



## Q1 2017 Earnings Call

### Company Participants

- Tomaso Tommasi di Vignano, Executive Chairman
- Stefano Venier, Chief Executive Officer
- Luca Moroni, Group Director of Administration, Finance and Control

### Other Participants

- Javier Suarez, Analyst
- Enrico Bartoli, Analyst
- Stefano Gamberini, Analyst
- Meris Tonin, Analyst

## Presentation

### Operator

Good morning. This is the Chorus Call operator, welcome to the presentation as of the 31st of March of the Hera Group. All participants are in listen-only mode. Following the initial presentation there will be a Q&A session. (Operator Instructions)

Now, the floor goes to Mr. Tomaso Tommasi di Vignano, Executive Chairman of the Hera Group. You now have the floor.

### Tomaso Tommasi di Vignano, Executive Chairman

Good evening. We are here together with the usual team that has just been confirmed by the General Assembly. And, as you know, we have just concluded the first Board of Directors Meeting with the new term of office.

We already on marche, as the French would say. We are all very happy with the results of the first quarter. And, as you can see, Jens has been very creative in this slide, in this graph when comparing the results of this first quarter with previous years. This is a further proof of the fact that we're going through a very positive period and our Board of Directors who wished the same opinion. So we do hope that we will share our ideas as well.

I think that our paths in executing the industrial plan started off on the right, in the right way. If we have a look at what happened in 2016, then you will see that we are fully committed to achieve the results that have been put into the industrial plan. As you will hear from Mr. Venier there's been some items, there's been some events that have played a very important role. The fact that we were awarded the tender for the market of safeguarded clients was good news for us.

This helped us to have some positive results and this will ensure this positive results for the next two years, because the results of this tender will then continue over a longer period of time, namely two years. Now, talking about the waste sector and my colleagues will then provide further insight on this. We did not embed the results of the Aliplast acquisition into the results that you're going to see today. We have already talked about it and the results could have even be more rounded up if we have had the opportunity to consolidate the presence of this acquisition within our accounts in Q1. But since the application phase of the contract started on recently is on the productive results were only -- were haven't been embedded yet. Since the contract has been formally signed with the fact as of April, the 1st. So in the first half-year report, you will see the results included into our account. Other than that, all the results are very positive. There has been no inconsistency whatsoever in terms of profit and loss account related data, you see a constant average plus 10%. So there is no loss whatsoever. And you do see that the net profit is doing particularly well. We have a plus 20% and this of course has a positive influence on the EPS since the number of shares hasn't changed so this determines a very important result for the EPS as well.

Let me now make a second comment, and my colleagues will then provide further information on this, but I do think that this is really very important. These positive results that you see are driven by all our business areas. This is very important. We not only have a very positive result at the end of quarter, the first quarter, but again, in all the business areas, we have some positive results.

And in most of the cases, we exceeded our expectations, your expectations as well. Having said this, if you go to page three, you see again, all the elements contributed to this growth. The largest portion of the growth is linked to the expansion of the market in the energy sector, but also in the other business areas as I've just pointed out. This is the result of our participation in different tenders, in many different areas and this is proved once again our capacity to be very reactive to be present on the market. And we are fully committed to this and we would like to continue on this path which is more tenders in other sectors, at least this is our hope. So these are the highlights of the first quarter. What I would also like to point out is that on the one hand, the market is being expanding, the prices in the field of waste has also been doing very well. Tariffs had been subject to some restrictions during the past, and now things are doing very well.

Then as a second very important item, we say of the improvement of the efficiency of the Group. And this is perfectly in line with our business plan, which we of course wanted to adhere to plus EUR4.5 million in terms of efficiency -- efficiency made.

And then last, but not least [ph] thing, we have the M&A sector and here again, I don't want to add anything, because the two small transactions that we carried out are part of these accounts. But again, you just see the initial results of this operations. And again, there can be some differences in terms of the acquisitions of new clients but again we are talking about figures, as I mentioned that are not surprising us at all.

But we do know that there is again something that is going to play very important role in our account and we are already doing our test, we are already closely cooperating with Aliplast and I think here with a reason to be very positive about the future. So we fully paid, of course, the acquisition and you will also hear about the costs and the state-of-the-art about mergers and acquisitions.

Now I would like to give the floor to Stefano. Thank you.

## **Stefano Venier, Chief Executive Officer**

Thank you and good evening. I will start off with the waste sector. If you go to page four, you see the results. We have already commented upon this result several times during 2016. The result is made up of several elements. We have some negative effects due to the expiry date of some incentives. And we are talking about the six of (inaudible) which expired during the third quarter of 2016. And then we had some extraordinary maintenance operations on WTE, waste treatment plant which determined this cost. These costs were completely offset by organic growth, which is mainly due to the growth of the sector of special waste treatment and to wet dry and hazardous waste.

This is nothing new for us. We have already talked about this in the past and these results further consolidated during this first quarter and they're providing the full contribution. We are talking about 7.1 million, in terms of organic growth and waste totaled EUR46.7 million. As our Chairman correctly pointed out, the effect of the consolidation of Aliplast will become evident in the next few months. In terms of financial cost everything has already been integrated into the account.

But at end of January, we also bought the assets of a company called Teseco. And their activities are complementary to waste to recycling activities and they will enable us to further enhance our activities in the local geographical territory where the company is operating, and we will see some further positive results as in 2016.

If we now turn to the growth of networks. Here you see two components that determined a growth of EUR6.5 million. On one hand, we made more efficiency in this field. We reduced the operating costs of the water cycle and the energy-related activities.

We use a parameter that is called PDR, and this parameter improved over the last 12 months period by 1.3% up to 2.5%. So again efficiency has been made and this is a result of what we did in 2016 and what we have done in 2017. And then there has been a balancing mechanism in terms of tariffs. And as regards the first quarter of 2017, we were awarded some premiums in 2016 because of the good quality of the service that we deliver. Here you see some further results in terms of water, plus 3.4, gas distribution/district heating, plus 2.4, electric energy distribution plus 0.5. These are the main items in terms of the development of investments. They did not determine a significant variation of the Hera B [ph] of the last quarter. So again these results are mainly due to the factors that we have already pointed out.

Now turning to the trading sector, to the commercial sector. First of all, we can say that we have been exceeding the threshold of 2.5 million. Within clients, we have more than 900,000 clients for the gas sector. And this determines that we exceeded the threshold of 2.5 million times, that was the target for us.

In terms of profitability, the best result as expected came from the electricity sector, 11 million growth, they relate to safeguarded clients to new services and the remaining portion EUR4 million. Here is, they are related to a better performance in terms of trading and sales on the free market.

Then on top of this, we also have the small contribution on power generation. Here again, we are reaping the fruit of what we showed in the beginning of the year. And you will remember that this is linked to the situation on the French market in January and in February and better result tells us that we managed to confirm some positive results of 2016 and we further improved this result EUR4 million.

This is the growth of the gas sector. This growth by EUR4 million is partially related to the gas default market, half of which is linked to that and half of that is linked to a better margin on -- with regard to activities on the free market. And this enabled us to reach EUR111 million in this first quarter of the year. So in a nutshell, these are the most relevant components of our financial results.

Let me now turn to the financial and tax profile. But in order to deal with this, I would like to give the floor to our colleague, Mr. Luca Moroni.

## **Luca Moroni, Group Director of Administration, Finance and Control**

Good afternoon. I think that slide number seven perfectly illustrates the work that we carried out on these two items of the profit and loss account. In the first quarter, the financial management did very well again, this is mainly due to a reduction of costs in general. But this is also due to the good contribution of the company that operate in the trading, in the business and in the energy sectors. So they provided a very good contribution as all the other companies or other Group did.

29.8%, this is the tax rate, which is decreasing, further decreasing, corporate tax rate reduction, what we call (Foreign Language), was the further reason for these good results. And this enabled us to fully seize all the opportunities made available by the financial budget laws, I'm talking about tax related patent box, related regulations and what we call maximal duration related laws. All this makes very good contribution to the net profit and therefore to the EPS.

As regards the financial management of the company, we have had positive cash flows by more than EUR100 million, to be more specific, EUR160 million in terms of operating cash flows. And this result comes from an operating, and even net of the payment of taxes and financial charges.

The networking capital absorbed EUR20 -- EUR22 million. This is due to two different items. On the one hand, we have the positive contribution of the work that we carried out in terms of receivables. And here, we have good reason to be satisfied. And we had plus EUR10 million in terms of this positive management of liabilities. But again, we have not had the situation of EUR30 million due to safeguarded clients.

Investments of 66 million are perfectly in line with what we did last year and plus 116 free cash flow. They fully covered the costs of the acquisition of Aliplast and Teseco for an overall value of EUR97 million. And we therefore closed with a net debt of 2,648 (sic - 2,548.7). And as a result, as we have already said several times this net debt already includes the cost of the acquisition of Aliplast and the acquisition will be further executed in the next few months and then the next few years.

And the financial contribution of this acquisition will be further appreciated in the half yearly report, with retroactive effect as of January 1. So again, this company will be fully integrated with the number of parameter with retroactive effect.

I will conclude here and will give the floor to our Executive Chairman.

## **Tomaso Tommasi di Vignano, Executive Chairman**

I don't actually have too much to add to this. I think that all these figures speak for themselves. And the explanations that we gave you on the top of this made it very clear that it was easy for us to tackle the acquisitions, which we had planned. And in terms of company related effect, I'm sure that you have already had all the important information from reading the newspapers.

The Board of Directors met for the first time today and the climate amongst us to say was very positive. We had the -- the presentation of some private list for the first time, and I do believe, again that the representatives of this list contributed to a very positive environment within the meeting of the Board of Directors. And then we have a new representative of the private portion of the company. The ship has sailed so to speak, and all the tasks have already been distributed, so each of us perfectly knows what awaits us.

Now we would like to open the floor for questions, please.

## **Questions And Answers**

### **Operator**

This is the Chorus Call operator. We are now going to start the Q&A session. (Operator Instructions) The first question is by Javier Suarez of Mediobanca.

### **Javier Suarez, Analyst**

Yes, good evening everybody. I would like to ask two to three questions. Slide number four, that's my first question and it concerns the waste business. I was struck by the organic growth, this EUR7.1 million growth. Could you provide some more details on this? So what is going to happen in terms of volumes and prices and what are the dynamics that you're witnessing on the market. Could you expand on this? Is this growth going to be sustainable during 2017 and in the years to come?

And then from an industrial point of view, I'm interested in the fact that this activity is going to have on the acquisition of Aliplast and Teseco. So I would like to know what it is going to lead to from an industrial point of view. So these acquisitions, we do hope will help the business to grow.

And then turning to slide number six. I would like to understand how the supply of the electricity and gas is evolving.

Of course, I'm not talking about the growth that is related to safeguarded clients and default market. I would like to -- you to explain about what you mean about the underlining gases supply expansion. And then the third question concerns the cost of debt. Could you provide us some indications in absolute terms as regards the current cost of debt and a forecast, definitive cost of debt by the end of the year. Thank you.

## **Stefano Venier, Chief Executive Officer**

Now, as regards the colorful elements concerning your organic growth of EUR7 million, of course they are driven by two to three elements. The first element being the treatment of waste. As you may have noticed, there has been an increase of volume of special waste. And as -- regards this, there is a volume delta effect and then there has been a further increase of the prices and the tariffs of special waste. These variations goes from EUR1 up to EUR5 depending on the type of projects. We have seven to eight macro categories of product.

And on average, which should conclude that we have EUR2.53 for the overall amount of tons. This growth of 46,000 tons edge up on the top of the growth that we recorded last year. So we are talking about 630,000 tons, the price has been up by 3% on average. And then we have higher margin given the fact that the overall number has increased, and this lead to the overall result of EUR3 million to EUR4 million.

The remaining portion to reach the EUR7 million is linked to some efficiency that we made in terms of the collection and treatment of waste and in the operation of plants. And then we have EUR1 million further that is linked to the treatment of paper and plastics, all these totals EUR7 million.

Now, going back to your second question. So the contribution that we expect from the acquisitions of Teseco and Aliplast. Teseco and Aliplast are two acquisitions which will be providing quite different contributions. Teseco is a platform of clients, which means that they have a direct access to the sea. So they are located near Piazza close to our waste recycling plant. And it has chemical and physical plant that are similar among themselves.

But they also have complementary plants for soil washing. And then on the top of that, they also have storing facilities. This will enable us to increase the supply of services in the local area, in the region of Toscana, Sviluppo. We were quite close to saturated the situation in terms of ways to recycling opportunities. So we can further consolidate business areas where we already operating. And then on the top of this, this company will help us because of the logistic positioning it enjoys. This will particularly be helpful in the special waste sector, waste recycling, pharmaceutical sector, laser treatment sector and mechanical sector.

In terms of production capacity, it will add up to 40,000 to 50,000 tonnes, that can be -- treated. Aliplast is also operating in the waste treatment sector. But as you know, it recycles and it re-manufactures plastic materials polyethylene and PET. And this perfectly fits with the production activities that are part of our portfolio of services where plastic materials do play an important role, I'm talking about the food and beverages sector where there is a large use of plastic packaging. But this also informs other sectors where a lot of plastics has been used. So what are the synergies that we do farther expect?

We do expect synergies to be made with our traditional activities. As a result, we will bolster our full service, a larger service activities on our key accounts and this will also allow us to improve -- our ability to improve the lifecycle of plastic materials and this will enable us to make full use of our plants. This will [ph] in a nutshell, the contribution that Aliplast will make for us. Aliplast was already sending for waste recycling, but it also closes the circle for us. It's really in line with our circular economy philosophy.

Hera together with the treatment or waste treatment, which I'm going to turn to in a second is going to be the only operator to do this. All the other factors that are involved here are usually falling within the remit of the producers of the raw material. I am talking about steel paper and glass, for instance.

Again as I said, this is the last step for us to fully close the circle, because at the end of March, we obtained the authorization for the construction of our first plant. So there will just be only two of us to be able to build a plant to transform wet waste biomasses into biomethane. This is a plant that will be set up in Sant'Agata. And as we have already mentioned several times, the capacity will be EUR7 million per year, and it will absorb 100,000 tons of volumes per year.

In terms of sales margin, well, first of all we need to make a distinction, distinction between the free household residential market from the industrial market. When it comes to the marketed companies, then you know that high season is the summer for the gas and then on -- the winter for electricity. So we are still working on the situation. We are very active on the market. The conditions last year were bit more interesting, because the low prices that we had in the first quarter of 2016 favored the signing of contracts ahead of time, while all the negotiation procedure that took place in the last six months has slowed down this process.

So as I said, we will have to wait and see for the real metric to be played. Then as regards, all the rest and I see the usual competition levels. So I don't see any major changes.

And then the last element as regard to procurement of raw material in terms of electric energy, we are working on a back-to-back basis, so there are no major variation. The margins have already been basically fixed in signed contracts. When it comes to the gas sector, we have good down in contract, the supply terms for next year as well and the terms and the conditions are very similar to the conditions that are already in place until September of this year.

And as regards to the cost of debt, it's now 3.7. As we mentioned during the presentation of the industrial plan, we do expect to go down to 3.5 by the end of the year and 3.2 for next year. This is our target.

## **Javier Suarez, Analyst**

Thank you.

## **Operator**

The next question is by Enrico Bartoli of MainFirst.

## **Enrico Bartoli, Analyst**

Good evening, everybody. I would also like to ask some questions. I would like to go back to the electricity business. Could you please expand on this 16 million of the EBITDA. Could you please expand on the contribution made by safeguarded clients and what is the contribution of the dispatchment market.

What are the sales margins to clients? Then I have a question concerning networks, this brings me back to slide number five, more specifically when it comes to water and to gas. Could you please provide some more comments you mentioned the organic growth, what is the contribution of the tariffs, what is the contribution of the quality premium and what is the contribution of efficiency approaches. And do you think that this trend will be sustainable in the next quarters? And then as regard to the tax rate, I think the last figure that was mentioned was 33.5, could you please confirm this or give us an update?

## **Stefano Venier, Chief Executive Officer**

All right. Here, I am. So, as regards the growth of the electricity business, we have altogether EUR50 million. This is a commercial business. We have EUR11 million due to the variation of the parameter of the safeguarded clients market and the remaining EUR4 million of margins made on the market.

And then under the item power generation, you see MSC [ph] and you see the efficiency making process and this accounts for 1.5 percentage improvement. And then I think that in general, we are talking about EUR8 million.

And then as regards the water tariffs, we have EUR3 million, we have a guideline of fully paid premiums in terms of the quality of the services. It's EUR5 million for this year and in the first quarter of the year, all the performance indicators are in line with the objectives that have been set and we therefore recorded the corresponding figure, which is EUR1.2 million, EUR1.5 million.

The remaining portion EUR2.5 million, here we have a 50% due to an adjustment of the tariffs system and then we have 1 million, 1.5 million due to a higher efficiency. And in terms of gas distribution, we have a very similar breakdown. Please consider that within the entire perimeter of the networks that we have EUR2.55 million and again this is due to the gas distribution and to the networks as well. This -- these are the answers to your questions.

And then as to the tax rate, the guideline that we gave around 32%. In the first quarter, we always have, and this is the case with many other companies. We have again a profile, we adopt [ph] to profile, which is the average in the first portion of the year and above the average in the last portion of the year.

## **Enrico Bartoli, Analyst**

Thank you.

## **Operator**

The next question is by Stefano Gamberini of Equita SIM.

## **Stefano Gamberini, Analyst**

Good evening, everybody. I may -- may I ask a few questions, the first one concerns Aliplast and Teseco. Could you tell us by how much they will contribute to the EBITDA by the end of the year. And could you please expand on the payments made as regard to the dividend. The Executive Chairman pointed out that you have been awarded a tender in the field of safeguard clients. And this may even favor your participation into other tender process. So will this take place in the gas distribution field? When will these tenders take place and that there are any news worth mentioning in the waste sector as well?

And one last question for Mr. Moroni, please go to slide eight, as regard of the cash flow, you mentioned EUR116 million. And could you please put it this in relation to the EBITDA, because the CapEx, has spent to be deducted, so what are other items, will then lead up to an operating cash flow of EUR211 million? Thank you.

## **Stefano Venier, Chief Executive Officer**

Well, as regard to the waste sector, let's now, recap for a minute the payment installment. Teseco has already been fully paid EUR9 million at the end of January 2017. As regards Aliplast, as you may remember the payment has been divided down in two instalments, the first installment has been paid. It was paid on the 3rd of April. That was the first 40% and the remaining 40% will be paid at December 31st.

The equity value is EUR88.5 million. So, you need to multiply 9 by EUR435 million. This is the first installment, and we will pay the same amount for the second installment.

And then the recent, earn out component, which is very difficult to define for the time being, we will pay this in December and then afterwards once we will fully acquire the remaining 20% of the company, which may be around EUR15 million distributed over a period of time.

This is the way in which we're going to pay or which we have already paid for this acquisition. So, how the way to put down all these items in the PFM, Teseco EUR9 million and Aliplast we recorded 100% of the capital, again we entered into a commitment to pay the remaining 20% over a period of whole year.

So, in the profit and loss account, we also need to record and account for this commitment that we have find. This as regards of the cost of the acquisition.

In terms of the return on these acquisitions, on this investment as, Teseco this is a small company, so the return will be about EUR1 million for the first year. As to Aliplast, on a yearly basis, the contribution to the EBITDA will be around EUR15 million.

Oh, yes, let me also mention the topic of tenders. I think that when our Executive Chairman mentioned other tenders, he was not really referring to other gas distribution tenders. And the last tender in Milan surprised everybody and again the atmosphere is now quite hot.

And again, we do expect that two tenders might be published by the end of the year. So, you do know how fast this sector is moving. So, I do not really needed to give you any insights on this. So one, our Executive Chairman mentioned other tenders, he meant the tenders we are currently involved in, a tender for the management of electricity services for the Municipality of Modena. In the first quarter of the year, we were awarded some more tenders in terms of public lighting services.

So, these are tenders that do not perfectly relate to our core business, but they do help us because they enable us to keep an eye on the market to put our structures, our facilities under stress situation and to start thinking about a different sector, where you can lose one client today and get another client tomorrow.

This is a matter to play once and this match will then be played next, like in 10 years' time or in 12 years' time. And now I'll give the floor to Luca that he will give some more details about free cash flow.

## **Luca Moroni, Group Director of Administration, Finance and Control**

211 is a figure net of financial charges, we have tax that accounts for 49. So, we have 82, which is the value of the operating lever and then we have EUR24 million, EUR25 million, which is the provision for doubtful debts, which are part of the Delta CCN.

And the value of this item is EUR7 million, additional provision for doubtful debts that we've made and all this is mainly attributable to the clients of safeguarded client. So, these are client that cannot be disconnected from the grid, from the network and we therefore made larger provisions based on the experience that we gather over the last few years.

And as you know, as part of the Resolution 360, again for the remaining portion will -- then the authority will settle the outstanding accounts.

## **Operator**

(Operator Instructions) The next question is by Meris Tonin of Intesa Sanpaolo. Please.

## **Meris Tonin, Analyst**

Good evening, everybody. My question will be very simple. I'm talking about provisions and accounts. How do you reconcile this data with the year-end data?

## **Luca Moroni, Group Director of Administration, Finance and Control**

In terms of amortization, we have 3.5 million more in terms of amortization, and this is the effect of the investment made last year. So, this is a drag on effect. And then we have provisions for EUR1.5 million, as an additional millions. They relate to the management of post-mortem fund. As you will see in the report, the adjustment to the IFRS [ph] accounting principles made it this necessary. And then we have a EUR7 million for the depreciation fund and a portion of this is linked to safeguarded clients.

And the EBIT amounted to roughly EUR5 million, which is in line with what we have forecast in terms of the effects of the safeguarded client market. So, this is perfectly in line with what the data that we mentioned during the presentation of industrial plan.

## **Meris Tonin, Analyst**

If I may, I would like to ask a second question, in terms of the higher efficiency that you made. Of the last few years, you made more efficiency and -- can this EUR6 million efficiency that you made in the first quarter be replicated in the next quarters?

**Luca Moroni, Group Director of Administration, Finance and Control**

We have a target for the whole year, which is EUR15 million to be in line with our target for 2020. Since we have already made efficiency for EUR4.5 billion, then I think that we are already -- we have already managed to again make one-third of the path, basically.

**Meris Tonin, Analyst**

(Operator Instructions) Mr. Tomaso di Vignano for the time being, there are no questions.

**Tomaso Tommasi di Vignano, Executive Chairman**

Well, thank you very much once again. And I think we will talk very soon. We will move on with our plans, and we will keep you updated. Thank you.