

## 1.05

# Reference scenario and Group strategy

The public utilities sector plays a leading role within the Italian economy, accounting for approximately 7% of the country's Gross domestic product (GDP; source: Top Utility report drafted by Althesys). This result, however, is reached through levels of service and efficiency that differ greatly across the country on account of the high level of fragmentation among variously sized 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 of these services, over time 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 the widest-reaching investment plans. The areas concerned by the tenders have in fact been geographically widened, now covering provinces instead of municipalities. It follows that, according to estimates made by sector professionals, a reduction should be seen in the number of companies, from over two hundred to twenty or thirty.

During 2018, the Regulatory authority for energy, networks and the environment (Arera, Autorità di regolazione per energia reti e ambiente), began preparations for a new definition of the new tariff system, which will come into effect as of 2020 and cover a period of four years. After establishing a higher degree of uniformity in tariffs and service quality nationwide, expectations are that higher efficiency will be achieved and the sector will be rationalised, turning to means including a definition of the mechanisms used in tenders for granting concessions for urban waste collection and street cleaning.

In liberalised businesses, the government's objective is to promote a higher level of market competition, to the advantage of end consumers. For this reason, an intention to completely liberalise 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 the sector of (free market) waste treatment, the year that has just come to a close confirmed the country's persistent undercapacity in the area of plants. This situation has become even more critical by various foreign factors, such as China's import ban on low-quality plastic waste (plastic mix) and an increase in waste exports from the United Kingdom, with the effect of saturating the continent's treatment plants, which were the destination for a significant amount of Italy's waste. In this scenario, considering the continual difficulties in building new plants over the short term, prices for waste

disposal increased for the fourth consecutive year. The pace of this growth over the last year seems destined to persist in 2019, going to the advantage of operators owning plant capacities.

In the energy sales business, 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 2020 was confirmed by the Milleproroghe Law 91/2018. 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.

The scenario seen in the sector is therefore marked by factors pointing towards a higher industrialisation of activities, to be achieved through increasing investment plans and involving a consolidation of smaller businesses. In this context, Hera operates with its usual 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. This strategy has been coherently pursued by the Group since its establishment, and its effectiveness has been proven: over the past sixteen years, its size has been quintupled and a position of national leadership has been reached in all areas of activity (the country's first operator in the waste management sector, second in the integrated water service, third in gas distribution and in energy sales to end customers).

The results for 2018 as well are the fruit of this strategic approach, which has led the Group to reach the milestone of one billion euro in Ebitda, even exceeding the target established by the five-year business plan for 2014-2018 (1,031 million euro, as against the goal of 1,020 million, and a net debt/Ebitda ratio coming to 2.5 instead of the objective set at 2.9). All activities managed contributed to this positive result, confirming the validity and effectiveness of the Group's perfect balance between regulated and free market activities that allows it to maintain a high level of risk diversification. The portfolio's balanced mix, that combines areas with a low return but no risk (in regulated businesses) and areas with a higher return but also risks from which the Group is protected (in free market businesses), makes it possible to obtain an overall return capable of creating value; that is, this portfolio leads to rates of return that exceed the average cost of the financial resources used.

**Hera reaches its previously set targets**

The new business plan to 2022, presented in early January 2019 and based on the Group's strong position and acquired leadership, is aimed at grasping the opportunities arising within the reference scenario and continuing along its path of uninterrupted growth. Ebitda is expected to increase by 200 million euro, reaching the goal of 1.185 billion euro by the end of the period in question, a target which is higher than the one set in the previous plan.

**The new business plan to 2022**

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 3.1 billion euro, increasing by 260 million over the previous plan. The Group will be able to meet this objective thanks to one of the most solid set of assets seen in the sector and its visibly growing cash generation (+30% Cagr over the last five years).

1.1 billion euro will be exclusively dedicated to growth: investments in new plants and network modernisation, tenders for renewing gas concessions and M&A operations. This strategy calls for an efficient allocation of capital, conserving the Group's current low risk profile, and confirms its objective of maintaining financial solidity, with a net debt/Ebitda target set at 2.9 that leaves further room to finance the growth opportunities not included in the plan.

Three quarters of investments will go to regulated activities: approximately 70% will go towards networks and approximately 6% to urban waste collection. It follows that most of the growth foreseen by the plan will fall into these areas, whose overall weight will increase from 51% to 55%. The balanced aspect of this mix will be guaranteed by factors including growth in free market activities. In the waste management sector, the Group – Italy's leading operator in this field – can rely on a wide and diversified set of plants, within the context of a market whose prices are continually growing due to the country's structural lack of disposal capacity. In the energy sector, the Group – which ranks third in the country – counts on expanding its customer base, making the most of both the liberalisation expected in the protected electricity market and initiatives in cross selling its services. In late 2018, tenders were also held for renewing concessions in safeguarded electricity and default gas services, and the Group confirmed its status as Italy's foremost operator for the upcoming two years, gaining roughly 70% of the market.

The new plan also expects dividends to increase (from 9.5 cents in 2018 to 11 cents paid in 2023), showing uniform growth over the five years in question and testifying to a transparent dividend policy benefitting all shareholders. The Group's multi-business model, indeed, allows it to give a significant visibility to cash generation, given that it offers protection from external market factors, as is amply shown by the resilient growth constituting its track record.

**Creating shared value**

The plan includes targets and projects that the Group intends to pursue in a sustainable way, creating value for all stakeholders. Its strategy has identified lines of development oriented towards pursuing the targets set out in the Un Agenda that can be applied to the activities in which it is involved (covering at least 10 of the 17 goals indicated): almost 3/4 of the growth expected over the five years covered by the plan will be sustained by projects that respond to these ten “calls to action”, thus bringing shared value Ebitda to reach over 470 million euro (40% of overall Ebitda) by 2022.