



directors' report
and financial statements
for the year ended december 31, 2002
Summary

> Hera S.p.A.

Headquarter

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Share capital Euro 786.531.529 fully paid-in

Company registration no. at Bologna, Fiscal
and Vat code: 04245520376

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1. Introduction

This document is a translation into English of the Italian Consolidated Financial Statements of Hera Group as at 31 december 2002.

This translation is not a complete versions of the original Italian document since the Financial Statements of Hera Spa (the Holding company) and the disclosure to the Consolidated financial statements have not been included.

A fully translated English version has been performed and has been fully audited by Deloitte & Touche who has issued an audit opinion without qualifications.

The fully translated English version is available on demand and will be made available within the end of June on the corporate web site **www.gruppohera.it** on the "Investor Relations" page.

2. Letter to the shareholders

Dear shareholders,

The corporate integration which, was completed in 2002 represents the most significant consolidation operation ever realised in the local utilities sector in Italy.

The creation of Hera has significantly modified the national "landscape" in the management of local public services and has offered to the entire sector the testimony that it is possible to construct a true "industry of public services", overcome the fragmentation that today characterises the structure of the offer, close the competitive, financial and research & development gap that distances the Italian companies from their principal European competitors.

Hera finds itself positioned within the most recent legislation that has harmonised the liberalisation of the energy markets to the European Directives. Within this new set of regulations are contained, in a large collective project, the indications for reform and support for the consolidation of the sector that, although not completely clear, are contained in article 35 of the Finance Act for 2002.

It is significant that your companies knew how to read the new scenario that gradually developed into an occasion not to be missed, as an opportunity for growth and a testing ground for the competence of senior management, managers and staff, in therefore taking up the challenge to succeed in combining the necessity of producing new revenues and profits along with the high quality service standards that represent a typical and characteristic trait of your territory.

Perhaps it is not by chance that the first important corporate integration operation between local public companies came into being at Bologna, in the towns and in the provinces of the Romagna region: there is a deep-rooted, widespread and consolidated entrepreneurial tradition in the management of public services and there exists a fervent and vital system of institutional, economic and social relations that drives the various players to search outside of their own "area" the reasons and the path to growth and development.

Hera is today a large multi-utility group that presents significant numbers and characteristics in each of the principal sectors of activity: it is one of the national and European leaders in the management of environmental services, third Italian player in the distribution and sale of natural gas and among the first five operators in the management of integrated water cycle.

From this high ranking positioning in the sectors we can outline some strategic objectives for your company:

- > a greater coverage of the entire value chain in all the services managed, with continued growth of the offer that requires greater focus in the development of our autonomous capacity of electrical production and in the search for a strategic and solid positioning in the trading of electricity and natural gas;
- > growth of Hera by geographic area, intended to develop the client base, exploit the operating synergies and increase the value of the company, using our entrepreneurial formula to new entrants ready to share in your objectives, strategies and rules;

- > a strong orientation to the customer no longer passive and undifferentiated, no longer only a source of business, but co-producer and co-developer of services, so that the growth of the company and its new horizon of value creation can intertwine with the expectations of the consumers and respecting the territory.

The priority assigned of a greater focus of Hera in the energy sector has already been translated into some significant activity. We have taken part in the acquisition of a share in Interpower, the last generation company sold by Enel and an agreement has been signed with the Swiss company Atel, the operating contents of which will allow us to offer a greater quantity of energy to our customers.

As you will certainly have learned from a wide review of the national and specialised newspapers, Hera is more and more at the centre of attention of operators in the sector who have the objective of entering into agreements and partnership to increase their shareholder value, their human capital and experience, in order to grow and best face the liberalisation processes.

Our choice to make an open ended organisational model is however focused to well precise boundaries: the geographic contiguity of the potential partner; the superimposing of the strategic areas of activity and their consistency to the multi-business characteristic of Hera; the industrial potential of new entrants.

In these first six months of life we have guaranteed high quality standards of service and reconfigured the business organisation, processes, distribution of resources, trade union relations, information systems, fleet management: the process is still ongoing and the results achieved, some very significant in terms of the time period involved, would not have been possible if we had not been able to rely upon the commitment, the availability, the competence and the professionalism of all the of the collaborators of the company.

Every day millions of your customer access the services of Hera. Despite the fact that the integration process has absorbed a large part of our efforts, the company has never lost sight of what is certainly its greatest value: the customers in the water, gas and environment services to whom we dedicate our work in 2003 so that the services are always efficient, accessible and adequate to their requests.

The chairman of Hera S.p.A.

Tomaso Tommasi di Vignano



3. Summary data of Hera

Value of production (millions of Euro)

2001 Euro 1.097,8
2002 Euro 1.133,3
Growth rate (+3,2%)



EBITDA (millions of Euro)

2001 Euro 180,5
2002 Euro 191,9
Growth rate (+6%)



Operating cash flow* (millions of Euro)

* net profit, amortisation, depreciation and provisions

2001 Euro 133,2
2002 Euro 147,5
Growth rate (+10,7%)



Dividends (millions of Euro)

2001 Euro 20 c.a.
2002 Euro 27,5
Growth rate (+37,5%)



Economic Data (millions of Euro)	31.12.2001 Pro forma	31.12.2002
Value of production	1,097.8	1,133.3
Value added	352.1	381.4
Personnel costs	(171.6)	(189.4)
EBITDA	180.5	191.9
Amortisation, depreciation and provisions	(97.5)	(114.3)
EBIT	83.0	77.6
Net financial income (charges)	(7.9)	(14.4)
Net extraordinary income (charges)	1.2	12.1
Profit before taxes	76.3	75.3
Income taxes	(39.5)	(38.7)
Net profit	36.8	36.6
Minority interest	(1.1)	(3.4)
Net profit of the Group	35.7	33.2

Financial data (millions of Euro)	31.12.2001 Pro forma	31.12.2002
Investments	126.2	177.0
Operating cash flow*	133.2	147.5

Operating data	31.12.2001 Pro forma	31.12.2002
Gas sold (millions of m3)	1,439.4	1,444.5
Water sold (millions of m3)	171.5	176.3
Refuse collected (thousands of tonnes)	1,114	1,171
Refuse treated (thousands of tonnes)	2,252	2,490
Electrical energy sold (GWh)	619.8	948
Electrical energy produced (GWh)	207.9	252.0
N° of customers:		
Gas (units)	638,647	667,930
Water (units)	599,033	616,860
Environment (population)		1,633,241
Network (km):		
Gas	7,761	7,880
Electrical	1,403	1,411
Aqueduct	16,689	17,591

(*) net profit, amortisation, depreciation and provisions

4. The mission of Hera

- > Gain a market position that maximises the value of the plant, networks and experience in the core business sectors of the companies that have taken part in the integration; increase the value of the Group and its competitive capacity, avail of the opportunities that are presented with the liberalisation of the markets
- > Fulfil the "Hera system", creating synergies, optimising the available resources in relation to a better price /quality and ensuring further margins of growth and development
- > Combine the capacity to respond positively to market expectations with the objective of always providing adequate responses to the needs of the customers/clients, guaranteeing the quality, continuity and safety of the services, respecting the environment and maintaining constant relations with the territory
- > Develop the core business activities in adjacent territories to those currently served, which present the possibilities for the attainment of economies of scale and synergies in the short-medium term

5. Company officers

5.1 Board of Directors

Role	Name and surname
Chairman	Tomaso Tommasi di Vignano
Managing director	Stefano Aldrovandi
Deputy chairman	Aleardo Benuzzi
Deputy chairman	Ermanno Vichi
Director	Enrico Biscaglia
Director	Filippo Brandolini
Director	Gianluigi Magri
Director	Nicodemo Montanari
Director	Roberto Sacchetti
Director	Giovanni Tamburini

5.2 Board of statutory Auditors

Role	Name and surname
Chairman	Antonio Venturini
Standing auditor	Fernando Lolli
Standing auditor	Fulvio Alberto Medini
Alternative auditor	Mauro Conti
Alternative auditor	Roberto Picone



Dott. Tomaso Tommasi di Vignano
Chairman



Dott. Stefano Aldrovandi
Managing director

6. Description of the integration operation

Hera was created at the end of 2002 following the first significant consolidation process of the local utilities sector in Italy and is today positioned among the largest companies in the management of local public services, with a turnover of Euro 1,133 million, and is positioned within top 5 companies in all business areas (gas, water, waste management).

The company operates in 137 municipalities in the Emilia – Romagna region within the provinces of Bologna, Rimini, Ravenna, Forlì – Cesena, in a territory with a GDP and pro-capita consumption among the highest in Europe and where the quality and level of local public services have always represented a typical trait of economic and social development.

Hera was created following a careful reading of the dynamics of the sectors characterised by a progressive liberalisation of the demand, by an increase in competitive pressures and therefore the necessity of the companies to reach an adequate level of activities to compete in an increasingly competitive market place and to avail of the new opportunities for growth offered by the deregulation of the traditional monopolies.

The integration was completed in a short period of twelve months (November 2001 – November 2002), involving 137 Municipality shareholders, who took the decision to converge in a single enterprise their participations previously allocated in 11 companies.

The merger was guided by the owners and the management of the companies within three working groups, which oversaw three crucial aspects for the conclusion of the agreement:

- > **the legal area**, to define the structure of the operation, corporate governance and the consistency of the project with legislation for the sector and the most recent regulations introduced with article 35 of the Finance Act 2002;
- > **the economic – financial area**, within which the valuations of the economic capital were made for each of the companies in order to determine the share-swap ratio, thus sharing the principles of a single industrial plan and development strategy;
- > **the operational area**, to determine the most appropriate organisational model for the new structure and its markets.

Although in the absence of the Regulation for the implementation of article 35 of the Finance Act 2002, the integration operation in Hera occurred in anticipation of the application of the separation principle between ownership of the networks and plant and the management/provision of the services.

This took place through a corporate merger/spin-off project that saw, on the one hand, the creation of the **“asset company”** in conformity with the provisions of article 113 of the Finance Act on the Regulation of local Public Bodies, as reformulated in article 35, and on the other the incorporation of operational business divisions with Seabo S.p.A. as beneficiary, who at the same time changed its name to Hera. The emission of new Hera shares following the corporate merger/spin-off was underwritten by the Municipalities transferring their assets in relation to the share swap ratio representative of the value of the operational business divisions incorporated.

The “asset companies” then entrusted to Hera the management of the networks and plants owned by them on the basis of a contract that defines the rental fee paid for their use, the commitment concerning ordinary and extraordinary maintenance, the planning of development and improvement investments and the terms for the restitution of the networks at the end of the contact.

The important integration process described has permitted Hera to reach – as to company size and market share - a significant positioning in each of the activities managed in a sector still too fragmented.

The integration in Hera represents, thus, in this phase of great ferment in the sector, a first concrete step also in our country towards the creation of a true and proper “industry of local public services”.

7. Description of the activity

Hera operates in the offer of services in the following areas of activity:

- > **Energy**, that includes the sectors of gas (distribution and sale of methane gas and LPG and the provision of other services) and electrical energy (distribution and sale);
- > **Integrated water cycle**, that includes abstraction, adduction, distribution, sewerage and purification services.
- > **Waste management**, which relates to operative territorial services (collection and transport of refuse, sweeping, urban hygiene) and treatment activity (recovery and disposal);

The EBITDA of the company is divided equally among the activities; this multi-utility characteristic ensures a reduced exposure of the results to the specific risks of each sector in which Hera operates.

The combined activities also present many common operating aspects, whose single management has already allowed significant synergies through the optimisation of the organisation of work and services.

The increased size reached by Hera will result in a “multiplier” effect of the existing economies of scale and greater efficiency in the purchasing policies, in the management of information systems and in the management of human resources.

7.1 Energy

Distribution and sale of gas

Hera manages a methane gas distribution network of 7,880 km that in 2002 distributed 1,444.4 million cubic metres of gas to 667,930 users.

Furthermore the company has implemented 11 cogeneration and district heating systems that distribute thermal energy through dedicated networks. In 2002 Hera produced 252.6 GWh of thermal energy serving 14,833 building units and industrial buildings that occupy a total building space of 2.9 million cubic metres.

The company also performs management services of thermal plants for third parties (heat management) performing activities of plant management, ordinary and extraordinary plant maintenance and fuel supply.

Production, distribution and sale of electrical energy

The company performs the distribution and sale of electrical energy to approximately 49,000 residential domestic users in the area of Imola and has commenced in all of the other areas in which it operates an incisive activity of sales to eligible customers. In 2002 Hera sold a total of 948 GWh of electrical energy, which was destined for 242.5 GWh to non-eligible customers and for the remainder of the offer to 138 eligible customers.

In 2002 the company produced 252 GWh of electrical energy from its own plants dedicated mainly to other productive processes (cogeneration, waste-to-energy, biogas, turbo expansion, etc.). In addition, the improvement or the renewal projects of the principal waste-to-energy and cogeneration plants are in advanced phases, as well as initiatives aimed at the realisation of new gas and steam combined cycle plants.

Hera acquired in 2002, through the consortium Energia Italiana/Acea-Electrabel, a participation equal to 5.5% in the share capital of Interpower S.p.A., the third generation power company sold by ENEL S.p.A., which has power plants with 2,600 MW of capacity installed.

7.2 Water Cycle

Hera has under management the integrated water cycle services in 127 municipalities in the provinces of Bologna, Forlì-Cesena, Ravenna, Rimini and, to a minor extend, Florence, with approximately 1.9 million inhabitants to whom 176.3 million cubic metres of water was distributed in 2002 for civil and industrial use.

The company disposes of a wide range of sources in provisioning that in 2002 provided continuity and efficiency to the demand from the wide catchment area served. The water network managed by Hera extends to 17,591km, over a territorial surface of 9,000 square km. The users served are 616,860, with a significant swing in the demand in the summer months due the presence of tourists concentrated on the Adriatic coast between Ravenna and Cattolica.

The sewerage connections are ensured by a network that extends 6,601 km, with 619 collection stations. In 2002 the users of the sewerage service were equal to 470,343 for a total volume of 133.4 million m³ of sewage.

Through the management of 346 purification plants, that in 2002 treated 153.5 million cubic metres of sewage, the company performed depuration service for 528,297 users. During the year the degree of utilisation of the plants capacity was equal to 70%.

7.3 Waste management

In the Environment Division the company has an integrated operating system for the management of refuse services in 100 municipalities serving a population of 1.7 million inhabitants. In 2002 of the total solid urban refuse produced in the geographic area served, equal to 1,171 thousand tonnes, 26% (307 thousand tonnes) was collected as differentiated and sent for recovery.

With approximately 40 plants dedicated to the treatment and disposal of refuse of different origin (urban, special, dangerous and non-dangerous, solids and liquids), Hera is positioned amongst the main operators in the sector in Italy.

In 2002, of the total refuse managed by the company, equal to 2,490 thousand tonnes, 62% was subjected to treatment and recovery, with only the residual share equal to 38% destined for landfills. It is noted in relation to this that the latest national data available (Federambiente Report 1999) indicates a national average landfill equal to 74% of refuse produced.

Hera has commenced new projects and initiatives aimed at further increasing the treatment capacity of refuse and the production of energy from waste-to-energy plants, in order to further reduce the quota of solid undifferentiated refuse that today is sent to landfill. In particular, the renewal and extension of the waste-to-energy plant at Frullo (Bologna) will allow within 2004 an increase in the capacity by approximately 180,000 tonnes/year, with a recovery of electrical energy equal to approximately 130 GWh/year compared to the current 35 GWh/year, that will be sold to GRTN in accordance with the CIP6/92.

8. Company organisation and Group structure

8.1 The organisational macrostructure

In November 2002 the company commenced the internal procedures for the activation of the organisational structures of the Hera Group on the basis of the macrostructure already agreed by the owners and contained in the integration agreement.

In Hera, the loyalty and the roots of the public enterprise to its territory have become a peculiarity to the business model that, while within its centre – in the Holding - the strategies and activities from which it is possible to achieve economies of scale are performed, maintains and reorganises locally the operating activities that require a constant relationship with the customers and their need of efficient services.

At the centre of the organisational model are two group structures: the **divisions** and the **territorial operating companies**. The divisions have been structured by business area, with the purpose of creating maximum focus within their market. The operating companies - that represent the historical memory of the Group and the technical and managerial know-how – are assigned the task to perform the activities in the territory, developing the efficiency and quality of the services provided.

The principal staff departments – administration, finance and control, organisation and management of personnel, purchases and contracts, legal and corporate affairs, business development, external relations - have been reorganised under the General Direction with light structures and a strong focus on the objectives of improvement of profitability and business growth.

The model adopted by Hera can also be substantiated as an **“open ended organisational model”** as it can be further repeated, allowing new shareholders on the one hand to acquire a role and functions in the governance of the company and on the other to maintain locally a corporate operating structure capable of fully interpreting the territory needs, and above all ensuring high quality service standards, being able to take from the experience of the Group the best practices and benefit from the synergies.

The attribution of the main responsibilities in the parent company and in the territorial operating companies was made through a process of management assessment which identified the best professional attributes existing in the companies converged into Hera; all the key figures have matured a long experience in the sector and possess the know-how of the best practices of the Group.

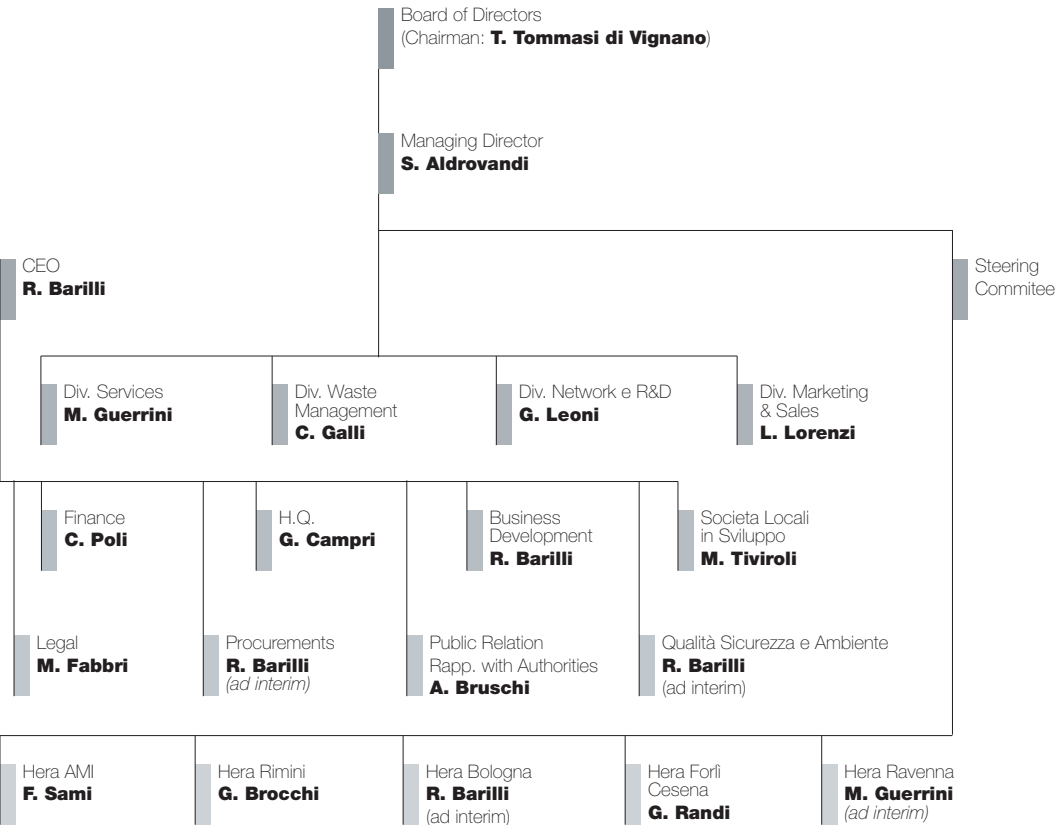
8.2 The structure of the Hera Group

At the end of 2002, Hera has established, five territorial operating companies in which it holds 100% of the share capital:

- > **Hera Bologna** S.r.l.
- > **Hera Ami Imola** S.r.l.
- > **Hera Ravenna** S.r.l.
- > **Hera Forlì – Cesena** S.r.l.
- > **Hera Rimini** S.r.l.

The sale of gas and electrical energy was concentrated - also in compliance with the regulations in the sector that disciplines the corporate separation between distribution and selling - in a separate company, **Hera Comm** S.r.l., into which all the gas and electricity contracts previously in the companies converged into Hera were transferred.

At the end of 2002, the Hera Group was comprised of 70 companies of which 36 direct or indirect subsidiaries and 34 associate companies. The current Group configuration is the result of the integration process and thus a reorganisation process began of the corporate participations held that will be implemented in 2003 through unifications and mergers and, to a lesser extent, through the disposal of participations no longer considered strategic.



9. Human resources

At December 31, 2002 the number of employees in the Hera Group was 4,538 (consolidated companies), with the following division by category: Senior Management (68), Managers (105), White-collar (1,646), Blue-collar (2,719).

From negotiations with the Trade Unions, commencing in 2002 before the conclusion of the merger, an agreement was made programmed in support of the integration process, through which a new "group" system of trade union relations was implemented with the objective of facilitating the relationship between the parties in a phase of considerable business transformation and in a very diversified territorial and regulatory context.

In this manner, within a short time frame, the available resources were allocated to the structures of the Holding, to the territorial operating companies and to Hera Comm, also facilitated by the new regulations that discipline the territorial mobility of personnel, defined – in agreement with the OO.SS. – for the implementation of a wide-ranging rationalisation process.

Under the training profile, in 2002, the various companies that converged into Hera - although in consideration of different approaches and different cultures in relation to training and professional updating - ensured an adequate promotion of the training necessary to achieve the different educational objectives as determined locally.

The theme of operative and specialised training has been addressed in collective courses aimed at teaching new technologies and operating practices, in the participation of the responsible individuals and of employees in qualified external courses and training on the job for both new operating machines and new personnel in the different sectors.

This was also the case of training in relation to the prevention and protection of the health of workers, with campaigns having the objective to reduce the percentage of accidents and to communicate safe behaviour in relation to the specific risks analysed.

Further courses took place to make employees aware on specific themes of the sectors involved in changes in operating procedures and to sustain the processes in course of certification for ISO 9000 and ISO 14000.

The managerial training related to the professional development of senior management and managers in relation to "leadership" skills and management of the resources.

The table below quantifies (in man hours) the training activity in the year.

Training activity	Man hours
Professional training	29,615
Quality, security and environment	10,916
Training and specialised course	14,629
Managerial training	4,578
Total	59,738

10. Regulatory framework concessions

The company has been entrusted with the distribution of natural gas services in 84 municipalities in the provinces of Bologna, Ravenna and Forlì-Cesena. The duration of the contracts, originally fixed for very long periods, will be redefined on the basis of the regulations introduced by the Legislative Decree no. 164/00, which introduced the European discipline on the liberalisation of the natural gas market.

On the basis of the legislation in force for the sector (article 15 of Legislative Decree no. 164/00) Hera may benefit from a further extension of two years of these contracts over their normal transitory expiry period of December 31, 2005, taken into account that the company has a user base greater than 100 thousand final customers and the quantity of gas distributed is over 100 million cubic metres per year. With the commencement of the admission project to a Market regulated by Borsa Italiana S.p.A. of a quota superior to 40% of the share capital, the company can benefit from a further extension to the transitory period of two years, thus resulting in an expiry date of the contracts in force of 31.12.2009.

In relation to the contracts for the integrated water cycle services and the refuse management service – of which the company performs the service in 127 and 100 municipalities respectively – the relative discipline is contained in the regional law no. 25 of 1999 instituted by the Agenzie d'Ambito Ottimale (Catchment areas - ATO).

The characteristics of territorial coverage and of the users served by Hera, compared with the decree of the regional legislator, indicate 31.12.2012 as the expiry date of the transitory period before the definitive passage to the system of contracts through public tenders, established by article 35 of law no. 488/01, that introduced this method in the re-formulation of article 113 of the Finance Act no. 267/00 on the Regulation of Public Bodies.

The Environment Agencies of the provinces of Ravenna, Forlì-Cesena and Rimini have already provided Hera with recognition approval as eligible to manage the services, while the recognition from the agency of Bologna is expected in the first half of 2003.

The distribution of electrical energy and the sale of electricity to non-eligible clients – disciplined by the Legislative Decree no. 79/99 – is assured in the Imola district by a concession given by the Minister for Productive Activities with an expiry date fixed by law on 31.12.2030. The most significant matter in the sale to non-eligible clients is the progressive lowering of the admission threshold of electrical customers to the free market. In relation to this it is noted that following the changes in the Legislative Decree no. 79/99 of law no. 57/01, this threshold is fixed at 0.1 GWh commencing from the ninetieth day of the sale by ENEL of not less than 15,000 MW of power, this sale was concluded with the sale of Interpower S.p.A., completed on January 29, 2003.

As noted, with the exception for the energy services (gas and electricity), the theme of the duration of the transitory periods also involves the discipline of article 35 of the Finance Act for the year 2002 that had raised perplexity both within the European Union and in relation to the complex redefinition of the roles between State and Regions concerning local public services after the reforms of Title V^o of the constitution.

The resulting debate has until now prevented the emanation by the Government of the implementation of the regulation of article 35 in which the transitory period of continuity of the operations should be defined.

11. Regulation and tariffs



11.1 Electricity

The Legislative Decree no. 79 of March 16, 1999 ("so-called" Bersani Decree") introduced the EU Directive into Italian legislation, and has considerably innovated the governing of the electrical sector, in the various areas of activity, providing a gradual liberalisation of the electrical energy sector. Based on the Bersani Decree production activity can be performed by any subject, Italian or foreign, in compliance with the obligations of public service. In particular, commencing from January 1, 2003, no subject can produce or import, directly or indirectly, more than 50% of the total electrical energy produced or imported in Italy.

The activities of transmission and dispatch are reserved to the State and attributed in concession to the Network Operator. The Network Operator is concessionaire of the activities of transmission and dispatch of electrical energy, including the unified management of the national transmission network.

The Bersani Decree provides for the division of electrical users in two categories: eligible and non-eligible customers.

The eligible customers are those who, in relation to the consumption threshold established by the Bersani Decree, can stipulate electric energy purchase contracts with any producer, distributor or Italian or foreign wholesaler.

The non-eligible customers are those who, not entering within the category of eligible customers, can stipulate electric energy purchase contracts exclusively with the distributor holding the concession license in the territorial area where the user is located. The non-eligible customers must be assured equality of treatment in all of the national territory, also in relation to tariffs.

The Bersani Decree provides that the distributor must receive a license for the concession from the Industry Minister. The distributor companies are obliged to connect to their network all persons making a request, without compromising the continuity of the service and in such a manner that the technical regulations are respected as well as the provisions emanated in relation to tariffs, contributions and charges.

11.2 Electricity tariffs

The electricity tariffs for non-eligible customers are defined in the tariff options established by AEEG; the reform of the tariff system has introduced margins of flexibility between domestic clients and distribution companies in conformity with a market in the liberalisation phase.

The price of electrical energy for non-domestic non-eligible customers, differentiated based on the level of voltage to which each customer is connected (low voltage; average voltage; high and very high voltage) and its use, is defined by the distributor companies on the basis of the criteria established by AEEG. The final customers (free or non-eligible) pay a fee for the transport of electrical energy (to cover the transport costs on the national transmission network and local distribution); this fee is represented by the tariff options proposed by each distributor, determined on the basis of the criteria defined by AEEG and also approved by AEEG.

For the eligible customers the fee for the sale is not recognised to the distributor since the customers in the free market are supplied directly through sellers and/or wholesalers with whom the fee is freely agreed.

11.3 Natural gas

The Legislative Decree no. 164 of May 23, 2000 (so-called "Letta Decree") which introduced the EU Directive 98/30 into Italian legislation, provides for common regulations for the internal natural gas market, innovating the governing of the sector and introducing a gradual liberalisation of the market.

The Letta Decree defines the activity of transport and dispatch as *"the activity having as its purpose the utilisation and coordinated exercise of plant for the exploitation, storage, transport networks and distribution and accessory services"*. In accordance with article 8 of the Letta Decree, this activity is considered of public interest.

The distribution activity, defined as *"the transport of natural gas through the local gas-pipeline networks for delivery to customers"*, is *"public service activity"* owned by the local public entities, to be given under licence to natural gas companies through tenders for periods not superior to 12 years. The granting local public entity conserves supervision and directional powers and establishes, within the service contracts, the method for the fulfilment of the service and the qualitative objectives to be achieved.

The existing contracts and concessions of the distribution activity at the date of coming into force of the decree continue for a transitory period of five years commencing from December 31, 2000.

This period can be extended, on the conditions as listed below, not superior to:

- > one year, if at least one year before the expiry of the first five years, a corporate merger takes place that permits an increase in users served at least double that previously served by the larger of the companies merged;
- > two years, if at least one year before the expiry of the first five years, the users served are greater than 100,000 final customers, or the natural gas distributed is superior to 100,000,000 cubic metres per year or the operations of the company is in the provincial territory;
- > two years, if at least one year before the expiry of the first five years, private capital constitutes at least 40% of the share capital of the concessionaire.

Where more than one of the conditions indicated applies, the relative extensions are cumulative.

In accordance with the Letta Decree, commencing from January 1, 2002, the activity of transport and dispatch of natural gas is subject to corporate unbundling from all the other activities in the gas sector, with the exception of storage activity, which is in any case subject to separate accounting and administration.

The Letta Decree II also establishes that within the same period, the natural gas distribution activity is subject to separate corporate unbundling from all the other activities of the gas sector and that the sale of natural gas can only be performed by companies that do not perform any other activities in the natural gas sector, except import, export, exploitation and wholesaler to customers.



In accordance with article 22 of the Letta Decree, commencing from January, 1, 2003, all customers are considered eligible and can therefore acquire natural gas from any operator.

11.4 Natural gas distribution tariffs

Up to June 30, 2001 the gas tariff structure provided for a differentiation in the determination of the price practiced by the distributor companies between civil users and users in dispensation.

From July 1, 2001 until June 30, 2004 the distribution tariffs are determined based on Resolution 237/00, with which AEEG has adjusted the tariff system to the liberalisation process of the gas sector. This resolution provides that the tariffs are defined by the distributors in respecting an obligation on the total maximum annual revenues for each tariff class. The maximum revenue, that also includes the remuneration of the capital invested, is defined with parametric criterion based on the number of users, the lengthen of the network, the volumes distributed and population, relating to each municipality managed. The new tariff system continues the objective of aligning the tariffs to the necessary costs for the provision of the service in conditions of security, quality and efficiency established by AEEG for the whole national territory.

The progressive entry into force of the tariff reform, which commenced at the beginning of 2001, has resulted in a re-equilibrium of the tariffs, previously considerably differentiated based on the characteristics of the individual distributors.

The tariff increases consented by the new regulation can only be applied by distributors that demonstrate to be in conformity with regulations on security and quality of the service.

From July 1, 2001 the previous tariffs differentiated by destination of use are replaced by degressive tariffs (decreasing unitary cost on increasing consumption) operated via stepped levels of consumption. On June 26, 2002, AEEG – following the partial annulment by the TAR in Lombardy of the AEEG resolution no. 237/00, on the appeal of several methane gas distribution companies, including Seabo (now Hera) – adopted resolution 122/02 that substantially modified the exclusive parametric method provided for in resolution 237/00 for the determination of the capital necessary for the performance of distribution activity, remunerated in the tariff. The new resolution, that modifies and integrates the preceding, consents the operators that have audited financial statements since 1990, to choose, for the determination of the annual capital recognised as necessary for the performance of gas distribution activity, between the parametric methods provided for in resolution 237/00 and the new method of revalued historical cost based on data from the financial statements.



During the course of the year Hera applied the tariff increases permitted for the quota of distribution in the various tariff classes in which the company operates (10 classes). On average, at Group level, the tariff component for the distribution quota increased by 2 – 2.5%, while overall in 2002 the average supply tariffs to customers (distribution and sale) decreased approximately 0.04 Euro/m³ due to the reduction in the cost of the raw materials.

11.5 Integrated water cycle sector

The legislation relating to the water sector is governed by different regulations, among which are noted in particular the law of January 5, 1994 no. 36 (so-called “**Galli Law**”) concerning water resource regulations.

The Galli law has considerably innovated the regulations in the sector of water resources, providing for

the vertical unification of the different operating segments through the institution of the Integrated Water Service, intended as the combination of public services of abstraction, adduction and distribution of water for civil use, sewerage and purification.

In implementation of the Galli Law, the Emilia Romagna Region approved the regional law 25/99, recently modified by regional law no. 1/2003, that:

- > outline the ATO area for the application of the local public entities in accordance with article 9, paragraph 4, of the Galli Law in relation to integrated water and article 23 of the Ronchi Decree in relation to the management of urban refuse;
- > govern the forms of cooperation between local public entities, with optimisation in the territory for the functioning of the administration of the organisation, regulation and supervision of public services;
- > determines terms and procedures for the organisation of public services in order to achieve an industrial management approach according to criteria of efficiency, effectiveness and inexpensiveness and to ensure the protection of the environment and the territory.

In relation to the management of the integrated water service the Environment Agency, in order to make its first activation:

- > identifies the existing management that can be recognised the safeguard as per article 9, paragraph 4, of the Galli Law, in respecting the principle of the re-unification of the integrated water service;
- > determines the overcoming of the direct management and those that do not respond to the criteria of efficiency, effectiveness and inexpensiveness that, subject to comparison on the basis of criteria of a technical, economic and entrepreneurial nature of the possible managerial solutions and taking into account the overcoming of the fragmentation of the management, converge into the management safeguarded or are entrusted to a new party;
- > determines the base tariff for each of the management referred to in the preceding two points;
- > determines directional policy for those safeguarded in relation to coordination and functional integration for the achievement of economies of scale and their progressive integration.

The safeguard can only be granted to existing operators of an industrial nature characterised by efficiency, effectiveness and inexpensiveness. The Environment Agency stipulates with each operator a safeguard convention for the management of the integrated water service for a minimum of three years.

The duration of the convention can be:

- > five years where stipulated with a party deriving from a merger of at least two operators safeguarded;
- > ten years where stipulated with an operator who performs the service relating to at least seventy-five percent of the population concerned.

11.6 Integrated water tariffs

The principal regulations concerning integrated water tariffs are contained in the CIP provisions no. 45 and no. 46 of October 4, 1974 and no. 26 of August 11, 1975, and in the provisions of the Inter-Ministerial Committee for Economic Programming (Comitato Interministeriale per la Programmazione Economica - CIPE) no. 8 of February 19, 1999, no. 62 of June 22, 2000 and no. 52 of April 4, 2001 that have emanated directives for the determination of water tariffs, on a transitory basis, respectively, for the year 1999, for the year 2000 and for the year 2001, until the complete implementation of the Galli Law.

On the basis of the current discipline, and until the application of the "normalised method", the tariff is differentiated based on the use of water resources (domestic uses, non-domestic uses and other uses) and period of use.

In Hera the different periods of consumption vary in consideration of the different municipality territorial areas in which the company operates.

Hera manages the aqueduct service in municipalities in six different provinces; therefore, the tariffs applied are, until the implementation carried out by the ATO, extremely diversified.

In the years 2000 and 2001 a large part of the companies converged into Hera did not apply the increased tariffs permitted. In 2002, on the basis of the CIPE resolution, Hera will increase the water tariffs by 0.5% for the aqueduct service and 1.7% for the sewerage and purification services.

All increases, as permitted by the CIPE regulations, will have effect from July 1, 2002.

11.7 Waste management

The Ronchi Decree – legislative decree February 5, 1997 no. 22 – has introduced an environmental provision in relation to refuse management.

The Decree has the objective of the production of refuse in order to favour its re-utilisation through cooperation of all parties involved in the production, distribution and utilisation of goods in which the refuse originates.

The Decree prescribes that the activities of collection, transport, recovery and disposal of urban refuse is organised on the basis of optimum territorial environment (ambiti territoriali ottimali - "ATO") coinciding, except in the case of differing regional legislation, with the territorial area of the provinces. For technical or for reasons of efficiency in the management of urban refuse, the provinces can authorise operators even at a sub-provincial level, as long as the fragmentation of the management in the territorial area is overcome.

With the Law of April 21, 1999 no. 3 and the Law of September 6, 1999 no. 25, recently modified by the regional law no. 1/2003, the Emilia-Romagna Region has implemented the Ronchi Decree, modifying the previous discipline.

In particular, the regional law 25/99 outlines the ATO area and disciplines the form of cooperation between the local public entities for the organisation of the service of the management of urban refuse.



The Environment Agency, instituted by the regional law 25/99 in order to organise the integrated cycle of urban refuse, organises the service activities in respecting the provisions of the provincial management plans for refuse prepared by the province, with the objectives of efficiency, effectiveness and inexpensiveness as well as the industrialisation of the management.

With the objective of making the first activation, overcome the management fragmentation and rationalise the organisation of the service, the Environment Agency within eighteen months of its institution:

- > identifies the existing management that operates in coherence with the provisions of the provincial management plan and responds to the criteria of efficiency, effectiveness and inexpensiveness;
- > determines the overcoming of the direct management and those not identified in the regional law 25/99 that converges in this latter or are entrusted to a new operator subject to comparison on the basis of criteria of a technical, economic and entrepreneurial nature of the possible managerial solutions and taking into account the overcoming of the fragmentation of the management;
- > stipulates with each operator at the preceding two points a convention for the management of the service for a duration of three years. This convention is for a period of five years where agreed with a party deriving from a merger of at least two existing operators, identified in accordance with point one and ten years where agreed with an operator who performs the service for at least 75% of the population of the ATO.

11.8 Refuse tariffs

The Ronchi Decree provides for the progressive substitution of the TARSU with the Refuse Tariffs that must cover the costs relating to the management of urban refuse and refuse of whatever nature or origin on roads and public areas.

The substitution of the TARSU with the tariffs will commence from:

- > January 1, 2004 for the municipalities that have reached in the year 1999 a level of coverage of costs superior to 85%;
- > January 1, 2005 for the municipalities that have reached in the year 1999 a level of coverage of costs between 55% and 85%;
- > January 1, 2008 for the municipalities that have reached in the year 1999 a level of coverage of costs inferior to 55%, as well as the municipalities that have a user base of up to 5,000 inhabitants without reference, in this latter case, of the coverage reached in 1999.

The tariff – approved by the municipalities on the basis of the "reference tariff" resulting from the application of the normalised method disciplined by the DPR of April 27, 1999 n. 158 - is applied and collected by the operator.

The "normalised method" consists the definition of the cost components to cover with the entry of the new tariff system and to determine the "reference tariff" relating to the management of urban refuse.

The table below shows a summary of the application of the "Refuse Tariffs" in the municipalities served by Hera at January 1, 2003.

	Tarsu	Refuse tariff	Total
Municipalities	88	31	119
Resident inhabitants	970,451	692,790	1,663,241

12. Notice convening ordinary and extraordinary shareholders' meeting

The shareholders are called to an ordinary and extraordinary shareholders' meeting at la Sala Alpi, Via del Frullo 5, Granarolo dell'Emilia (BO), on April 28, 2003 at 10.30 on first call and on April 29, 2003, at the same time and place on second call, to discuss and resolve the following

Agenda:

Ordinary Part:

1. Chairman's communication;
2. Approval of the financial statements for the year ended December 31, 2002;
3. Approval of the regulations for shareholders meeting;
4. Updating of the development plan of Hera S.p.A.
and industrial plan 2003/2007: consequent provisions;
5. Miscellaneous.

Extraordinary Part:

1. Approval of the "Spin-off project" between Hera S.p.A. and Geat S.p.A.;
2. Approval of the "Merger project" of Partecipazione S.r.l. unipersonale into Hera S.p.A.;
3. Increase in share capital through conferment in kind.

The intervention at the shareholders' meeting is governed by the provisions of law and the bye-laws of the company.

Bologna, March 24, 2003

The Chairman of the Board of Directors:

dott. Tomaso Tommasi di Vignano

13. Directors' report on the Hera Group

13.1 Economic and financial summary of the Hera Group

13.1.1 Comments on the consolidated results

Hera ends its first year with an increasing value of production and EBITDA, despite the significant organisational efforts required for the realisation of the integration process as previously described.

Following the considerable transformations with this integration process, for an understanding of the financial performance, a comparison between the data relative to the year 2001 of the Seabo Group with that relating to the year 2002 of the Hera Group is not significant.

The present report on operations is therefore based on a comparison between economic-financial 2002 data of the Hera Group with reconstructed data "proforma" for 2001.

The table below shows the list of subsidiary and associated companies held by Hera S.p.A. with the percentage held and the consolidation method used:

Companies consolidated by the full integral method	Holding at 31/12/2002
Subsidiaries	
Medea S.p.A.	100.0%
Hera Comm. S.p.A.	100.0%
Inter.Imm S.r.l. unipersonale	100.0%
Selecta S.r.l.	100.0%
Genista S.p.A.	99.7%
Ares S.p.A. Consortile	93.3%
Sis. Ter. S.p.A.	92.5%
Amga Energia S.r.l.	80.0%
Ideametropoli C.G.S. S.r.l.	77.0%
Ingenia S.r.l.	59.0%
EOS Energia S.p.A.	72.5%
LCM- Laboratorio Chimico Merceologico S.r.l.	66.5%
Sotris S.p.A.	62.0%
Dirama S.r.l.	61.0%
Famula On-Line S.p.A.	60.0%
Romagna Compost S.r.l.	60.0%
Cir Secco S.r.l.	56.5%
Ciscot S.r.l.	55.0%
Akron S.p.A.	52.0%
Frullo Energia Ambiente S.p.A.	51.0%
Nuova Geovis S.p.A.	51.0%
SBI S.r.l.	51.0%
Seabo Fleet Services S.r.l.	51.0%
Seabo Luce S.r.l.	51.0%
Sinergia S.r.l.	51.0%
Cales S.r.l.	50.1%
Baricella Ambiente S.p.A. ***	50.0%

Subsidiaries consolidated with other methods	Holding at 31/12/2002
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Subsidiaries consolidated at cost *	
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Hera Rimini S.r.l.	100.0%
Hera Forlì-Cesena S.r.l.	100.0%
Hera Ravenna S.r.l.	100.0%
Hera Ami S.r.l.	100.0%
Hera Bologna S.r.l.	100.0%
Partecipazione S.r.l. Unipersonale	100.0%

Subsidiaries consolidated under net equity method**	
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CLR Inerti in liquidazione S.r.l.	100.0%
Campagna Bioenergie CBE S.r.l.	99.0%
Ami Più (in liquidazione) S.p.A. (in liquidation)	60.0%

Associated companies	
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Gal.A S.p.A.	50.0%
Linpha S.r.l.	50.0%
Sinergie Ambientali S.r.l.	50.0%
Acantho S.p.A.	49.5%
Amav Ambiente S.p.A.	49.0%
Viviservizi S.r.l.	48.0%
Leucopetra S.p.A.	48.0%
Penisola Verde S.p.A.	48.0%
Attivabologna S.r.l. Consortile	48.0%
Energetic S.r.l.	42.5%
Seas Lavori e Servizi S.c.a.r.l.	42.0%
SGS S.r.l.	41.0%
Oikothén Srl	40.0%
Astra	40.0%
Service Imola S.r.l.	40.0%
S.T.A. S.r.l.	36.4%
Adriatica Acque S.r.l.	35.0%
Yele S.p.A.	35.0%
V.M.B.O. S.r.l.	34.0%
Hydrolazio in liquidazione S.c.a.r.l. (in liquidation)	32.0%
Torricelli S.r.l.	31.7%
Azimut S.r.l.	29.0%
Castellamare di Stabia	27.5%
Locride Ambiente S.p.A.	25.0%
Ravenna Compost S.r.l.	25.0%
Ecolegno Bologna S.r.l.	25.0%
Agess S.c.a.r.l.	24.4%
Recupera S.r.l.	24.5%
Aspes Multiservizi S.p.A.	24.0%
Tower Multi – utilities S.r.l.	23.0%
Rio d'Orzo S.r.l.	21.0%
Asa S.p.A.	20.0%
Tirana Acque S.c.a.r.l.	20.0%

* The subsidiary companies indicated are recorded at cost as they are operative as of January 2003.

** The subsidiaries consolidated under the Net Equity method are non-operative or companies in liq-

uidation: the consolidation method permits a better representation of the value of the companies.

*** Baricella Ambiente is considered a controlled company due to the significant contractual obligations existing with the Hera group. These transactions relate prevalently to environment services performed by the Group.

It is noted that the companies Akron, Amga Energia, Ares, Cir Secco, Dirama, Genista, Inter. Imm, LCM, Medea, Romagna Compost, Selecta, Sinergia, Sis-ter and Sotris entered into the consolidation area only in the year 2002. The effect of these changes to the consolidation area will be noted, where significant.

The consolidated and reclassified results for the year 2002 are shown below

(Millions of Euro)	December 31, 2001	%	December 31, 2002	%	Change
	(pro forma)				
Revenues	1,041.6	94.9%	1,067.0	94.1%	+2.4%
Other revenues and income	56.2	5.1%	66.3	5.9%	+18%
Value of production	1,097.8	100.0%	1,133.3	100.0%	+3.2%
Operating costs	(745.7)	(67.9%)	(751.9)	(66.3%)	+0.8%
Personnel cost	(171.6)	(15.6%)	(189.4)	(16.7%)	+10.4%
EBITDA	180.5	16.4%	191.9	16.9%	+6.5%
Depreciation & amortisation, provisions and write-downs	(97.5)	(8.9%)	(114.3)	(10.1%)	+17.5%
Operating Profit	83.0	7.6%	77.6	6.8%	(6.5%)
Profit before tax	76.3	7.0%	75.3	6.6%	(1.3%)
Net profit	36.8	3.4%	36.6	3.2%	(0.5%)
Minority interest result	(1.1)	(0.1%)	(3.4)	(0.3%)	+2.1%
Net profit pertaining to Hera	35.7	3.3%	33.2	2.9%	(7.0%)

The Group consolidated value of production increased by 3.2% passing from Euro 1,097.8 million in 2001 pro forma to Euro 1,133.3 million in 2002.

The increase in the value of production is attributable to the increase in turnover in the water cycle and waste management business; this increase more than compensated the reduction registered in the energy area.

The Group consolidated operating costs decreased as a percentage of turnover by 1.6 percentage points; these savings were obtained prevalently through an improvement in the purchasing conditions of the methane gas raw material.

Personnel costs increased as a percentage on turnover by approximately 1.1 percentage points, prevalently in relation to the enlargement of the consolidation area, which included increased personnel numbers related to contractual agreements in force.

The EBITDA of the Group increased 6.3%, passing from Euro 180.5 million to Euro 191.9 million in 2002 and an increase of 0.5 percentage points as a percentage on turnover. This result was achieved

through an increase of the margin in all the core areas of activity and in a significant manner in the energy business.

Despite the improvement in the level of EBITDA, the Operating Profit decreased by 6.6%, principally due to the increase in amortisation, depreciation and provisions following the greater investments made by the Company during 2002 as well as the changes in the consolidation area; this in fact involved the consolidation of companies characterised by high levels of tangible assets. The percentage of the Operating Profit on the value of production passes, as a consequence from 7.6% to 6.8%.

The profit before taxes has decreased slightly (-1.3%) passing from Euro 76.3 million to Euro 75.3 million. Following a fiscal charge similar to 2001, the net profit amounts to Euro 36.6 million in line with the previous year.

In relation to the change in the consolidation area, the quota of minority interest net profit increases to Euro 3.4 million, and as a consequence, the Group net profit is equal to Euro 33.2 million decreasing (-7.1%) compared to the 2001 proforma result.

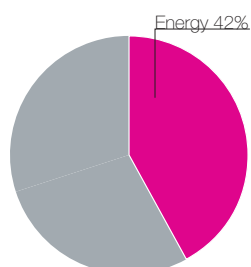
Below is set out an analysis of the operating performance of the business lines in which the Group operates. These results include structural costs and do not take into account the eliminations between business lines. For a better understanding of the results it is noted that these transactions are valued at normal market prices.

13.2 Energy

13.2.1 Significance of the Energy Division for the Group

Below is shown a representation of the Energy business compared to the overall results of the group:

**MOL EBITDA
Percentage on Group**



(Euro millions)	December 31, 2001 (pro forma)	December 31, 2002	Change %
Energy	589.2	565.5	(3.8%)
Value of production Group	1,097.8	1,133.3	+3.2%
Percentage of Group total	53.7%	49.9%	
EBITDA Energy*	72.7	79.8	+10.5%
EBITDA Group	180.5	191.9	+6.4%
Percentage of Group total	40.3%	41.6%	

* EBITDA is earnings before tax, depreciation and amortisation

This energy business is the most important for the Group from both a sales and profitability viewpoint. The division includes the areas of gas and electrical energy.

The activities relating to gas distribution are operated on the basis of concessions which, in light of the regulations in force, are valid until 2009.

Hera has significantly increased the size of business in the energy division following the aggregation operation and is presently the principal methane gas distributor in Italy among the local public utilities and third operator in the distribution sector (Source: elaboration of Company data for the "Annual Report on the state of services and activity performed in 2002" by AEEG).

The competitive advantage of Hera in the energy division is based both on the extended distribution network (only partially directly owned) and the significant number of the clients served characterised by average energy consumption levels which are among the highest in Italy.

The focus of the Group in the business of gas has permitted the accumulation of important know-how and to maintain a deep-rooted territorial presence. The 667,930 gas clients also represent a competitive lever for the development of the electrical energy business.

13.2.2 Analysis of the results in the Energy Division

Below is shown a analysis of the results of operations in the Energy Business.

(Euro millions)	December 31, 2001 (pro forma)	%	December 31, 2002	%	Change %
- Gas	525.7	89.2%	485.2	85.8%	-7.9%
- Electricity	63.5	10.8%	80.2	14.2%	+26.4%
Value of production	589.2	100.0%	565.5	100%	(4.3%)
Operating costs	(482.2)	(81.8%)	(449.9)	(79.8%)	(6.7%)
Personnel costs	(34.3)	(5.8%)	(35.9)	(6.4%)	+4.7%
EBITDA Energy	72.7	12.3%	79.8	14.2%	+9.8%
Amortisation & depreciation, provisions and write-downs	(34.5)	(5.9%)	(37.9)	(6.7%)	+9.9%
Operating profit	38.1	6.5%	41.9	7.4%	+10.0%

The total value of production in the Energy business, prevalently from the distribution and sale of gas, has decreased (-4.3%); this is attributable to the decrease in the tariffs (over 12%) following the reduction in the average cost price of the raw material.

On the other hand, the value of production of electrical energy has increased significantly, in line with the development strategies of the Group (+26.4%), in particular the sales to eligible customers.

Finally, it is also noted that the electrical energy production of Hera has increased (+15.3%) passing from 209.9 to 252.0 MWh.

Personnel costs sustained by the Group in the Energy Division have increased slightly, in percentage terms on sales, by approximately 0.5 percentage points, prevalently attributable to the decrease in the value of production as described above.

The EBITDA has increased by 9.8% passing from Euro 72.7 million to Euro 79.8 million in 2002 due to the effect of savings in the costs of provisioning.

In relation to the gas activity the principal economic data is shown in the tables below:

(Euro millions)	December 31, 2001 (pro forma)	%	December 31, 2002	%	Change %
- Methane gas & lpg	475.6	92.6%	432.6	91.4%	(9.0%)
- District heating and heat management	24.4	4.8%	25.9	5.5%	+6.1%
Revenues from other activities	13.7	2.7%	14.6	3.1%	+6.6%
Other income	11.9	2.3%	12.2	2.5%	+2.3%
Value of production Area	525.7	100.0%	485.3	100.0%	(7.7%)
Operating costs	(431.5)	(82.1%)	(382.6)	(78.8%)	(11.3)%
Personnel costs	(31.3)	(6.0%)	(32.1)	(6.6%)	+2.6%
(incl. Employee leaving indemnity)					
EBITDA	62.9	12.0%	70.5	14.5%	+12.1%
Amortisation & depreciation, provisions and write-downs	(31.8)	(6.0%)	(34.6)	(7.1%)	+8.8%
Operating profit	31.1	5.9%	35.9	7.4%	15.5%

The revenues from the distribution of methane gas and lpg decrease from Euro 475.6 million to Euro 432.6 million due to the reasons as already described.

It is noted that the company, although not having yet charged to customers the higher amounts relating to the transport of gas in compliance with the most recent provisions of AEEG (resolution 122/02), has recorded the increased revenues for a total amount of approximately Euro 8 million.

The evolution of the principal factors in determining the performance in the distribution and sale are set out below:

Gas activity (millions m ³)	December 31, 2001 (pro forma)	December 31, 2002	Change %
Number of users (units)	638,647	667,930	+4.6%
Non-eligible customers	638,406	667,695	+4.6%
Eligible customers	241	235	(2.5%)
Volume sold (millions m³)	1,439.4	1,444.5	+0.4%
Non-eligible customers	1,149.8	1,148.5	(0.1%)
Eligible customers	285.8	292.2	+2.3%
Sub suppliers	3.8	3.7	(2.6%)

The increase in the number of users (+4.6%) is principally connected to the acquisition of gas distribution services in new municipalities; the effect on the volumes of this increase was not however significant due to the reduction in the pro-capite consumption as a consequence of particularly mild climatic conditions in the second half of the year.

The value of production in district heating and heat management increased 6.1% passing from Euro 24.4 million to Euro 25.9 million due to the increase in the number of users served as a consequence of the expansion of the network and the completion of the cogeneration plants.

Other services managed by the Group in this division relate to public lighting and traffic lights. Also in this activities the value of production increased (+6.6%) due to the increase in the number of municipalities served.

The overall operating costs for the activities described above have also decreased as a percentage on turnover (-3%), due to significant savings in the average unitary cost of methane gas. The improved contractual conditions for purchases were obtained through the subsidiary Eos Energia (that operates in the trading of energy resources) which became fully operative in 2002.

The EBITDA increased from Euro 62.9 million to Euro 70.5 million (+12.1%) attributable to the synergies illustrated, which are also a result of the increased size of the Group.

The Operating Profit increased from Euro 31.1 million to Euro 35.9 million (+15.5%) after higher amortisation and depreciation of Euro 2.8 million, deriving from the investments made in the year (described in detail at paragraph 13.7).

In relation to the electrical energy activity the principal economic data is shown in the tables below:

(Euro millions)	December 31, 2001 (pro forma)	%	December 31, 2002	%	Change %
Revenues	61.6	97.0%	77.9	97.1%	+26.6%
Other revenue and income	1.9	3.0%	2.3	2.9%	+24.6%
Value of production	63.5	100.0%	80.2	100.0%	+26.4%
Operating costs	(50.7)	(79.9%)	(67.2)	(83.7%)	+32.5%
Personnel costs	(3.0)	(4.7%)	(3.8)	(4.7%)	(26.7%)
(incl. Employee leaving indemnity)					
EBITDA	9.8	15.4%	9.3	11.5%	(5.2%)
Amort & deprec, provisions	(2.7)	(4.3%)	(3.3)	(4.1%)	+22.2%
Operating profit	7.1	11.1%	6.0	7.4%	(15.6%)

The increase in the value of production, passing from Euro 63.5 million to Euro 80.2 million (+26.4%) is principally attributable to the increase in the number of eligible customers and volumes of electricity sold as shown in the table below:

	December 31, 2001 (pro forma)	December 31, 2002	Change %
Number of Users (units)	48,350	48,796	+0.9%
Non-eligible customers	48,316	48,743	+0.9%
Eligible customers	34	138	+305.5%
Volume sold/distributed (MWh)	619,821	948,257	+4.1%
Non-eligible customers	274,194	242,357	(11.6%)
Eligible customers	345,627	705,700	+104.2%

The activity of the sale of electrical energy represents an area of further growth potential and development synergies with the activities of gas; the Hera Group intends to continue the expansion in this direction which, also due to the increase in its own production capacity as provided for in the investments programmes, can ensure an improvement in profitability margins.

The following also enter within the same direction:

- > the recent commercial/strategic agreement with Atel (one of the principal foreign suppliers of electrical energy in Italy), that provides for, in addition to the supply of electrical energy destined for eligible users, cooperation in the production, transport and trading of electrical energy;
 - > the participation of Hera in Tirreno Power (ex Interpower, third Genco sold by ENEL) that guarantees the availability of approximately 140GW of installed production capacity.
- The operating costs in 2002 increased by 3.8 percentage points as a percentage on turnover prevalently due to the higher cost of the raw material acquired on the free market for eligible customers.

13.3 Integrate Water Cycle

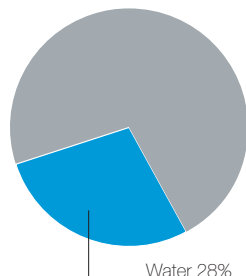
13.3.1 Significance of the Integrated Water Cycle division for the Group

Hera plays an important role in the competitive scenario in the national water sector and is placed among the primary operators in Italy due to its almost total coverage within the 4 ATO areas served (catchment areas).

The level of coverage and quality in the management of integrated water services has placed the Group in conditions to obtain, on the basis of current regulations in force, the exclusive license and recognition of the so-called safeguard period for the ATO in the provinces of Ravenna, Forlì-Cesena and Rimini. It is considered that this recognition can also be obtained within year end for the ATO in the province of Bologna where the municipalities concerned have already commenced the procedures for this request.

Below is shown a representation of the Integrated Water Cycle business compared to the overall results of the group:

MOL EBITDA
Percentage on Group



(Euro millions)	December 31, 2001 (pro forma)	December 31, 2002	Change %
Value of production Water Cycle	235.4	255.7	+8.6%
Value of production Group	1,097.8	1,133.3	+3.2%
Percentage of Group total	21.4%	22.6%	
EBITDA Water Cycle	52.3	53.6	+2.5%
EBITDA Group	180.5	191.9	+6.3%
Percentage of Group total	29.0%	27.9%	

The Integrated Water Cycle Division, that represents approximately 23% of the total turnover of Hera, expresses important future potential in view of the tariff adjustments connected to the application of the system provided under the Galli law.

The activities relating to the water cycle are managed on the basis of concessions that, in light of the regulations in force, are valid until 2012.

13.3.2 Analysis of the results in the Integrated Water Cycle business

Below is shown an analysis of the results of operations in the Integrated Water Cycle business.

(Euro millions)	December 31, 2001 (pro forma)	%	December 31, 2002	%	Change %
Value of production Water Cycle	235.4	100.0%	255.7	100.0%	+8.6%
Operating costs	(122.2)	(51.9%)	(137.1)	(53.6%)	+12.2%
Personnel costs	(60.9)	(25.9%)	(65.0)	(25.4%)	+6.7%
EBITDA	52.3	22.2%	53.6	21.0%	+2.5%
Amortisation & depreciation, provisions	(27.7)	(11.8%)	(32.9)	(12.9%)	+18.8%
Operating profit	24.6	10.5%	20.7	8.1%	(15.9%)

In 2002 revenues were Euro 255.7 million increasing by 8.6% compared to the previous year. This result is attributable to the acquisition of integrated water services in new municipalities and the increase in tariffs in relation to the investments to be made as per the so-called Stralcio law.

Operating costs have increased more than proportionally compared to the increase in the value of production also due to the effect of the higher costs connected to recovery and treatment from the water-bed to which greater recourse was made following the considerable drought registered in 2002.

The EBITDA increased by 2.5% passing from Euro 52.3 million to Euro 53.6 million.

The operating result decreased by 2.4% in percentage terms on turnover passing from Euro 24.6 million to Euro 20.7 million due to higher depreciation deriving from the investments made in the year (described in detail below).

The Hera Group manages the integrated water cycle that relates to the operating activities concerning aqueduct, sewerage and water purification.

The principal factors in determining the performance in this division are set out below:

Aqueduct	December 31, 2001	December 31, 2002	Change %
	(pro forma)		
Number of Users (units)	599,033	616,860	+3.0%
Domestic users	495,688	512,746	+3.4%
Other users	103,339	104,114	+0.7%
Volume of sales (millions of Mm³)	171.5	176.3	+2.8%
Domestic users	110.5	116.3	+5.2%
Other users	61.0	60.0	(1.6%)

The aqueduct network has leakage percentages at around 17%, compared to an Italian average of over 35%. These results were obtained due to constant monitoring of the aqueduct network (radio control) and periodic maintenance activity.

Sewage	December, 31 2001	December 31, 2002	Change %
	(pro forma)		
Users (Units)	433,230	470,343	+8.5%
Volumes sold (millions of Mm ³)	130.7	133.7	+1.7%

In 2002 Hera increased the number of users, prevalently domestic, by 8.3% with an increase of +1.7% in the volumes treated.

Purification	December, 31 2001	December 31, 2002	Change %
	(pro forma)		
Users	496,547	528,297	+6.4%
Volumes sold (millions of Mm ³)	154.1	153.5	(0.2%)

The table shows an increase in the customers acquired equal to 6.4% concentrated in the category of domestic users. The volumes sold are in line with the previous year.

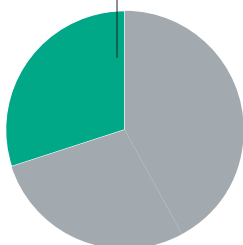
13.4 Waste Management

13.4.1 Significance of the Waste Management Business for the Group

Below is shown a representation of the Waste Management Business compared to the overall results of the group:

**MOL EBITDA
Percentage on Group**

Waste management 30%



(Euro millions)	December 31, 2001 (pro forma)	December 31, 2002	Change %
Value of production Waste mng	253.9	291.3	+14.7%
Value of production Group	1,097.8	1,133.3	+3.2%
Percentage of Group total	23.1%	25.5%	
EBITDA Waste mng	56.3	58.2	+3.4%
EBITDA Group	180.5	191.9	+6.4%
Percentage of Group total	31.2%	30.3%	

Hera is focused in the Waste Management activities that represents an important part in terms of turnover and EBITDA for the Group.

Hera benefits from one of the most important parks of waste treatment and disposal plants capacity at a European level. This division represents one of the core activities in which the Group has matured a long experience and today is able to optimise significant flows of material collected and has a large and diversified capacity of disposal plants, due to the dimensions reached following the integration operation.

This business, that represents approximately 26% of the overall turnover of Hera, expresses important future potential in view of the tariff adjustments connected to the application of the system provided in the Ronchi Decree.

The activities are driven on the basis of concessions which, in light of the regulations in force, are valid until 2012.

13.4.2 Analysis of the results in the Waste Management Business

Below is shown an analysis of the results of operations in the Waste Management Business.

(Euro millions)	December 31, 2001 (pro forma)	%	December 31, 2002	%	Change %
Value of production	253.9	100.0%	291.3	100.0%	+14.7%
Operating costs	(130.1)	(51.2%)	(154.0)	(52.9%)	+18.4%
Personnel costs	(67.5)	(26.6%)	(79.1)	(27.2%)	+17.2%
EBITDA	56.3	22.2%	58.2	20.0%	+3.4%
Amortisation & depreciation, provisions and write-downs	(33.7)	(13.3%)	(42.3)	(14.5%)	+25.5%
EBIT	22.6	8.9%	15.9	5.5%	(29.6)

The activities relate to the collection of refuse, urban hygiene services, treatment and disposal of waste.

The value of production increased by 14.7% passing from Euro 253.9 million to Euro 291.3 million. The increase was obtained through an increase in the refuse collected and treated that, as a consequence, also resulted in an increase in the production of electrical energy (largely sold to GRTN under the conditions established in the so-called CIP. 6/92) and thermal energy produced by the WTE plants. It is noted that a part of the increase is also attributable to the companies included in the consolidation perimeter commencing from 2002.

The Hera Group increased the volumes of differentiated refuse treated in 2002, increasing by 19.0% compared to the previous year, that permitted a containment of costs for the separation and disposal in landfills. The following table shows the refuse collection activity in 2002:

Refuse Collection (thousands of tonnes)	December, 31 2001 (pro forma)	December 31, 2002	Change %
Differentiated collection	258	307	+19.0%
Non-differentiated collection	856	864	+0.9%
Total Collection	1,114	1,171	5.1%
% of Differentiated collection on total	23.2%	26.2%	+3.0%

The Hera Group significantly increased the activity of refuse selection and waste-to-energy (urban and special), as a consequence decreasing the refuse sent to landfill (-5,3%) as illustrated below:

Volumes treated (thousands of tonnes)	December, 31 2001 (pro forma)	December 31, 2002	Change %
Urban refuse	1,117	1,245	+6.3%
Special refuse	1,081	1,245	+15.2%
Total volumes treated	2,252	2,490	+10.6%
Landfills	1,009	956	(5.3%)
Waste-to-energy	332	371	+11.7%
Selection plants	180	366	+103.3%
Compost plants	57	130	+128.1%
Inert chemical plants	674	667	(1.0%)
Total volumes treated	2,252	2,490	+10.6%

The waste-to-energy activity produced a total of over 125 GWh of electrical energy (of which approximately 83 GW/h sold at special CIP 6/92 prices) and over 46,400 Gcal of thermal energy.

At December 31, 2002, the active landfills of the Hera Group had a residual capacity of 4.35 million cubic meters which is considered sufficient to cover the territorial needs in which the group operates until 2014. In addition, the landfills permit the obtaining of an energy recovery from biogas that in 2002 was equal to 15,629 MW/h.

The growth in the activity resulted in an increase in the EBITDA margin of approximately 3.4% passing from Euro 56.3 million to Euro 58.2 million. This increase includes higher operating costs incurred for the improvement in the quality of the service that should result in higher revenues in future years with the application of the tariff system as provided for by the Ronchi Decree.

The EBIT decreased by 3.4 percentage points as a percentage of turnover passing from Euro 22.6 million to Euro 15.9 million after higher amortisation and depreciation compared to the previous year, equal to Euro 8.6 million; this increase is related to the considerable investments made and the enlargement of the consolidation area.

13.5 Other services

The Hera Group also manages, on behalf of shareholder Municipalities, some minor services such as public park areas and funeral and cemetery services. The value of production of these services has a negligible incidence on the level of overall business.

The Hera Group continues a strategy focused on core activities and therefore intends to develop high value complementary services and manage through out-sourcing those characterised by profitability not in line with core activities.

Below is shown a an analysis of the results in these activities:

(Euro millions)	Dec. 31, 2001	%	Dec. 31, 2002	%	Change %
	(pro forma)				
Value of production Other Services	24.7	100.0%	27.4	100.0%	+10.9%
Operating costs	(16.4)	(66.4%)	(17.6)	(64.2%)	+7.3%
Personnel costs	(9.0)	(36.4%)	(9.4)	(34.3%)	+4.4%
EBITDA	(0.7)	(2.8%)	0.4	1.5%	-
Amortisation & depreciation, provisions and write-downs	(1.5)	(6.1%)	(1.3)	(4.7%)	(13.3%)
Operating Profit	(2.2)	(8.9%)	(0.9)	(3.3)	(59.1%)

The value of production registered a slight increase in 2002 passing from Euro 24.7 million to Euro 27.4 million. The overall services resulted in a positive EBITDA compared to a small loss in 2001.

13.6 Analysis of the balance sheet and financial position of the Hera Group

The table below shows a reclassified balance sheet of the Hera Group indicating the net capital invested and the source of financing:

(Euro millions)	December 31, 2001	% December 31, 2002	%
Proforma			
- Intangible assets	386.1	38.5%	383.3 35.0%
- Tangible assets	642.2	64.0%	774.4 70.7%
- Financial assets	38.6	3.8%	44.3 4.0%
Total fixed assets	1,066.8	106.3%	1,202.0 109.7%
Net working capital	68.7	6.8%	50.8 4.6%
(Sources)	(132.2)	(13.2%)	(157.3) (14.4%)
Net Capital Invested	1,003.4	100.0%	1,095.5 100.0%
Net Equity	842.3	83.9%	841.7 76.8%
Long term loans	94.7	9.4%	185.4 16.9%
- short-term loans	100.6	10.0%	166.6 15.2%
- (liquid funds and other short-term assets)	(34.2)	(3.4%)	(98.1) (9.0%)
- Net financial position	161.1	16.1%	253.8 23.2%
Total source of financing	1,003.4	100.0%	1,095.5 100.0%

The net capital invested, prevalently comprising fixed assets, has increased passing from Euro 1,003.4 million to Euro 1,095.5 million following the significant investments made in the period, increased by 40.5%, passing from Euro 126.2 million to approximately Euro 177 million. These investments are described in paragraph 6 of the present report.

It is noted that the intangible assets, equal to Euro 383.3 million, are largely comprised of concession rights for gas supply and water services.

The net working capital equal to Euro 50.8 million has decreased compared to the previous year.

The provisions have increased prevalently due to the effect of the reserve for landfill closure and post-closure, as well as the reserve for the restoration of third party rented assets.

The net equity prevalently benefited from the result for the year that more than compensated the distribution of dividends in 2002.

The long-term indebtedness has increased Euro 90.7 million prevalently due to the project financing operation on a non-recourse basis for the concession of a total of Euro 144.6 million concluded with a pool of primary standing banks and with the objective of financing an important investment of re-powering and expansion of the incinerator at Frullo in the province of Bologna. At December 31, 2002 a total of Euro 44 million had been paid.

The increase in short-term financial payables is prevalently connected to bank payables and the short-term portion of loans. Short-term financial assets relate to temporary investments of liquidity in commercial paper of the Unipol Banca.

The Group net financial position has increased Euro 92.7 million, balanced between short-term and long-term debt, maintaining the strong asset backing of the Group's balance sheet characterised by a debt/equity ratio of less than 30%.

13.7 Investments of the Hera Group

The net fixed assets at December 31, 2002 amount to Euro 1,202.9 million, an increase of Euro 135.2 million compared to December 31, 2001.

The investments in tangible and intangible fixed assets of the Group increased passing from Euro 126.2 million to Euro 177.0 million for the year ended December 31, 2002.

In particular, the investments are shown below by sector of activity.

	31.12.2001	%	31.12.2002	%
Euro milioni	pro forma			
Energy Division	24.7	19.6%	30.0	16.9%
Water Division	26.6	21.1%	42.9	24.2%
Environment Division	47.0	37.2%	61.9	35.0%
Other Services Division and central structure	27.9	22.1%	42.2	23.8%
Total	126.2	100.0%	177.0	100.0%

13.7.1 Energy

During the course of the period under consideration investments amounted to Euro 30 million as shown below.

Euro millions	31.12.2001 pro forma	31.12.2002
Extensions, improvements and adjustments to gas networks and plants	12.1	16.1
Extensions, improvements and adjustments to district heating networks and co-generation plants	5.8	7.5
Gas distribution concessions	2.3	0
Other investments (public lighting and electricity)	4.5	6.4
Total	24.7	30.0

The principal investments in the Energy Business related to the extension of the gas methane distribution network for new users as well as two new co-generation and district heating networks at Casalecchio di Reno and Bologna.





13.7.2 Water

During the course of the period under consideration investments amounted to Euro 42.9 million.

The table below shows the principal investments made in relation to the Water Business.

Euro millions	31.12.2001 pro forma	31.12.2002
Extensions, improvements and adjustments to water networks and plant	21.9	32.0
Extensions, improvements and adjustments to purification/sewage networks and plant	3.8	9.5
Other investments	0.9	1.4
Total	26.6	42.9

The investments in the Water Business were principally made for improvements in the collection plants, improvements in the purifying and treatment as well as the maintenance and improvements to the distribution network in order to reduce the losses in the network and increase the water available. In addition, improvements were also made on the purification plant and network connections were installed.



13.7.3 Waste Management

During the course of the period under consideration investments amounted to Euro 61.9 million.

The table below shows the principal investments made in relation to the waste management business.

Euro millions	31.12.2001 pro forma	31.12.2002
New Frullo incineration plant	8.9	27.0
Waste treatment and disposal plant	20.3	23.9
Operating headquarter	3.0	1.7
Other equipment and vehicles	10.3	6.9
Other investments	4.5	2.4
Total	47.0	61.9

The main investments relate to the increase in waste treatment capacity both in the waste-to-energy sector and in the landfills at Galliera (Bologna) and Ravenna, the construction of a compost plant at Rimini and new waste separation plants at Forlì and Bologna.

13.7.4 Other investments

During the course of the period under consideration other investments amounted to Euro 42.2 million.

The table below shows the principal investments made in relation to the central structure and general services.

Euro millions	31.12.2001 pro forma	31.12.2002
Restructuring on headquarters and district offices	8.6	3.0
Intangible assets and IT (information systems, maps, etc.)	6.3	17.6
Other investments (fibre optics network, furniture, equipment, vehicles)	13.0	21.6
Total	27.9	42.2

In the Central structures and General services, the principal investments related to the expansion and restructuring of the administration and head office buildings, the acquisition and implementation of the information systems (SAP), furniture, equipment and auto vehicles.

13.8 Research and development



During the year 2002 various research and development activities were undertaken. The principal initiatives are listed below, divided by business area:

13.8.1 Electrical Energy

- > Feasibility study for the installation of a micro turbine for users in the territory of Imola

13.8.2 Gas

- > Study of forecasting model at 36 hours of gas samples in the territory of the province of Forlì – Cesena based on the meteorological forecasts and consequent verification of the response from the network

13.8.3 Water

- > Standardisation of IT control system on the principal water plants
- > Project for the monitoring of micro organic pollutants (MIMS) in drinkable water.
- > Project for the monitoring of the water system for its modelling in real time.
- > New methodical for the conservation of the water quality during the purifying/ disinfection processes
- > Initiative for achieving greater reduction of road dust
- > Project for the computerised control of the purification plants
- > Project for the insertion of the 'membrane' technology in the purification process of the depurator at Calderara di Reno
- > Project for the implementation of radio control systems in the plants present in the sewerage
- > Development of a mathematical forecasting model of water consumption
- > Operational model and plant installation hypothesis aimed at energy savings in the production station at Mirandola

- > Development and application modular instrumentation for the monitoring of micro organic pollutants in drinkable waters based on MIMS technology
- > Commencement and development of alternative disinfection technology to the usual treatments based on the use of chlorine reacting substances
- > Verification and updating of the technical solutions adopted in order to contain the phenomenon known as "red water" in the water network in the Bologna region.
- > Further research on a technical proposal for the use of polyacrylamide in the drinkable waters.
- > Management optimisation criterion aimed at a resolution to the matters introduced by the Legislative Decree no. 31/2001 in relation to the presence of chlorite in the water destined for human consumption
- > Study on the reduction of the elements figuring in the various purifying phases of the plant at Ravenna
- > Study for the reduction of chlorite in treated water, in the plants managed by Hera AMI S.r.l.
- > Experimentation of Biomass system for use in Borgo Rivola depurator

13.8.4 Waste Management

- > Experimentation machine for the treatment of dangerous solid waste based on the molecular thermal dissociation process
- > Automatic data tracking project on the collection of refuse with the assistance of the GPS satellite system
- > Experimental project on the use of Biodisel in the environment service motor vehicles in the territories of Ravenna and Lugo
- > Study on the effectiveness of reducing odour and pathogenic bacteria in the caissons for the collection of organic waste, through the use of hygiene agents
- > Solid rubbish gasification in dross (Pool Slag Gasification): realisation in laboratory scale of a gasification oven at high temperature (1700°) of refuse, without grill, at preheated temperatures of 1000° C and production of two liquid phases separated by siliceous and metal dross

- > Development of a graphic input-output interface for the simulation code of the compost bio reactor, in Excel - VisualBasic, so as allow a simple and direct use of the code, with the possibility of quickly changing the geometrical and operating input parameters and to visualise the results.
- > Mathematical emission model: development of a 3D non-stationary mathematical model at finished volumes for the determination of field speed, pressure, temperature and composition in the areas concerned of pollution coming from one or more sources.

13.8.5 Other Services

- > Feasibility study for district heating plants in the territory of Forlì: docks, cattle hold, agricultural consortium and neighbouring areas and preliminary project for district heating network and temporary exchanges and cogeneration servicing the area
- > Study for the evaluation of the biological air dispersal risk in accordance with the Legislative Decree 626/94. Control of bio-aerosol in the working environment such as purification plants, landfills, liquid refuse treatment plants, energy recovery plants and laboratory
- > Study for the verification of the water, gas and sewage network in the province of Forlì-Cesena
- > Control of the emission of Volatile Organic Substances (SOV) and of odours in the ceramic tile cooking process. New monitoring systems in continuation of the SOV for gaseous emissions. For this activity the company requested funds from the Innovation Technological Fund set up by law 46/82. The costs sustained for this project are equal to Euro 976,580.

For the fulfilment of these research and development activities the following costs incurred are summarised by business area:

	Cost (Euro)
Water	850,000
Gas	10,000
Environment	460,000
Electrical	2,500
Other Services	1,022,080
Total	2.344.580

13.9 Sustainability Report

Some of the companies taking part in the integration have prepared in recent years an Environmental and Social Report on an annual basis.

The company prepares, commencing with the initiatives undertaken in 2002 by the companies taking part in the integration, a Sustainability Report that describes the policies of the Hera Group in the social and environmental fields, carrying out a first application of what presents as a more appropriate and evolved instrument for management control and communication in order to fully integrate the three aspects of sustainability: economic, social and environmental.

The first Sustainability Report will be called "Number zero" to clarify the character of the first elaboration which, due to the short time frame from the commencement of Hera, cannot contain the full structural characteristics and detail of a Sustainability Report. With its publication Hera is voluntarily committed to the setting up of clear and coherent communication with the public through the publication of relative information on the social-environmental interactions in which it operates and carries out its production activities.

The Sustainability Report will be prepared following the methodological indications accredited at international level (AA1000 Institute of Social and Ethical Accountability, 1999 and Sustainability Reporting Guidelines, Global Reporting Initiative, 2002) and at national level (The principles in the preparation of the Social Report, Study Group for the Social Report, 1998 and from the social report and sustainability report of the Eni Enrico Mattei Foundation, 2002).

13.9.1 Energy

The territory served by the Hera Group is characterised by an extended network of the distribution of natural gas since the first half of the 1990's: with the utilisation of methane significant consumption of more polluting liquid fuels have been substituted.

Hera produces electricity from renewable sources, as well as assimilated sources (cogeneration, energy recovery from refuse) and from conventional sources.

The production of electrical and thermal energy in cogeneration plants, completed by the distribution of heat with district heating networks, permits the optimisation of the use of energy sources (natural gas) and increases the possibilities for control, and thus the reduction, of emissions into the atmosphere.

13.9.2 Waste Management

Hera has progressively introduced in the environmental operating services the use of vehicles fuelled with reduced environmental impact (methane, white diesel oil, biodiesel) and organises refuse collection and cleaning at appropriate hours in the day in order to contain the environmental impact connected to noise levels and road traffic.

The high percentage of the differentiated refuse collected and the characteristics of the treatment plants of the Hera Group have made possible the commencement of the correct recovery of over 62% of the refuse collected in 2002. In particular, the refuse is used for energy recovery activity (waste-to-energy



plants) or through the re-employment in productive cycles or in agriculture (CDR or compost) of the recovered materials. The Hera Group, in addition, has commenced energy recovery activity of refuse in landfills through the use of biogas, that consents the reduction of recourse to natural gas and to decrease, as a consequence, the emission into the atmosphere of polluting substance. The Tre Monti (Imola) landfill has a plant for the on-site percolated pre-treatment (and thus avoid the recourse to tank lorries for the transport in other suitable treatment plants), before transport, through underground pipes, to the urban water depurator of Santeramo Imola.

For some years the companies converged into Hera perform planning, characterisation and polluted site reclamation; in addition the company collaborates with research projects such as the study of vitrification systems of polluted grounds.

13.9.3 Water

The Hera Group, in cooperation with the authorities responsible for the planning of the use of water resources, plan and carry out interventions aimed at the increase of the amount of superficial water collected and a reduction in withdrawals of stratum water (well fields) in the territory served, concerned by the phenomenon of subsidence.

The Hera Group performs constant controls on the quality of the water distributed in order to verify the presence of any polluting substances. In relation to this, in consideration of the special composition of the aqueduct network managed, characterised by a significant percentage of pipes in asbestos cement, the Hera Group performs sample measurements in order to verify the presence of asbestos fibre in the water; the levels recorded have always resulted as significantly lower than the limits permitted in the United States regulations US EPA (Environmental Protection Agency) 1985, US EPA (Environmental Protection) 1994, in relation to drinkable water, taken as a reference by the Hera Group, as there does not exist specific laws either in Italy or in the European Union on this matter.

The principal purification plants which the Hera Group makes use of are equipped with odour treatment systems (collection and treatment with bio filters) and the plants with outgoing water in risk zones perform further refining treatment. The outgoing water from some plants (Santeramo, Bentivoglio) are subject to a "finishing", or rather a fito purification treatment in damp areas rebuilt on areas free from surface water.

13.10 Corporate Governance

The Hera Group has developed codified procedures in a series of codes of conduct in order to promote further improvement in managerial transparency in favour of the shareholders and to guarantee to the company the protection in relation to the best practice of companies quoted on the stock exchange.

With this purpose, the Board of Directors of Hera S.p.A. on November 4, 2002 approved the constitution of the Committee for Internal Control as well as the Remuneration Committee respectively to ensure a better monitoring and development of the instruments of efficient and transparent corporate governance.

In addition, on March 10, 2003 the Board of Directors of Hera S.p.A. approved the proposal "Regulations at Shareholders' Meeting of Hera S.p.A." to propose to the Shareholders' Meeting as well as the "Code of conduct of the components of statutory bodies and employees" ("Internal Dealing") of Hera S.p.A. and subsidiary Companies that operate in particular sensitive sectors, having the objective the discipline of the informative flows of the Companies by "significant persons" in relation to transactions undertaken by them on financial instruments indicated in the above-mentioned code and to improve the transparency and the homogeneity of informative to the shareholders and the market.

Finally, on April 4, 2003 the Board of Directors approved the adoption of the Self-discipline code for quoted Companies prepared by Borsa Italiana.

13.11 Significant events subsequent to the year-end

In the first months of 2003 certain events occurred and important agreements and acquisitions were made. The most important for the Group activity are summarised below.

13.11.1 Acquisitions

On January 29, 2003, with the "closing", the acquisition was completed by the joint venture Energia Italiana-Electracea of the third ENEL Genco, Interpower; thus the long tender process for the three Genco power stations was positively concluded that involved Hera (previously Seabo) through the holding (11%) in Energia Italiana. With this acquisition, under economic and financial conditions much more favourable than the preceding two generation companies, the Group is assured of the possibility of obtaining important supplies of electricity for the free market.

13.11.2 Agreements

On March 20, 2003 an important agreement was signed between Hera and Atel S.A. that sanctions the principles of a mutual cooperation in relation to electricity, energy services and the joint development of projects for the realisation of generation plants and of new electro ducts overseas. On the basis of this agreement Atel will make available to Hera energy supplies of its own share of Edipower production or of importation.

13.11.3 Corporate participations

The company "Galsi" has been incorporated that sees the participation of Hera, through the subsidiary EOS Energia, with a quota of 10%. The other shareholders of Galsi are: the Algerian company Sonatrach, one of the principal worldwide producers of methane gas, the German company Wintershall (Group BASF), Enel Power and Edison Gas. The objective of the company is to elaborate a technical, economic and financial feasibility study, for the construction of a new Algeria-Italy gas-pipeline, via Sardegna: if this study provides positive results the new infrastructure will be carried out by a second Newco to be incorporated by the same shareholders.

On February 24, 2003 the Board of Directors of Hera approved the incorporation of a joint share holding in a company with Caviro for the construction and management of a CDR electricity and steam production plant with an approximate potential of 90,000 tonnes/year. This initiative enters within the approved investment plan of Hera to consolidate its positioning in the treatment/disposal of refuse with green certificate electricity production.

13.11.4 Group participation rationalisation

From the first days of the incorporation of Hera S.p.A. a rationalisation process commenced of the corporate participations.

The Board of Directors of Hera have decided to commence unification projects/mergers and disposals/sales that relate in particular the following companies:

- > CIR Inerti, AMI Più, Ideametropoli, Astra, Torricelli, Ecolegno, Hydrolazio, V.M.BO, Ciscot, Genista, Castellammare di Stabia, for which liquidation procedures or sales have commenced
- > Dirama, CIR Secco and Selecta for which unification procedures have commenced.

13.11.5 Regional Energy Plan

The Emilia-Romagna regional council has approved the regional energy Plan identifying actions and objective directed at energy saving, the development of production of renewable and assimilated sources, and increasing the power generation capacity installed to cover the important production deficit. The strategies pursued by the Hera Group and the approved investment plans for the energy and waste management business are aligned to the energy plan of the Region and offer significant contributions to all of the objectives enunciated there in.

13.11.6 Business organisation

In March the Group organisation was definitively implemented. At the beginning of the current year the five territorial companies became operative through the conferment of business divisions, the definition of the organisational structure and the appointment at all the responsibility levels.

At the same time the rationalisation process of group personnel costs took place with the decrease in personnel of approximately 70 units in the first months of the year.

In addition procedures have commenced for the covering of some key positions in order to complete the organisation structure of the Group. The search has related to the position of Investor Relator (already in place), the person in charge of communications, the person in charge of relations with the Authorities (already selected) and the person in charge of Business Development (selection in course).

Finally it should be noted the advancement of the SAP project. Commencing from the development of the information systems of the ex-Seabo, that had already commenced the implementation of the ERP – SAP R3 system, the system is extending to the principal companies in the Group and in particular the operating companies.

13.12 Related party transactions

13.12.1 Management of services

The Hera Group performs, in almost the whole of the territory of the shareholder Municipalities, local public services of (i) gas distribution, (ii) management of the integrated water cycle, (iii) environmental operating services and collection and disposal of refuse and (iv) other services, such as district heating, heat management, the sale and distribution of electricity, refuse treatment and disposal, graveyard and funeral services and maintenance of public parks. These activities are performed by the entrusting of the services by the Municipalities.

The services entrusted by the shareholder Municipalities to the Hera Group can be summarised:

- > Energy: gas distribution and other connected services such as district heating and heat management (Area gas) and electricity distribution and sale (Area electricity);
- > Water Division: the management of aqueduct, sewerage and purification services;
- > Environment: the activity of collection and sweeping, refuse treatment and disposal;
- > Other Services: the management of the graveyard and funeral services and the maintenance of public parks.

Following the Integration, the Hera Group manages the services already entrusted to Seabo and those previously performed by AMF, AMI, AMIA, AMIR, AREA, ASC, SIS, TAULARIA, TE.AM and UNICA. In relation to this the resolution of the local public body shareholders in the companies spun-off and merged into Hera, expressly provide that for the effect of the merger and spin-off operation the previous contracts in force in the companies participating in the Integration, transfer to Hera.

In the management of these services Hera makes use of networks, plants and assets owned by the Group and manages other networks, plants and assets owned by the local public bodies who are shareholders in Hera and by the Asset Companies whose shareholders are also shareholders in Hera.

13.12.2 Energy Division

The relationship between Hera and the shareholder Municipalities for the fulfilment of services in the Energy Division have generally similar content.

The most significant relationships in the gas Area in terms of sales, costs and users served are those in place with the Municipality of Bologna, the Municipality of Ravenna, the Municipality of Forlì, the Municipality of Cesena and with the Municipality of Imola.

In relation to the relationships concerning the Gas Area the management of the service is, as is practice, entrusted exclusively to the Hera Group, in virtue of agreements of varying duration between ten and thirty-five years. Following the changes in the Letta Decree, the term for the duration of these conventions is identified as presumably as December 31, 2009.

The conventions have as their purpose methane gas distribution or similar, for heating, domestic uses, artisan, industrial and for other generic uses, as well as the production and thermal energy distribution.

The tariffs for gas distribution applied to the users are collected by Hera and are fixed in accordance with the regulations in force and the deliberations of AEEG.

In the conventions it is generally provided for the advance cancellation on the initiative of the Municipalities in the case of unjustified interruption in the gas distribution, even for short periods, by Hera as well as where this latter commits infringements in the law governing the sector so as to seriously compromise the provision of the service.

The contractual deeds also discipline the relationship with the users, the form for the management of the service, the respective accessory obligations of the parties, the maintenance charges for the functioning of the distribution network and the penalties for the irregular provision of the service that generally varies based on the type and gravity of the infringement committed.

In the electricity area, the contracts relate to the distribution of energy including, the management of the distribution network, the decisions for maintenance intervention, the programming and identification of the development interventions, the functioning of the plants, the execution of maintenance interventions and the realisation of the development interventions.

The most significant convention agreed is with the Municipality of Imola. This convention has a duration of thirty years. On its expiry it can be renewed on the basis of the provisions of article 2 of the Bersani Decree.

It is provided that AEEG can impose the suspension or the withdrawal of the concession, based on a predetermined procedure, against the confirmation of breaches and of violations attributable to the concessionaire company that compromises in a serious and sustained manner the provision of the distribution service of electricity.

In addition, there exists a right of revocation of the concession by the Municipality where, for the purposes of public order, the concession is no longer appropriate for its usage in general.

The concession does not provide for the recognition of exclusive rights.

The concessionary company is obliged to apply to the users the tariffs fixed by the current regulations in force and the resolutions adopted by AEEG.

13.12.3 Water

In the Water Business Hera manages the aqueduct service, as well as the sewerage and purification service.

The conventions with the Municipalities relate to the aqueduct service or the sewerage and purification service or the combination of the aqueduct, sewerage and purification services.

The management of the aqueduct service includes the public services of collection, purifying, distribution and sale of drinkable water for civil and industrial use; the sewerage and purification services include the management of the networks and sewage and purification plants.

In some cases the conventions also provide for the execution of the design and realisation of new networks and the construction of new plants to use in the management of the service.

The management of the service is entrusted exclusively to Hera for the municipal territory with the obligation of the Municipality not to grant to third parties the laying in the subsoil of its property or state aqueducts without the prior consent of Hera.

The duration of these conventions differentiates in relation to the different Municipalities served and varies from a minimum of ten years to a maximum of thirty years.

The conventions regulate, in addition, other aspects of the relationship such as the form of management of the services as well as reciprocal obligations between the parties relating to, principally, the charges for ordinary and extraordinary maintenance work on the networks and plants necessary for the functioning of the services. In the contracts for the services it is normally established that the Municipalities grant to Hera, even free of charge, the right to use the networks and plants for the functioning of the integrated water cycle. At the end of the concession Hera has the obligation to return to the Municipalities the assets utilised for the provision of the service. Any works carried out by Hera for the innovation or improvement of the networks must be returned, at the end of the concession, to the Municipalities against payment of the residual value of those assets.

The relationship of Hera with the users is disciplined and regulated by specific "Service Charts" that describe in detail the execution of the service by Hera and the rights of the users.

The conventions provide for the application of penalties on Hera as well as the possibility of the Municipalities to cancel the agreements in advance against, normally, the confirmation of the interruption of the service for a significant number of days due to events attributable to Hera or in the case of serious and reiterated infringements, by this latter, of the regulations in force or the provisions contained in the conventions.

The remuneration received by Hera for the management of the integrated water service is comprised of the payment of the tariffs in force applicable to the user.

The most important conventions in the Water Division in terms of revenues, costs and users served are those agreed with the Municipality of Bologna, the Municipality of Imola, the Municipality of Cesena, the Municipality of Forlì, the Municipality of Ravenna and the Municipality of Rimini.

In consideration of the level of efficiency and coverage reached by the Hera Group in the management of the water services, the Catchment Area Authorities ("ATO") of the provinces of Ravenna, Forlì-Cesena and Rimini have, on the request of the Municipalities concerned, recognised the so-called safeguard period in favour of the Hera Group in these ATO areas (respectively ATO no. 7, ATO no. 8 and ATO no. 9). This recognition represents an opportunity for growth for the Hera Group as it results in the exclusive management of the integrated water services in the Municipalities already served, as well as the entrusting of those still managed by the individual Municipalities, for the transitory period indicated by the regional law 25/1999.

The company believes it can shortly obtain the recognition of the so-called safeguard period for the water services managed in the province of Bologna (ATO no. 5), for which the Municipalities concerned have already commenced the request procedures.

13.12.4 Waste Management

In the Waste management business, the conventions between Hera and the Municipalities relate to refuse collection, road sweeping and cleaning and refuse recovery and disposal.

The management of the service is entrusted exclusively to Hera for the municipal territory. The duration of these conventions is diversified and varies from ten, twenty and a maximum of twenty-seven years.

The most important conventions in the Waste management business in terms of revenues, costs and users served are those agreed with the Municipality of Bologna, the Municipality of Ravenna, the Municipality of Rimini, the Municipality of Cesena and the Municipality of Forlì. The management of the service is entrusted exclusively to Hera.

There exists the possibility of advanced cancellation and of withdrawal from the convention by the Municipalities against (i) serious non-fulfilments and/or repetitive omissions by Hera that would compromise the provision of the service, (ii) when the company refuses to carry out orders of the Municipality for restoring the regularity of the service, and (iii) in the case Hera cedes the contract to third parties without prior authorisation of the Municipality. There are, normally, penalties applicable to Hera for the inobservance of the regulations governing the contract.

The assets, equipment and plant for the management of refuse are entrusted to Hera together with the drawing-up of a contract with obligations by the latter to return them to the Municipality subject to payment of an indemnity to the company defined by law.

The relationship of Hera with the users is regulated by specific "Service Charts" that indicate the principal information on the services provided. Hera receives payment directly from the users through the application of the tariffs in full application of current regulations in force.

Finally the conventions discipline the method for the functioning of the services, the amount payable to Hera for the services performed, the reciprocal obligations of the parties and the cost of the rental concession for the use or occupation by Hera of roads and their relevance to the performance of the service carried out.

For the use of the refuse treatment plants, the Hera Group has made specific conventions with the Municipalities where the plants are located.

In consideration of the level of efficiency and coverage reached by the Hera Group in the management of the environment services, the Environment Agencies of the provinces of Ravenna, Forlì-Cesena and Rimini have, on the request of the Municipalities concerned, recognised the so-called safeguard period in favour of the Hera Group in these ATO areas (respectively ATO no. 7, ATO no. 8 and ATO no. 9). This recognition represents an opportunity for growth for the Hera Group as it results in the exclusive management of the integrated water services in the Municipalities already served, as well as the entrusting of those still managed by the individual Municipalities, for the transitory period indicated by the regional law 25/1999.

The company believes it will shortly obtain the recognition of the so-called safeguard period for the environment services managed in the province of Bologna (ATO no. 5), for which the Municipalities concerned have already commenced the request procedures.

13.12.5 Other Services

The management of public parks and graveyard services are disciplined by conventions with the Municipalities.

13.12.6 Management of the networks, plants and equipment

The infrastructures through which the local public services are carried out, or rather the gas network and the aqueduct and sewerage networks, are in part owned by Hera and in part owned by third parties (Municipalities, Consortium of Municipalities, Asset Companies).

13.12.7 Propriety assets

Part of the assets utilised by Hera have been made available through concessions, with deferred property ownership. These assets are those conferred on the increase in share capital approved on December 30, 1996, following which the Municipality of Bologna and some of the Municipality members of the Consortium A.CO.Se.R. transferred to Seabo (now Hera) with effect from January 1, 1997 the networks, plant and equipment for the functioning of the services previously managed by the Consortium A.CO.Se.R. On January 1, 2003, the networks, plant and equipment relating to the distribution of gas under concession following the transfer described, become the property of Hera.

13.12.8 Assets conceded under rental contracts

Assets conceded under rental contracts by the Asset Companies

The most important part of the assets, originally owned by AMF, AMIR, AREA, SIS, TE.AM and UNICA, utilised for the carrying out of gas distribution and water services in the territories already served by the business divisions converged into Hera, are conceded under a rental contract to Hera in virtue of spe-

cific contracts made with the Asset Companies, in compliance with article 113 of the Legislative Decree 267/2000 as modified by article 35 of the Finance Act 2002.

The contracts provide that the Asset Companies concede in rental to HERA the business division whose purpose is the exercise of the activities of production, transport, treatment and distribution of natural gas as well as those relating to the integrated water cycle. All the works and plant relating to the exercise of the activity of the distribution of natural gas and of the water cycle that must be performed subsequent to the subscription of the rental contracts from the Municipalities or from private parties and from these transferred in ownership or in use to them will be conceded under a rental contract to HERA in compliance with separate agreements.

The aforesaid rental contracts have a duration equal to that of the gas and water service concessions entrusted to HERA, having longer expiry dates where this has been agreed between the parties or imposed by law.

Based on these contracts HERA must carry out, at its own expense, ordinary and extraordinary maintenance as well as expansion of the networks, as provided for in the investment plans agreed with the Asset Companies.

On the expiry of the contracts HERA will return the business divisions and at the same time pay the difference between the initial value of the assets on the stipulation of the rental contract (value equal to that resulting from the net book values recorded in the Asset Companies at the date of the rental) and the value of the aforesaid assets at the termination of the contract. This latter value will be calculated by deducting from the initial value of the assets that constitute the business divisions the depreciation sustained by the HERA Group on the rented assets up to the date of the return, adding to these values the net investments (or rather the net book value of the investments made by HERA up to the date of the return).

There is a provision for the cancellation of the contract in the case of bankruptcy, being placed in administration, dissolution and serious non-fulfilments by HERA. In the case of serious non-fulfilment, there is the obligation by the Asset Company to agree an appropriate period for HERA to eliminate the causes.

Integrated water cycle

For the duration of the contract after December 31, 2006, the rental will be equal to a sum corresponding to the final value (that indicated in the rental contract of the business division) multiplied by the percentage established in the tariff as a percentage remuneration on the net capital invested, as determined by the application of the normalised method for the determination of the tariffs as per the regional law 25/1999.

Gas distribution

The rental contract of the business divisions relating to energy services, does not predetermine the amount of the rental for the periods after December 31, 2006.

Assets conceded under rental contracts by CON.AMI

A rental contract has also been signed with CON. AMI for the network and assets necessary for the performance of the distribution of gas and electricity services, environmental services, water services and district heating services owned by them. This contract contains similar provisions to those contained in the contracts with the Asset Companies.

State property conceded in use to HERA together with the entrusting of the services

The state properties utilised by HERA for the fulfilment of the activities are provided in use to HERA together with the entrusting of the relative public services.

13.12.9 Guarantees conceded to HERA by the Asset Companies

The Asset Companies are committed to subscribe to specific contracts that maintain HERA indemnified from any claim relative to payables or obligations that may be requested from any creditors, on the basis and within the limitations of article 2504, second paragraph of the civil code. In addition, the Asset Companies are also obliged to intervene requiring the exclusion of HERA, in accordance with article 108 of the civil code for civil procedures, from the judicial proceedings initiated by a creditor in compliance with article 2504, second paragraph of the civil, assuming at their own cost the legal expenses of HERA.

The obligation of indemnity has a duration up to November 2, 2012.

13.12.10 Transactions between HERA and Romagna Acque

The Municipalities of Ravenna, Forlì, Cesena and Rimini, principal shareholders of HERA, are also the principal shareholders of Romagna Acque with whom AMF, AMIR, AREA, SIS, TE.AM and UNICA, participating companies in the Integration, have agreed contracts for the provisioning of water. These contracts have an annual duration and are tacitly renewed except where withdrawal is communicated with a notice period of at least three months.

HERA, following the Integration, has sub-entered into these aforesaid provisioning contracts.

The water supplied by Romagna Acque, through the secondary level aqueduct system called "Acquedotto della Romagna" that traces its origins from the artificial storage capacity of Ridracoli, has high chemical, physical and organoleptic characteristics, does not require further treatment and is delivered to HERA under high pressure so as not to require further and onerous recovery costs.

In 2002, the companies participating in the Integration acquired from Romagna Acque a total of 43,875 million Mm³ for water a total value equal to Euro 18,815 thousand.

The availability of the water supplier Romagna Acque, that integrates the sources of the HERA Group, confer to the Company high margins of reliability and continuity in the provisioning in a territory such as Romagna, particularly vulnerable due to the existence of subsidence.

13.12.11 Transactions between HERA and Con.Ami / Acantho S.p.A.

Acantho S.p.A. operates in the sector of design, realisation, installation, maintenance, management and supplier of public and private telecommunication networks and telecommunication services. HERA holds 49.74% in the share capital of Acantho S.p.A.. The remaining 50.53% is held by the consortium CON.AMI.

The current shareholder structure is the result of recent operations relating to the share capital.

On November 13, 2002 HERA ceded to CON.AMI, shareholder in HERA, 899,071 shares (equal to 34% of the share capital) for an amount of Euro 100. The parties have agreed to a right to repurchase by HERA and the corresponding obligation to sell by CON.AMI (call option) at the price of Euro 100. The call is exercisable, partially or in several tranches within 18 months of the sale of the investment.

The parties have also agreed mechanisms to adjust the exercise price where, in the intervening period between the date of the sale of the investment and the exercise date of the call, share capital operations are carried out.

This operation was rendered necessary in order to re-equilibrate the role of shareholders in relation to the territorial area served. In the determination of the price the parties took into consideration the trend in the sector in which Acantho S.p.A. operates, the amount of the assets, the forecast future economic trend as well as the right to re-purchase the investment that Con.Ami conceded to Hera as per the sale agreement.

In addition, on November 27, 2002, HERA exercised the rights option for the increase in share capital approved by Acantho S.p.A. on April 10, 2002, entirely subscribing to the aforesaid increase reserved to UNICA (company participating in the Integration) through the conferment of the rights and non-exclusive utilisation of the networks and infrastructures for the passage and installation of a fibre optics telecommunications network.

At present, therefore, the share capital of Acantho S.p.A. is equal to Euro 16,722,350 fully paid-in.

13.12.12 Transactions between HERA and Frullo Energia Ambiente S.r.l. (FEA)

FEA operates in the sector of the management of refuse treatment plants and in particular the management of the waste-to-energy refuse plant at Frullo (located at Granarolo in Emilia, Bologna, via del Frullo no. 5).

HERA holds 51% of the share capital of FEA, while the remaining 49 % is held by Actelios S.p.A.

The waste-to-energy plant was conferred on January 1, 2001 to Seabo, today HERA. The plant, in operation since 1973, incinerates solid urban and special refuse in the Municipality of Bologna and the adjacent Municipalities, producing electricity that enters the Enel network and thermal energy that is sold to the district heating network managed by HERA and destined for civil and industrial use.

Currently the work for the executive design, reorganisation and technological and environmental re-qualification of the plant are in the completion phase. The new work has the objective of increasing the potential for the disposal and production of electricity.

In relation to the contractual relationships between HERA and FEA it is noted that on December 18, 2001 a contract was agreed having as its purpose the performance by HERA of the services necessary for the management of the accounting of FEA. The contract that was valid from January 1, 2001 to December 31 of the same year, was renewed and is currently in force.

On February 27, 2002, FEA granted under a rental contract to HERA the existing waste-to-energy plant at Frullo. The rent will continue until the date in which the production of electricity commences following the completion of the technical re-qualification work of the plant

In addition, also on February 27, 2002, binding contracts were agreed relating to the conferment of refuse and the provisioning of thermal energy.

With reference to the conferment of refuse, HERA is committed to confer this, through the Put or Pay formula, for an annual minimum quantity of 136,500 tonnes. The refuse is subject to waste-to-energy treatment for the production of thermal energy. The contract has effect from January 1, 2001 and up to the date of the completion of the new plant. Commencing from that date the binding contract will come into force, relating to the newly constructed plant and have a duration of 25 years.

Finally, with reference to the provisioning of thermal energy, HERA is obliged to acquire, through the Take or Pay formula, this source of energy for introduction into the district heating network of HERA (Take). HERA is, therefore, committed to the purchase of a minimum quantity of heat per calendar year (Pay). This contractual formula is in force since January 1, 2001 and will cease effect at the date in which the plant under construction will definitively enter into function. At this date, in addition, the effects of the contract will come into operation with similar purpose to the new plant having a duration of 25 years.

13.12.13 Transactions between HERA and HERA COMM S.r.l. Unipersonale

HERA COMM S.r.l. Unipersonale is held entirely by HERA and supplies energy (gas, electrical energy and district heating) to final users, in accordance with the provisions of article 21 of the Letta Decree.

On November 20 2001, Seabo incorporated Seabo Energie S.r.l. Unipersonale with registered office at Bologna for the purpose of complying with the obligation of the separation of the sales activity from the activity of gas distribution.

Subsequently, on July 31, 2002, Seabo Energie S.r.l. approved the increase in share capital from Euro 10,000 to Euro 52,100,000 through the transfer in kind of the business division relating to the supply of energy to the final users by the sole shareholder Seabo.

On November 28, 2002, following the Integration process, Seabo Energie changed its name to HERA COMM S.r.l. Unipersonale, and at the same time changed its registered office to Imola.

Finally, on November 4, 2002, the Companies concerned by the Integration conferred their business divisions that provide energy to final users to HERA COMM S.r.l. Unipersonale following the increase in share capital from Euro 52,100,000 to Euro 87,362,741.

13.12.14 Transactions between HERA and Eos Energia S.p.A.

On May 30, 2001 the company Eos Energia S.p.A. was incorporated, in which HERA holds 72.49 % of the share capital (the remainder is held by ASM Rovigo S.p.A., AGEA S.p.A., Società Gas Rimini S.p.A., Metano San Clemente S.r.l. and Aspes Mutiservizi S.p.A.).

Eos Energia S.p.A. performs the activity of provisioning and sale of natural gas for the benefit of their shareholders and special customers.

Eos Energia has performed, on behalf of its shareholders, the negotiations that have resulted in the conclusion by the shareholders of supply contracts for the total supply of the gas requirements of its shareholders (2 billion m3) at competitive conditions for the period October 2002 - September 2003: 90% of the gas will be acquired from ENI Gas & Power S.p.A., the remaining 10% from minor suppliers; Eos Energia has also performed the negotiations that have resulted in the conclusion by the HERA Group of contracts for the supply by Enel Trade S.p.A. of methane gas destined for important final users, in the period February 2002 – September 2002.

In addition, in order to reduce further dependence on the current suppliers and create alternative options for provisioning that will consent the HERA Group to be more competitive in the free gas market, Eos Energia in August 2002 adhered to the Protocol of Understanding, subscribed to in December 2001 between Sonatrach, Algerian national company for the research, production, transformation and sale of hydrocarbons, ENEL Power S.p.A. and Wintershall A.G., a German company operating in the sector of trading in energy products (fuel and gas oil); the Protocol of Understanding has the purpose of the feasibility study, and possible participation in the management company, of a gas-pipeline connecting Algeria-Italy, via Sardegna.

Commencing from January 29, 2002, HERA provides management services for the activity of consulting and operating support of a technical – commercial nature to Eos Energia S.p.A.

13.12.15 Transactions between HERA and ASPES Multiservizi S.p.A.

HERA holds 24% of Aspes Multiservizi S.p.A., company that manages the water, distribution and sale of natural gas and environment services in some municipalities in the provinces of Pesaro – Urbino.

The current shareholding of HERA is a consequence of the awarding of the public tender by the Municipality of Pesaro, as mandatee from the public shareholders in Aspes Multiservizi S.p.A., as provided for in the public tender published in the official gazette on December 14, 2001.

Following this award, HERA on September 19, 2002 entered into a contract in which it acquired a shareholding equal to 24% of the share capital in Aspes Multiservizi S.p.A.. Based on this contract HERA it is also committed to acquire, by simple request of the public shareholders of Aspes Multiservizi S.p.A., further holdings up to the maximum amount of 65% of the share capital. The aforesaid obligation expires on September 18, 2006.

Previously, on September 17, 2002, ROLO Banca 1473 S.p.A. (now, UniCredit Banca d'Impresa S.p.A.) provided a surety for a maximum amount of Euro 27,680,976.93 exercisable on first request, in favour of the Municipality of Pesaro, as mandatee of the public shareholders in Aspes Multiservizi S.p.A., and on behalf of HERA as guarantee for the fulfilment of the obligations of this latter following the stipulation of the above contract. This guarantee has a duration equal to 4 years, from the moment of the signing of the contract, extendable to an unappealable request by the Municipality of Pesaro for a further 6 months.

Below is show a summary of the transactions between related parties:

Related party	Dec 31, 2002			
	Receivable	Payable	Costs	Revenue
Municipality of Bologna	4.191.690,29	4.452.621,97	7.469.086,90	51.471.222,00
Municipality of Cesena	1.125.000,00	572.000,00	1.831.000,00	2.805.000,00
Municipality of Imola	7.188.397,76	2.040.134,03	72.620,69	6.264.965,43
Municipality of Rimini	5.385.203,52	396.812,63	454.218,22	36.604.593,95
Municipality of Ravenna	11.602.746,00	2.157.697,00	1.749.446,00	23.217.395,00
Municipality of Forlì	805.000,00	-	1.446.000,00	5.136.000,00
CON.AMI.	356.057,64	190.579,90	4.990.186,32	696.998,63
HERA COMM S.p.A.	116.068.896,68	101.586.026,49	10.063.471,83	70.212.819,46
EOS ENERGIA	98.305,38	251.000,00	47.848.526,48	580.657,00
Frullo Energia Ambiente	2.804.066,00	2.235.038,00	13.260.948,00	1.033.877,00
ROMAGNA ACQUE	275.961,96	5.356.469,21	18.843.697,40	267.990,00
Asset Companies	-	-	-	-
UNICA Reti	4.079.000,00	8.533.000,00	10.522.000,00	-
AMF Asset	2.565.633,25	1.071.802,96	92.558,43	12.207,63
AMIA Asset	-	2.717.932,52	1.155.830,00	-
AMIR Asset	3.413.129,00	2.781.463,00	2.781.463,00	-
AREA Asset	-	13.147.639,00	8.840.598,00	-
TEAM Asset	287.257,70	360.954,51	1.111.485,84	997,50
SIS Asset	2.793.106,00	1.172.214,00	1.172.214,00	-

14. Consolidate Financial statements of the Hera Group

14.1 Balance Sheet

Assets		Dec. 31, 2002	Dec. 31, 2001
A) SUBSCRIBED CAPITAL UNPAID			
Called		718	
Uncalled			3.701
Total subscribed capital unpaid		718	3.701
B) FIXED ASSETS:			
I Intangible assets			
1) formation, start-up and similar		7.998	99
2) research, development and advertising costs		2.739	1.943
3) industrial patents and intellectual property licenses		6.738	1.576
4) concessions, licenses, trademarks and other similar		241.679	205.397
5) goodwill		94.727	3.099
6) assets under construction and payments on account		12.049	7.085
7) other		11.772	950
8) consolidation differences		5.640	2.367
Total		383.342	222.516
II Tangible assets			
1) land and buildings		120.759	27.259
2) plant and machinery		414.798	262.155
3) industrial and sales equipment		43.162	8.102
4) other fixed assets		38.761	17.043
5) assets under construction and payments on account		156.949	65.578
Total		774.429	380.137
III Financial assets			
1) investments in:			
a) subsidiaries not consolidated		820	118
b) associated companies		23.915	8.684
c) parent companies			
d) other		926	362
2) Receivables:	Payables within one year		
	Dec. 31, 2002	Dec. 31, 2001	
a) subsidiaries not consolidated	246	262	
b) associated companies			4.295
c) parent companies			
d) other	3.266	1	18.032
	3.512	1	
3) other securities		261	2
4) treasury shares			
Total	44.216	16.174	
Total fixed assets	1.201.987	618.827	

Assets (continued)		Dec. 31, 2002	Dec. 31, 2001
C) CURRENT ASSETS			
I Inventory:			
1) raw materials, supplies and consumable stores		18.936	7.580
2) work in progress and semi-finished products		197	93
3) contract work in progress		13.545	1.130
4) finished goods		740	5
5) payments on account		36	
Total		33.454	8.808
II Receivables:	Payables over year		
	Dec. 31, 2002	Dec. 31, 2001	
1) trade receivables	2.555	104	468.238
2) subsidiaries not consolidated			77
3) associated companies			4.640
4) parent companies			10.173
5) others	7.809	3.528	119.432
Total	10.364	3.632	592.387
III Current financial assets:			
1) investments in subsidiaries			
2) investments in associated companies			
3) investments in parent companies			
4) investments in other companies			
5) treasury shares			
6) other securities			8.424
Total			8.424
IV Liquid funds:			
1) bank and postal accounts			72.864
2) cheques on hands			8
3) cash-in-hand and cash equivalent			102
Total			72.974
Total current assets		707.239	217.643
D) PREPAYMENTS AND ACCRUED			
Prepayments and accruals		19.515	861
Discounts on loans			
Total prepayments and accrued income		19.515	861
TOTAL ASSETS		1.929.459	841.032

Liabilities		Dec. 31, 2002	Dec. 31, 2001
A) SHAREHOLDERS' EQUITY:			
I	Share Capital	786,531	404,124
II	Share premium reserve	11,505	11,505
III	Revaluation reserve	3,048	2,339
IV	Legal reserve	3,312	2,342
V	Reserve for own shares in portfolio		
VI	Statutory reserves		
VII	Other reserves:		
	Extraordinary reserve	286	31
	Reserve for paid in capital to cover losses	6,000	
	Reserve for accelerated depreciation	2,194	
	Share swap surplus reserve	9,399	
	Capital grants reserve		
	Reserve for valuation of investments under net equity method		
	Reserve for difference on translation		
	Reserve for profits carried forward from subsidiaries and other reserves	(13,800)	1,714
	Consolidation reserve	50	50
	Other reserves		
VIII	Retained earnings or losses carried forward		
IX	Net profits for the year	33,156	14,127
Total shareholders' equity for the Group		841,681	436,232
Pertaining to minority interests:			
X	Share capital and reserves	20,146	10,631
XI	Net profit for the year	3,459	760
Total shareholders' equity pertaining to minority interests		23,605	11,391
Total consolidated shareholders' equity		865,286	447,623
B) PROVISIONS FOR CONTINGENCIES AND CHARGES			
1)	pension and similar provision		
2)	taxation	1,393	955
3)	other	81,729	10,847
4)	consolidation provision: for future contingencies and charges		
Total provision for contingencies and charges		83,122	11,802
C) EMPLOYEE LEAVING INDEMNITY		74,209	33,441

Liabilities (continued)		Dec. 31, 2002		Dec. 31, 2001	
Payables over year					
D)	PAYABLES	Dec. 31, 2002	Dec. 31, 2001		
	1) debentures	5.165		7.747	
	2) convertible debentures				
	3) due to banks	46.761		187.395	54.788
	4) sums due to other financial institutions	139.555	60.427	157.672	73.414
	5) payments on account			1.925	224
	6) trade payables	1.154		303.632	125.733
	7) accounts payable on bills accepted and drawn				
	8) due to subsidiaries not consolidated			45	35
	9) due to associated companies			3.029	12.524
	10) due to parent companies				3.874
	11) sums payable to taxation authorities			95.294	25.305
	12) social security payables			11.492	4.040
	13) other sums payable	36.362		94.628	26.520
Total payable		228.997	60.427	862.859	326.457
E) ACCRUED EXPENSES AND DEFERRED INCOME					
	- Accrued expenses and deferred income			43.983	21.709
	- Discounts on loans				
Total accrued expenses and deferred income				43.983	21.709
TOTAL LIABILITIES				1.929.459	841.032

Memorandum account		Dec. 31, 2002	Dec. 31, 2001
A) GUARANTEES GIVEN:			
1) to third parties:			
a) guarantees	112,124	33,170	
b) endorsements	5,762		
c) other personal guarantees			
d) real guarantees	22,404	3,615	
Total	140,290	36,785	
2) to associated companies:			
a) guarantees			
b) endorsements			
c) other personal guarantees		10,329	
d) real guarantees			
Total		10,329	
B) OTHER MEMORANDUM ACCOUNTS:			
- third party assets not conferred			
- bills presented for payment	20		
- raw materials and finished products held by third parties			
- securities held by third parties	21,104		
- other memorandum accounts	1,473,722	37,370	
Total	1,494,846	37,370	
TOTAL MEMORANDUM ACCOUNT	1,635,136	84,484	

14.2 Income Statement

Income Statement		Dec. 31, 2002	Dec. 31, 2001
A) (+) PRODUCTION REVENUES:			
1) Turnover - goods and services		1.066.974	433.525
2) variation in product inventory		283	5
3) variation in contract work in progress		2.712	946
4) increases on internal work capitalised under fixed assets		30.990	11.961
5) other revenues and income:			
- other revenues and income		26.733	6.129
- grants received		5.559	2.282
Total		1.133.251	454.848
B) (-) PRODUCTION COST:			
6) raw materials, consumables and supplies		(469.269)	(224.849)
7) services		(208.046)	(50.840)
8) use of third party assets		(54.386)	(16.899)
9) personnel expense:			
a) wages and salaries		(131.218)	(51.181)
b) social security contributions		(45.425)	(18.311)
c) employee leaving entitlement		(10.067)	(3.808)
d) pension and similar costs		(120)	
e) other costs		(2.568)	(1.195)
10) amortisation, depreciation and write-downs:			
a) amortisation of intangible fixed assets		(32.110)	(18.601)
b) depreciation of tangible fixed assets		(49.361)	(22.615)
c) other write-downs of fixed assets		(983)	
d) write-down of assets forming part of working capital		(2.918)	(1.010)
11) variation of raw materials, consumables and supplies		(123)	(603)
12) provisions for contingencies		(3.481)	(682)
13) other provisions		(25.502)	(1.648)
14) other operating cost		(20.107)	(5.936)
Total		(1.055.684)	(418.178)
(A - B) DIFFERENCE BETWEEN PRODUCTION AND COST		77.567	36.670
C) Financial income and charges:			
15) (+) income from investments:			
a) subsidiaries not consolidated		433	511
b) associated companies		16	1.154
c) other companies		16	20
16) (+) other financial income:			
a) from receivables classified as fixed assets:			
- third parties		649	16
- associated companies		192	321
- parent company			
b) income from securities classified as fixed assets		30	
c) income from securities classified as forming part of working capital		90	117
d) other income:			
- third parties		3.223	2.790
- associated companies		58	
- parent company			
17) (-) interest and other financial charges:			
a) third parties		(13.706)	(7.017)
b) associated companies		(3.889)	
c) parent company		(12)	
Total		(12.900)	(2.088)

Income Statement (continued)		Dec. 31, 2002	Dec. 31, 2001
D) ADJUSTMENT FINANCIAL ASSET VALUES			
18) (+) revaluations:			
a) investments	5,654		
b) financial fixed assets			
c) securities included under assets forming part of working capital			
19) (-) write-downs:			
a) investments	(7,101)	(2,493)	
b) financial fixed assets			
c) securities included under assets forming part of working capital			
Total adjustments to financial assets values	(1,447)	(2,493)	
E) EXTRAORDINARY INCOME AND (EXPENSE)			
20) (+) extraordinary income:			
a) gains	9,918	2,171	
b) gains on assets sales	7,016	722	
21) (-) extraordinary expense:			
a) expense	(4,592)	(3,296)	
b) loss on assets sales	(288)	(250)	
c) taxes relating to prior years			
Total extraordinary items	12,054	(653)	
Profit before taxation	75,274	31,436	
22) (-) taxation on profit for the year:			
a) current taxation	(46,384)	(16,233)	
b) deferred taxation	7,725	(316)	
23) Net profit for the year	36,615	14,887	
Net profit for the year pertaining to minority interest	(3,459)	(760)	
Net profit for the year pertaining to the Group	33,156	14,127	

The Board of Directors

14.3 Form and contents of the Consolidated Financial Statement

14.3.1 Structure and format of the consolidated financial statements

The consolidated financial statements consist of a balance sheet, income statement and notes (prepared in the format required by article 25 of the Legislative decree no. 127/91 and subsequent modifications), which provide the information required by article 38 of the aforesaid decree.

The consolidated financial statements are presented in comparative format with the financial statements of the previous year prepared by Seabo S.p.A. Due to the effect of the previously mentioned integration operation the financial, economic and equity data at December 31, 2002 are not comparable with those in the previous year and, as a consequence, a comparison with the same would not be significant. For a better understanding of the financial statements reference should be made to the report of the directors on the operations, which includes a comparison of the data for the year 2002 with the pro-forma data for 2001.

14.3.2 Consolidation area

The consolidated financial statements of the H.E.R.A. S.p.A. Group includes the financial statements of the Parent Company and those companies in which H.E.R.A. S.p.A. directly or indirectly controls the majority of the voting rights at an ordinary shareholders' meeting, the companies in which it holds sufficient voting rights to exercise a dominant influence at an ordinary shareholders' meeting, the companies in which it has a dominant influence in virtue of a contract or the bye-laws of the company, where the applicable law consents this, and the companies in which it has autonomous control of the majority of the voting rights based on agreements with other shareholders.

The investments in subsidiaries whose size is insignificant, the associated companies whose voting rights are subject to serious and long term restrictions and the subsidiary companies held for the exclusive purpose of their successive disposal are excluded from the full consolidation method.

There are no companies consolidated with the proportional method.

The investments in associated companies classified under non-current assets whose values are not insignificant are valued under the net equity method. Those companies in which H.E.R.A. S.p.A. holds directly or indirectly at least one fifth of the voting rights at an ordinary shareholders' meeting are considered associated companies.

The investments in non-consolidated subsidiaries and associated companies classified under non-current assets whose values are insignificant or non-operative are valued under the cost method.

The subsidiary Seabo Energia S.p.A., previously excluded from the consolidation area became operative during the year and is therefore included under the full consolidation method. The company has changed its name to HERA COMM S.p.A..

Following the conclusion of the integration operation between Seabo S.p.A. and the companies AMI S.p.A., AMIA S.p.A., AMF S.p.A., AREA S.p.A., ASC S.p.A., TAULARIA S.p.A., TEAM S.p.A., UNICA S.p.A. (the so-called "Perimetro Romagnolo Companies") and the companies AMIR S.p.A. and SIS S.p.A. (the so-called "Adhering Companies" in so far as they adhered in a second phase to the integration with Seabo and the companies of the Perimetro Romagnolo), Seabo changed its name to HERA S.p.A.. In this manner the companies controlled by the "Perimetro Romagnolo Companies" and the "Adhering Companies" entered into the consolidation area during the year.

At the same time as the integration operation Seabo changed its name to HERA S.p.A..

This aggregation was made by way of the following extraordinary corporate operations:

- merger by incorporation in Seabo of the companies AMI S.p.A. and TAULARIA S.p.A.;
- proportional partial spin-off, with Seabo as the sole beneficiary, of the company divisions of the other Perimetro Romagnolo Companies and of AMIR and SIS, having as objective the performance "of the business of distribution of public services to end users" as defined by Article 35 of Law No. 448 of December 28, 2001.

The list of the companies consolidated by the full consolidation method and the net equity method, as well as the investments in subsidiary and associated companies excluded from the consolidation area are shown at the end of the present notes.

14.3.3 Reference date

The consolidated financial statements are prepared on the basis of financial statements approved at the shareholders' general meeting or in the absence of this, the financial statements approved by the Board of Directors as at December 31, 2002.

In the case where the statutory financial statements do not close at the end of the calendar year, consolidated financial statements are prepared to coincide with the year-end of the Group.

14.3.4 Consolidation principles

The financial statements used for the consolidation are the financial statements of the single companies. These financial statements have been duly reclassified and adjusted so that they comply with the accounting principles of the Parent Company, which are in compliance with Articles 2423 and subsequent articles of the Civil Code and those recommended by CONSOB.

In the preparation of the consolidated financial statements, the assets and liabilities and the income and expenses of companies included in the consolidation are fully included. However, the receivables and payables, income and expenses, profits and losses resulting from operations carried out between companies included in the consolidation have been eliminated. The carrying value of the participations consolidated is eliminated against the corresponding quota of the subsidiary's net equity.

The difference between the carrying value of the participations, that is eliminated, and the corresponding quota of the subsidiary's net equity, is recorded as an adjustment to the consolidated net equity. In the event of acquisitions, the aforesaid difference is attributed to the elements of assets and liabilities of the companies included in the consolidation. Any remaining difference, if negative, is recorded in the account consolidation reserve, or, where it is the result of expected unfavourable economic results, in the account consolidation provision for future contingencies and charges. If it is positive, the difference is recorded in the balance sheet under consolidation difference. The amount of capital and reserves of subsidiaries relating to third parties are recorded within shareholders' equity in the account "Total shareholders' equity pertaining to minority interests". The portion of the consolidated result relating to third parties is recorded in the account "Net profit (loss) for the year pertaining to minority interests".

The taxes on non-distributed profits of the consolidated companies are not recorded, as it is assumed that they will be distributed with the application of a tax credit for the parent company or will be reinvested within the group.

14.3.5 Accounting principles and policies

a) General criteria

The accounting principles and policies have been applied in a uniform manner for all of the companies consolidated. The accounting principles adopted in the consolidated financial statements are those utilised by the Parent Company H.E.R.A. S.p.A. and are in conformity with the legislative requirements previously mentioned above, integrated and interpreted by the Accounting Principles issued by the Italian accounting profession (Consigli Nazionali dei Dottori Commercialisti e dei Ragionieri).

The accounting principles utilised in the year do not differ from those utilised in the preparation of the consolidated financial statements in the previous year, in particular in the valuation and in the continuity of these accounting principles.

The financial statement items have been valued in accordance with the general criteria of prudence and accruals and on a going concern basis.

The profits are recorded only if realised within the end of the year, while consideration is made of risks and losses even if known subsequent to the year-end date. Similar account items classified together in the financial statements are valued separately. The assets that are destined to be used in the long-term period are classified under non-current assets.

b) Adjustment to values and write-backs

The values of tangible and intangible assets whose useful life is limited are adjusted in value through the provision of amortisation and depreciation. These assets and the other assets in the balance sheet are written-down if there is a permanent impairment in their value; the original value is restored if the reasons for their write-down no longer exist. The method of amortisation and depreciation and write-downs adopted are described in the present notes.

c) Revaluations

No revaluations have ever been made except those as permitted by specific legislation in relation to tangible assets.

d) Departures

In the present and in the previous years no departures from accounting principles took place in the preparation of the financial statements and consolidated financial statements as permitted by legislation.

The most important accounting principles are as follows:**e) Intangible assets**

Intangible assets are recorded at the acquisition or production cost inclusive of directly allocated charges or at conferment value established by expert's appraisals on the business assets, and amortised on a straight-line basis for the period of their envisaged future use.

The amortisation commences when the asset is available for utilisation or in any case begins to produce economic benefit for the business.

Set-up and expansion costs, and research and development costs that can generate future benefits are recorded in the balance sheet and amortised over the period of their future economic use, but in any case not greater than five years. The set-up and expansion costs relating to landfills and land rights are respectively amortised based on the relationship between tonnes of refuse treated and the future potential of the landfill and in relation to the residual duration indicated in the construction contract of the land rights.

Advertising costs are charged directly to the income statement.

Industrial patent rights and copyright utilisation rights consist mainly of software purchased for ownership and are amortised on the basis of a period of presumed future use but in any case not greater than 5 years.

Concessions, licences and trademarks principally relate to concession rights for the management of public services and are amortised on a straight-line basis over the lesser period between the economic/technical life of the assets granted and the duration of the concession.

Goodwill is recorded only if purchased, up to the amount paid and amortised over a period not greater than its utilisation. It is noted that the share swap deficit deriving from the incorporation process, supported by a expert's valuation appraisal, is classified under goodwill and amortised over a period of ten years commencing from the effective date of the mergers.

Assets under construction and payments on account included in intangible assets relate to sums paid in on account and the costs sustained for which the full rights have not yet been acquired or for research and development activity relating to projects not yet completed.

The other intangible assets are recorded at their purchase cost, inclusive of accessory charges and principally relate to improvements to leasehold assets, which are amortised for the lesser period between the economic/technical life of the asset and the duration of the concession and for penalties on renegotiating loans amortised on the basis of the duration of the loans.

The consolidation difference arises in the consolidated financial statements on the elimination of the carrying value of the participations consolidated against the corresponding quota of the subsidiary's net equity. Any positive difference not attributed to the assets of the companies included in the consolidation, is recorded as an adjustment to the consolidated net equity or where the necessary conditions exist, recorded under assets in the item "consolidation difference": this item is amortised over the period in which the benefits are expected to arise, with a maximum limit of ten years.

The intangible assets whose economic values at the end of the period are permanently impaired are written-down to their net realisable value. If the reasons for the write-down no longer exist they are restored to their original value.

f) Tangible assets and amortisation

Tangible assets are recorded at the acquisition or production cost or at conferment value established by expert's appraisals on the business assets. Included in cost are directly allocated charges: the value of internally constructed assets with internal resources and all the directly attributable costs.

Tangible assets include assets gratuitously received: they are depreciated each year on a straight-line basis on economic/technical rates determined from the residual possible future use of the asset.

In relation to depreciable assets with a modest unit value that can only optimally be used within the course of the year, in view of their rapid consumption and high susceptibility to damage, the write-down has been calculated on a prudent basis envisaging a single depreciation rate equal to the cost of the asset.

Normal on-going maintenance costs are charged in full to the income statement in the year in which they are sustained. Maintenance costs that result in an increase in the productive capacity of the assets or increase the security are attributed to the assets to which they refer and amortised according to the possible residual utilisation of such assets.

The depreciation rates used, unchanged compared to the previous year, are as follows:

General services	min. %	max %
Land		
Buildings	1,51	3,00
Light constructions	5,00	10,00
General plant	7,50	15,00
Equipment	5,00	10,00
Office furniture and machines	6,00	12,00
Data processing machinery	10,00	20,00
Vehicles and internal means of transport	10,00	20,00
Auto vehicles	12,50	25,00
Measurement and laboratory instruments	5,00	10,00
Remote control	10,00	30,00
Electric cabins	3,50	7,00

Purification services	min. %	max %
Land		
Buildings/Civil works	1,50	3,03
Buildings IDAR construction section	5,00	10,00
Buildings Punta purification	5,00	10,00
General and specific plants	7,50	15,00
Specific IDAR plants	5,00	10,00
Specific ITFI plants	5,00	10,00
Specific Punta purification plantsPunta	5,00	10,00
Lifting plants	6,00	12,00
Laboratory equipment	5,00	10,00
Network	2,50	5,00
Electric cabins	3,50	7,00
Equipment	5,00	10,00
Furniture	6,00	12,00

District heating and gas service	min. %	max %
Land		
Stage one units – Abstraction		
- Buildings	2,75	5,50
- General plant	7,50	15,00
- Specific plant	5,00	10,00
Stage two units – district – specific plant	5,00	10,00
User reduction units – specific plants	4,00	8,00
Distribution network	4,00	8,00
Outlets	4,00	8,00
Meters	5,00	10,00
Cathodic protection	4,00	8,00
Electric cabins – specific plants	3,50	7,00
Co-generation and district heating		
- Production – buildings	2,75	5,50
- Production – general plants	4,50	9,00
- Production – specific plants	4,50	9,00
- Distribution network	4,00	8,00
- Heat exchange unit	4,50	9,00
- Electric cabins	3,50	7,00
Equipment	5,00	10,00

Water service	min. %	max %
Land		
Buildings/Civil works	1,75	3,50
Wells		
- Buildings/Civil works	1,75	3,50
- General and specific plant	1,25	2,50
Abstraction – Buildings/Civil works	1,25	2,50
Lifting and fresh water stations		
- Buildings/Civil works	2,50	3,60
- General plants	7,50	15,00
- Specific plants	6,00	12,00
- Fresh water plants	4,00	8,00
Reservoirs	2,00	4,00
Pipelines and distribution network	2,50	5,00
Intakes and connections	2,50	5,00
Meters	5,00	10,00
Electric cabins – specific plant	3,50	7,00
Vehicles	10,00	20,00

Environment service	min. %	max %
Land		
Buildings	1,50	3,00
Secondary real estate units	1,50	3,00
General plant	7,50	15,00
Specific IIR plants	5,00	10,00
Specific BIOGAS plants, storage +IRE	5,00	10,00
Specific waste composting plants	5,00	10,00
Vehicles and internal means of transport	10,00	20,00
Waste containers and equipment	5,00	10,00
General equipment	5,00	10,00
Snow service equipment	5,00	10,00
Hygienic equipment	5,00	10,00
Light constructions	5,00	10,00
Auto vehicles	12,50	25,00
Controlled landfills	5,00	10,00

Funeral service	min. %	max %
Industrial and commercial equipment:		10,00
- Minor equipment (SOT)		10,00
- Various machines (SOT)		16,70
- Automobiles		6,70
- Furniture and office machines		

The depreciation rate applied in the year of acquisition is 50% of the normal rates considered a reasonable approximation of the period held for the acquisitions made in the year.

Financial leasing contracts are recorded within tangible assets in the category of assets they refer to and are amortised, as for propriety assets, over the period of possible residual utilisation. Within liabilities a payable is recorded, under short-term and medium term, towards the leasing company; the lease payments are reversed from expenses for the use of third party assets and the quota for the period of financial charges are recorded in the financial statements. In this manner a representation of financial leasing contracts is obtained in accordance with the so-called "finance method" as required by International Accounting Principle (I.A.S.) no. 17, that best represents the economic substance of the financial leasing contracts in place.

g) Financial assets

The investments recorded in this item relate to long-term investments.

The investments in "non-consolidated subsidiary companies", as they are not fully operative at the year-end or not significant in relation to the consolidated net equity or result, are recorded in the financial statements at acquisition cost or subscription.

The investments in "associated companies" are valued according to the net equity method and thus for an amount equal to the corresponding fraction of the net equity resulting from the latest financial statements of the company, after the deduction of dividends and the adjustments required by the accounting principles of the consolidated financial statements.

The profits and losses deriving from the application of the net equity method are recorded in the income statement under the line items "revaluation of investments" and "write-down of investments" respectively.

In the case of non-operative companies the investments in associated companies are valued under the cost method.

The other investments and securities are valued at cost. In the case of permanent impairment in value, deriving also from stock exchange quotations, a write-down is made and in the year in which the conditions for the write-down no longer exist, they are restored to the value prior to the write-down.

The "treasury shares" recorded in current and non-current assets are recorded at acquisition cost. Included in treasury shares are the shares of the parent company held by other consolidated companies. In the net equity a specific reserve has been created equal to this amount.

The receivables of a financial nature are recorded at their realisable value.

h) Inventory

Inventories are valued at the lesser value between cost of acquisition or production, inclusive of accessory charges, and their market value at the end of the period.

The cost configuration adopted is that of LIFO (last in, first out).

Stocks of obsolete or slow-moving articles are written down bearing in mind their possible utilisation or sale.

Contract work in progress is valued at cost.

i) Receivables

Receivables are recorded at their nominal value taking into account the solvency of the debtors, the overdue period of the receivables, existing contentious issues and the guarantees exercisable.

This value is obtained through direct provisions against the receivables in an analytical manner for the most significant positions and as a general provision for the other positions.

The recording of the receivables at their realisable value is made through the creation of a specific provision for doubtful debts. Trade receivables also include the allocation of income from gas and water supplied but not yet invoiced. This is estimated at the end of the period on the basis of historical analyses determined according to previous consumption levels.

l) Current financial assets

The current securities are valued at the purchase cost or realisable value, taken from market prices in the case of quoted securities, if lower. This lower value is not maintained where the reasons no longer exist.

m) liquid assets

The liquid assets are expressed at their nominal value and are not subject to restrictions.

n) Prepayments and accruals

Prepayments and accruals are recorded based on the accruals principle of costs and revenues covering more than one accounting period.

o) Employee leaving indemnity

The employee leaving indemnity relates to the entire liability due to employees under current laws and collective labour/supplementary company contracts in force in Italy.

p) Provision for contingencies and charges

Provisions for contingencies and charges are recorded in respect of certain or probable losses or liabilities, the amount or due date of which could not be determined at year-end. The provision includes the provision for deferred taxation that is provided in the case of deferred taxation to pay on significant components of income.

The reserve made against the post-closure landfill costs are charged to the income statement based on external technical expert's appraisals.

The reserve for the restoration of third party assets relates to the provisions charged to the income statement necessary to ensure the restoration of the networks, plant and assets under rental at the moment of restitution.

q) Payables

Payables are recorded at their nominal value.

r) Risks, commitments, guarantees

The commitments and the guarantees are shown in the memorandum account at their contractual value.

The risks for which it is probably a liability will arise are described in the notes and a provision is made under provision for contingencies and charges. The risks for which a liability is only a possibility are described in the notes, without any provision in the provision for contingencies and charges, in accordance with the applicable accounting principles. No consideration is made of remote risks.

s) Recognition of revenues and costs

Revenues and costs are stated net of returned items, discounts and rebates, and net of direct taxes related to the sales of products and services rendered.

More specifically:

- > revenues from gas and water sales are recognised and recorded at the time they were supplied. The account also includes allocations of revenues in respect of the provision of gas and water that has been supplied but not yet invoiced at the end of the period, which has been estimated on the basis of historic analyses determined according to prior consumption levels;
- > revenues from services rendered are recognised on the basis of services provided and in compliance with the relevant contracts;
- > revenues for connection and extension of the network are recorded in accordance with the accruals principle;
- > revenues from the sales of goods are recognised at the time of the transfer of ownership;
- > costs are stated in accordance with the accruals principle;
- > financial income and expenses are recognised in accordance with the accruals principle;
- > dividends from subsidiaries are recognised on an accruals basis according to the period in which the credit entitlement materialised. Fiscally, the dividends are recognised on a cash receipts basis. The entitlement to the relevant tax credit also arises on the cash receipt of the dividends. Where the collection of dividends takes place in a financial year subsequent to that in which they are recorded, the relevant deferred tax is recorded in the year to which they relate.

t) Income taxes

Income taxes are determined on the basis of the fiscal assessable result of each of the companies consolidated in accordance with current fiscal regulations in force. In the consolidated financial statements deferred taxation is recorded on temporary timing differences between the fiscal assessable result of the companies consolidated and those of the financial statements utilised for the consolidation.

The deferred taxes are calculated based on current rates in force at the moment the temporary difference arises and adjusted to take account of changes in rates each year.

15. Report of the Statutory Auditors

REPORT OF THE BOARD OF STATUTORY AUDITORS ON
THE CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2002 – December 31, 2002
(in accordance with article of 41 of the legislative decree no. 127 of April 9, 1991)

Dear Shareholders,

The consolidated financial statements for the year January 1, 2002 – December 31, 2002 prepared in accordance with article of 41 of the legislative decree no. 127 of April 9, 1991, is comprised of the Balance Sheet, Income Statement and notes thereto accompanied by the directors' report on the operations.

It should be noted that the complex corporate integration operation between Seabo Spa and other companies in the Emilia Romagna region, for a description of which reference should be made to the detailed information contained in the notes to the financial statements and the directors' report on the operations, resulted, due to the retrospective effective accounting date of the operation to January 1, 2002, in significant differences in the financial data contained in the Balance Sheet and Income Statement compared to the previous year.

The financial statements, subject to control by the Board of Statutory Auditors in accordance with article of 41 of the legislative decree no. 127 of April 9, 1991, presents the following summary results expressed in thousands of Euro:

TOTAL ASSETS	Euro	1,929,459
GROUP SHAREHOLDERS' EQUITY	Euro	841,681
MINORITY INTEREST CAPITAL AND RESERVES	Euro	23,605
LIABILITIES	Euro	1,064,173
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	Euro	1,929,459

The memorandum accounts shown as an attachment to the balance sheet amounts to Euro 1,635,136 thousand, as also indicated in the notes to the consolidated financial statements of the Group.

The consolidated net profit for the year 2002 amounts to Euro 33,156 thousand compared to Euro 14,127 thousand for the previous year as follows:

A) Value of production	Euro	1,133,251
B) Costs of production	Euro	(1,055,684)
Difference	Euro	77,567
C) Financial income and charges	Euro	(12,900)
D) Adjustment to financial assets	Euro	(1,447)
E) Extraordinary income and charges	Euro	12,054
Net profit before taxes	Euro	75,274
Income taxation	Euro	(38,659)
Minority interest profit	Euro	(3,459)
NET PROFIT FOR THE YEAR	Euro	33,156

The consolidated financial statements and the directors' report on the operations have been audited by the audit firm "Deloitte & Touche S.p.A.".

The Board of Statutory Auditors have performed the following controls:

A) CONTROLS MADE ON THE CONSOLIDATED FINANCIAL STATEMENTS AND THE NOTES THERETO

Our examination was performed in accordance with the code of conduct for the Board of Statutory Auditors, and in conformity with those principles we have referred to the legislative provisions that govern Consolidated Financial Statements integrated and interpreted by the Accounting Principles issued by the Italian accounting profession (Consigli Nazionali dei Dottori Commercialisti e dei Ragionieri).

The consolidated financial statements correspond to the underlying accounting records and the information provided by the Companies included in the consolidation, as well as the underlying accounting records of the Parent Company "Hera S.p.A".

The consolidated financial statements correctly present the consolidated balance sheet, financial position and result for the year 2002, in conformity with the legislation that governs consolidated financial statements as mentioned above.

The financial statements of the subsidiaries and/or associated companies were verified in accordance with legislation by the respective Board of Statutory Auditors and their relative reports were reviewed by us.

The notes to the Consolidated Financial Statements provide the necessary information relating to the consolidation area and the consolidation principles adopted and valuations made.

B) CONTROLS MADE ON THE DIRECTORS' REPORT ON THE OPERATIONS

The directors' report on operations accompanying the Consolidated Financial Statements for the year 2002, was verified by us in order to ascertain the respecting of its contents in accordance with article of 40 of the legislative decree no. 127 of April 9, 1991 and its compatibility with the Consolidated Financial Statements as required by article of 41 of the legislative decree no. 127 of April 9, 1991.

On the basis of the verifications made, the Board of Statutory Auditors believe that the directors' report on operations of the Group is correct and is compatible with the Consolidated Financial Statements.

The Board of Statutory Auditors also verified that the Consolidated Financial Statements were integrated with the reconciliation between the Net Equity and result for the year of “Hera S.p.A.” and the consolidated Net Equity and result for the year.

The Board of Statutory Auditors having reviewed and considered the Consolidated Financial Statements for the year 2002 of “Hera S.p.A.” and of the subsidiary and/or associated Companies presented for your attention, represented in a true and fair manner the balance sheet, financial position and income statement of the group, expresses a favourable opinion.

Bologna, April 14, 2003

THE BOARD OF STATUTORY AUDITORS

Antonio Venturini – President

Fulvio Medini – standing auditor

Fernando Lolli - standing auditor

16. Report of the Auditing firm

16. Report of the Auditing firm

This document is a summary of the fully translated Financial statements as at 31 december 2002.
Deloitte & Touche has fully audited the Financial Statements of Hera S.p.A. (Holding Company) and the
Consolited Financial Statement as at 31 December 2002 of Hera Group.
The audit opinion issued by Deloitte & Touche do not contain qualification.

Realizzazione grafica ed editoriale
Barabino & Partners

Stampa
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maggio 2003