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# Report by the independent auditor

# Deloitte.

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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 31<sup>st</sup>, 2019, 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 31<sup>st</sup>, 2019, 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.

#### Accounting treatment of the "Hera-Ascopiave Partnership" business combination

##### Description of key audit matter

As explained in greater detail in the note entitled "Hera-Ascopiave Partnership", on December 19<sup>th</sup>, 2019 the Hera Group (also the "Group") and the Ascopiave Group completed a transaction that involved an exchange of assets of equivalent value in the energy and gas distribution businesses worth a total of Euro 607 million (the "Transaction").

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In the energy sector, a single operator was created for their respective businesses in the Veneto, Friuli-Venezia Giulia and Lombardy regions through EstEnergy S.p.A., previously jointly controlled by both groups. The Hera Group took over control of it by changing the governance agreements, at the same time recording a capital gain of Euro 81 million in accordance with IFRS 3 for a "business combination achieved in stages". Because of the Transaction, the commercial activities of both the Ascopiave Group (carried out through its subsidiaries) and the Hera Group (carried out through the subsidiary Hera Comm NordEst S.r.l.) joined EstEnergy S.p.A. As a result of the previously mentioned exchange of assets, the share capital of EstEnergy S.p.A. is held 52% by the Hera Group and 48% by Ascopiave S.p.A. Moreover, Ascopiave S.p.A. was granted an irrevocable put option to sell its non-controlling interest in EstEnergy S.p.A. which can be exercised once a year on all or part of the shareholding, at its own discretion, within and not later than December 31<sup>st</sup>, 2026. In consideration of this option, the Group did not show the minority portion of equity attributable to Ascopiave S.p.A. in the statement of consolidated financial position, i.e. recognizing the equity investment in EstEnergy S.p.A. as wholly owned. Therefore, the put option was recorded as a payable and measured by Hera Group management ("Management") on the basis of IAS 32 and IFRS 9, using the future scenario that it is deemed most likely on the basis of the information available to date. The payable was recorded at fair value for an amount of Euro 553 million, including both a portion of the value of the put option at the date it would be exercised and an estimate of the dividends that should be distributed by EstEnergy S.p.A. to the Ascopiave Group during the period of the put option. This occurs because, under the terms of the contract, they are to be deemed part of the overall consideration payable to the other party.

As regards the gas distribution business, Ascopiave S.p.A. acquired from the Hera Group, for Euro 168 million, the entire share capital of AP Reti Gas Nord Est S.r.l., to which a series of concessions in the Veneto and Friuli-Venezia Giulia regions had previously been transferred. The value of the net assets sold amounted to Euro 134 million and the sale generated a capital gain of Euro 30 million, classified under "Other non-operating revenues".

Lastly, the Hera Group sold 3% of Hera Comm S.p.A. to Ascopiave S.p.A. for Euro 54 million. This last transaction, by virtue of the contractual structure used and the obligations of the counterparties (e.g. Ascopiave S.p.A.'s put option), did not give rise to the recognition of a non-controlling interest in equity attributable to Ascopiave S.p.A., but it was represented as a fixed rate loan measured at amortised cost.

The additional effects generated by the Transaction and, in particular, determining the overall acquisition cost for the Group, estimating the fair value of the identifiable assets, liabilities and contingent liabilities of the entities acquired at the acquisition date and the fair value of intangible assets previously not recognised in the financial statements, as well as calculating goodwill, are all explained in the note previously mentioned.



Given the complexity of the Transaction, the contractual agreements and the accounting effects of it, and considering the importance of the assessments that Management had to make in the process of allocating the overall price paid to the other party, which they did with the support of experts, and estimating the fair value of the payable relating to the put option, we considered the business combination to be a key aspect of the audit of the consolidated financial statements of the Hera Group.

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**Audit procedures performed**

The audit procedures that we carried out on the key aspect, namely the accounting treatment of the "Hera-Ascopiave Partnership" business combination, included, among others, the following:

- a discussion with Management to understand the structure of the Transaction and its objectives;
- an analysis of the contractual agreements signed between the parties;
- a discussion with Management on how they applied the purchase method for the accounting recognition of the business combination, while also gaining an understanding of the process and significant controls put in place by the Hera Group in relation to the accounting treatment of this Transaction;
- checking the implementation of these significant controls identified as part of the process;
- checking the consistency of the accounting treatment adopted by the Group with the accounting standards applicable in this case, with the support of our specialists in the application of IFRS;
- a review of the approach used to determine the cost of the acquisition, including the treatment of the options provided for in the contractual agreements;
- an analysis of the methods used to identify the assets, liabilities and contingent liabilities involved in the Transaction, Management's estimate of the related fair values and the methods used to determine the value of goodwill, also by examining the report prepared by the professionals appointed by Management to support the key decisions made as part of the purchase price allocation process. This analysis was carried out with the involvement of our network's specialists in company valuation;
- checking the accuracy of the accounting records;
- a review of the adequacy and compliance of the information provided by the Company on the business combination with IFRS 3.

**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 electricity, gas and water sales 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 31<sup>st</sup>, 2019 amounted to Euro 358 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 31<sup>st</sup>, 2019 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 that we carried out on the accrual for revenue earned but not yet billed at the reporting date included, among others, 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 and compliance of disclosure provided on the recognition of revenue earned but not yet billed at the reporting date with the applicable accounting standards.

**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 21 to the consolidated financial statements, the following are recognised in the consolidated financial statements for the year ended December 31<sup>st</sup>, 2019: i) in the statement of financial position, assets and liabilities arising from the measurement of derivatives of Euro 113 million and Euro 166 million, respectively, and cash flow hedge reserve recognized in equity for a negative amount of Euro 38 million; ii) in the income statement, net operating income and net financial costs arising from the measurement of derivatives of Euro 14 million and Euro 15 million, respectively, as well as net operating income and net financial income realised during the year with reference to derivatives of Euro 31 million and Euro 12 million, respectively. With reference to the derivatives on commodities designated in hedge accounting, management has carried out specific sensitivity analyses to estimate any impacts that may arise in the future following the health emergency caused by COVID-19, which management is considering a subsequent event that does not have to be reflected in the numbers of the consolidated financial statements at 31 December 2019.

For the above mentioned 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 31<sup>st</sup>, 2019.

**Audit procedures performed**

The audit procedures that we carried out on the recognition and measurement of derivatives included, among others, 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;
- 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;
- verification of the sensitivity analyses carried out by Management to estimate any impacts which may arise in the future following the health emergency caused by COVID-19;
- review of the adequacy and compliance of the disclosures provided in the explanatory notes with the 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.
- 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 31<sup>st</sup>, 2015 to December 31<sup>st</sup>, 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 31<sup>st</sup>, 2019, 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. 720B 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 31<sup>st</sup>, 2019 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 31<sup>st</sup>, 2019 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 7, 2020

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