholders' Meeting of Hera S.p.A. has appointed us on April 23, 2014 as auditors of the Company for the years from December 31st, 2015 to December 31st, 2023.

We declare that we have not provided prohibited non-audit services referred to in art. 5 (1) of EU Regulation 537/2014 and that we have remained independent of the Company in conducting the audit.

We confirm that the opinion on the financial statements expressed in this report is consistent with the additional report to the Board of Statutory Auditors, in its role of Audit Committee, referred to in art. 11 of the said Regulation.



REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Opinion pursuant to art. 14 paragraph 2 (e) of Legislative Decree 39/10 and art. 123-bis, paragraph 4, of Legislative Decree 58/98

The Directors of Hera S.p.A. are responsible for the preparation of the report on operations and the report on corporate governance and the ownership structure of Hera Group as of December 31st, 2018, including their consistency with the related consolidated financial statements and their compliance with the law.

We have carried out the procedures set forth in the Auditing Standard (SA Italia) n. 7208 in order to express an opinion on the consistency of the report on operations and some specific information contained in the report on corporate governance and the ownership structure set forth in art. 123-bis, n. 4 of Legislative Decree 58/98, with the consolidated financial statements of Hera Group as of December 31st, 2018 and on their compliance with the law, as well as to make a statement about any material misstatement.

In our opinion, the above-mentioned report on operations and some specific information contained in the report on corporate governance and the ownership structure are consistent with the consolidated financial statements of Hera Group as of December 31st, 2018 and are prepared in accordance with the law.

With reference to the statement referred to in art. 14, paragraph 2 (e), of Legislative Decree 39/10, made on the basis of the knowledge and understanding of the Group and of the related context acquired during the audit, we have nothing to report.

Statement pursuant to art. 4 of the Consob Regulation for the implementation of Legislative Decree 30 December 2016, no. 254

The Directors of Hera S.p.A. are responsible for the preparation of the non-financial statement pursuant to Legislative Decree 30 December 2016, no. 254.

We verified the approval by the Directors of the non-financial statement.

Pursuant to art. 3, paragraph 10 of Legislative Decree 30 December 2016, no. 254, this statement is subject of a separate attestation issued by other auditor.

DELOITTE & TOUCHE S.p.A.

Signed by
Mauro Di Bartolomeo
Partner

Bologna, Italy
April 8, 2019

This report has been translated into the English language solely for the convenience of international readers.