

Q1 2021 Earnings Call

Company Participants

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

Other Participants

- Analyst
- Javier Suarez

Presentation

Operator

Good afternoon. This is a Chorus Call operator. Welcome to the Q1 2021 Financial Results of Hera Group. All participants are in a listen-only mode. (Operator Instructions)

I'd now like to give the floor to Mr. Tomaso Tommasi di Vignano, Hera Group's Executive Chairman. You have the floor, sir.

Tomaso Tommasi di Vignano {BIO 1449180 <GO>}

Good afternoon, everybody. We have just wrapped up our Board meeting, which was a little longer than expected, and I hope you have received the press release today. What we want to share with you today is that in this first quarter of the year we decided to look broadly to all of the strategic levers we use, which you are familiar with ever since we presented the business plan, to support a phase which at the time seemed to be especially complex. But in fact, what we did see was that our results were better than expected. And I think you will agree with us on that. The first quarter did have a number of fairly important things to look at, but things are going well.

Let me mention something, which I think is the backbone of my presentation. Namely that we are so convinced of the fact that we are headed in the right direction with good results. And so much so in fact that we made some partial corrections, regarding the dividend as you may remember. Although I'll be mentioning that later on, because what we felt was fair was that since things were better than expected in the midst of the pandemic. We felt we could afford to review the dividend policy.

And as you'll be hearing today, we are working and we're also looking for the future to see whether or not we can improve things. And even more, when it comes to the forecast we had made in that initial phase I mentioned. So, this is the meaning behind the things

we did, of course, in light of the positive results we posted during the quarter and this is what we want to present to you today.

As I was mentioning a recipe hasn't changed, the context has changed, whereas our job was to continue to focus on the things we did regardless of the things, which happened outside of the company in terms of difficulties, which Stefano will be going over some figures, with show how committed we were to growth and to sustainability, without going into other aspects. I think these two are the summary of our traditional strategy.

And the performance, we were able to obtain compared to our expectations it was better and it had an impact on our dividend policy. And we also wanted to see whether or not other items in the business plan could be further updated. And all of these elements, I think are important because they help us to consolidate our competitive profile during the year is of course, the world didn't stop. So, what we saw for instance was that our ability to continue to be competitive and tenders were something that allowed us to obtain good results in the past. But we were also able to be successful even in the regulated businesses.

And finally, the tenders in the regulated businesses brought about some very satisfactory results in our territory. We have experimented a couple of tenders in the waste sector, in the waste collection business, specifically and also in the water sector. The most recent tender we made a bid in was for the gas distribution sector, making it the very first gas distribution tender in our area. And we put a lot of effort into focusing on all of the events in the period. We also had a number of new element to the business that we will be able to announce officially as soon as possible.

So, the results we posted are in line with the trends we had seen during the previous year, before we had to face all the problems you're familiar with. And now, let's see what numbers we're actually referring to. The main results started to happen once things started getting back to a somewhat normal situation after we're able to overcome a few of the critical aspects. I'm referring to the problems links to the lockdown period.

And another thing, which was beyond our control was, of course, the mild winter last year, which didn't help us, of course, in our job. Whereas this year, the situation links to the COVID pandemic, a least, as far as governments and institutions, we're able to deal with it, despite a certain degree of confusion they had. They did try to choose a path to overcome the pandemic and even the climate wasn't -- as it was last year. So, these two elements, of course, are part of the general positive scenario.

Moving on to the business by business breakdown. The growth we're seeing in Q1 is a purely organic form of growth. And I will be explaining the reason behind that. You'll be seeing for the figures that all we have is organic growth. EBITDA was up by EUR13 million. EBIT was up by EUR11 million and the net profit was up by EUR8 million. And the interesting thing to notice that besides a good growth, we were also be able to allow our free cash flow to grow by 3x compared to the same period last year. That too, I think, it's always useful, especially when you plan to grow even more in the coming months.

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We have a EUR150 million in Q1 this year compared to the EUR50 million we had in Q1 last year. So, all in all, I think our results were in line with what we were expecting. There is plenty of room to consider other opportunities, even externally. Because, as we've had said in the press release, when we approved our most recent business plan, we have been continuing to work externally. And therefore, we are very close to the signing of operation of agreements, which will be implemented towards the end of the Q2.

And I think these agreements we will be able to launch some signals and messages to our competition, especially in the waste sector. And more specifically in the industrial waste business, where we are well positioned, but which also has to have a specific geographical approach, because of course, it's never a good idea to travel too far, between one's assets and one's clients.

We have to make sure that we have a presence in regions other than our traditional lines. That's what we'll be announcing soon during the next meeting we'll having. Because as I said, the agreement will be formalized by the end of Q2. That's when we intend to finalize the transactions we've been working on over the past few months. We have always also had some negative signs, of course. As you know, the safeguarded tenders will reduce a little bit. We obtained a little bit less than what we expected, but that's not necessarily a bad thing. As you know, that market is made up of bad payers, and therefore, we will be seeing, what the future we will hold regarding these tenders, who weren't awarded this time around.

As far as other things, which didn't work as we expected, I have to underline the fact that we had a stop in the Teverola plant, which lasted for a good part of the quarter. And which of course, had an impact on the ancillary services business, which did very well in 2020. Although we are beyond that, that the plant is now up and running again, and therefore the problem has been solved.

So, as we are summarizing what we've seen earlier, given the things I've said, I think, we have to mention the fact that we have been able to overcome the negatives that we saw and year-end last year, which had an impact on the growth that we were able to obtain during that quarter of last year due to the lockdown and due to the mild weather. We want to be positive, which is what our numbers deserve I think. Because our plans in fact haven't been reduced in any way, and in fact the upcoming nine months, we'll see us working hard, as we did during Q1. And there are quite a few wonderful things that we will be able to do.

I'll hand it over to Stefano now, who will be very happy to give you some even more specific details.

Stefano Venier {BIO 17107208 <GO>}

Good afternoon, everybody. Let's begin with Page 4 in the presentation with a business-by-business breakdown. We posted a slight decline in the networks sector, as we will be seeing later on. This is the consequence of some of the effects of tariffs stemming from

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2020, partly due to burden on electricity and efficiency. And in Q1 2021 compared to 2020, we had higher cost of electricity.

As far as energy is concerned, we made a another significant step forward from EUR138 million last year, which included the contribution of the recently consolidated activities of Ascopiave company, whereas in Q1 this year we stand at EUR151 million, which includes some of the synergies and efficiencies we worked on in 2020. Within that figure, we also have the positive results we obtained from the energy services, especially the activities led to incentives on condominium renovation works. We were also able to benefit as Chairman was saying, from the better weather. Besides having some higher activities, but the better weather had a positive impact on gas.

In the waste sector, we have a slight growth, which is the compensation, the offsetting of a slight decline in the risk collection, vis-a-vis a good trend in waste treatment and recycling. The volumes were higher compared to last year. Plastic recycling activities went very well as will be seeing. They've improved by 8% to 9% compared to 2019. And the price of electricity, in this case, also leads to a positive effect compared to the cost I mentioned earlier. The other activities have a slight growth boosted by public lighting.

On Page 5, you have the details on an area-by-area level referring to the various regulated businesses. Gas distribution is slightly on the decline, minus 1.3, due to energy efficiency and the tariff review, which as I mentioned happened in early 2020. Last year, we were able to offset that with other items, which were one-offs, electricity were stable, water as minus 2.2 that has an impact brought about by the cost of electricity and a few reviews on WRG.

And then as far as district heating is concerned, we had an improvement equal to 1.1 million. The business-by-business breakdown and this is one of the questions you always ask. In the Q1 2021 is equal to EUR130 million, EUR55 million of which refer to water distribution. The EUR11 million refer to electricity distribution, EUR56 million referred to gas distribution, and the remaining part refers to district heating.

This is it in a nutshell, the Chairman was mentioning the trend, he is referring to the tenders for concessions. Last time, we met we talked about the water tender for Rimini. We still haven't had the official assignment yet. They are still working on assessing the offers and we'll wait patiently for the final outcome. We've also reached the final phases in the tender for the gas distribution concession in the Udine 2 catchment area.

Moving on to the energy sector. Things went very well, especially the part links to sale of gas. The electricity, which has a slight dip worth EUR1.2 million. But as we mentioned earlier, we do know that as far as 2021 is concerned, our presence of safeguarded market is significantly lower compared to, we had in previous years. And this, of course, brought about a reduction equal to EUR7 million from that side of the business in the quarter, but we also had EUR6 million and better profitability in the liberalized market, which almost entirely offset this change.

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As far as gas is concerned, things went very well. We have higher volumes; we have better margins. And in fact, these results will be derived on to the rest of the year as well. We mentioned the procurement coming in from the TAP pipeline. We have 300 cubic meter supply from that. This has been brought ahead of schedule compared to the initial schedule, which would have let that gas pipeline to started in July 1st. And therefore, this is a good trend that we saw in Q1. EUR7.2 million refer to value-added services and energy services. Of the EUR7.2 million we have EUR6 million, which are connected to incentives for condominiums.

This is the Super Ecobonus or the facade bonus and all of those other incentives, which refer to renovation activities as a way of improving energy efficiency of buildings. The remaining portion of the EUR7.2 million is refers to value-added services. In power generation, we have a EUR5.1 million contraction, which is essentially brought about by the lower profitability in the ancillary services market linked to the stop of the Teverola plant we had in February. And also partly due to the fact that the extraordinary situation we had between March and April last year, with a higher demand this year, we did not have the same conditions we had last year. So, it is the combined effect of these two things, I mentioned. Although the results of the energy sector for the quarter were extremely satisfactory.

And then finally, moving up to the waste business. As I mentioned, the waste collection business has EUR3.3 million decline compared to Q1 last year. On the one hand, this is due to the cost of disposal, which grew in the special waste sector, and also grew in the urban waste sector. And then on the other hand, we also have a waste collection management cost, links to the need to use personal protection equipment, which of course, has an impact on these types of activities.

Then when it comes to plastic recycling, things went very well, as I mentioned, we have a plus 17% in volumes compared to 2020. But also as a way of giving you a more reliable comparison, we have a plus 8% compared to 2019, which means that we are swiftly heading towards our target, which is equal to almost 100,000 tons of recycled plastic. The margins are also very good.

Based on the dynamics linked to the cost of the virgin polymer, which, is of course, is also linked to the oil market. And some shortages, which had an impact on the entire commodities market on the global scale. When it comes to the liberalized market and specifically industrial waste, we have a result up by EUR3.5 million. We posted larger volumes in Q1, as far as special waste is concerned, roughly 50K tons.

The prices are the same, if not slightly improving, then we have of course, the profit from - with energy plants by digesters and biomethane. And therefore, the sum of all of these positive elements part about a plus EUR3.5 million growth and that we have others, which are worth roughly EUR1 million.

Finally, another thing I wanted to mention, which is linked to the period. It was something we finalized during the month of April. As we had already said, we had to submitted our plan to reduce climate change in gas to 2030 to the science-based of targets committee.

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And after submitting our plan, we reckon we received formal -- their formal recognition that we are a company committed to reducing an increase in temperature below 2 degrees, which is linked to the Paris Accord, which translates to the reduction of gas emissions in all three perimeters by 17% in 2030, 15% in 2024, and 5% by 2020 is something we already achieved at the end of the year.

In Italy, there are only 12 companies, which have obtained this kind of recognition. The more recent ones are just a handful. And globally speaking, there are 1,300 to 1,400 declarations, whereas only 600 companies obtained this recognition from science-based targets, which is also a recognition, which then leads to all of the ratings from other agencies, but it also has an impact on the guidelines linked to the taxonomy. I think this was something important to mention since it isn't something other companies typically have.

Let me give the floor to Luca now, who will comment -- Luca Moroni will be commenting our cash flow performance, which as the Chairman was saying, certainly was a very positive element linked to the results this quarter. And these results can allow us to meet the commitments we give ourselves in investments, which this year, when it comes to CapEx and financial investments it will be equal to over EUR660 million. But this performance will also allow us to mix some acquisition choices, which may be small, but which are significant nonetheless with the right degree of flexibility and with the right spirit, the right confidence, which is always useful. And last but not least, this good result that we were also able to share with the Standard & Poor's agency, gave us it another positive recognition last Friday.

Luca Moroni {BIO 17372407 <GO>}

Thank you, and good afternoon, everybody. This is Luca Moroni. And there are two things to say from the financial standpoint. On the one hand of the good cash flow we had in Q1, which is in line with the commitment we had made in terms of our CapEx, as it was already said. It's something we will continue to commit to, in the forthcoming quarters, and we've also paid very close attention to our net working capital. We're working hard, therefore, we are continuing to focus and once again, we were able to obtain a very good result. If we compare this performance to the same period last year. We had EUR150 million in the quarter, which as we said is 3x the cash flow we had over the same period of 2020. And I think that number speaks for itself.

And what better way to start the year. And to celebrate the good news we received after several years, we have been working on it. We received an upgrade from Standard & Poor's to BBB plus, which I think is definite proof of how Hera Group stands financially visa-a-visa the sector. As far as our leverage is concerned, we stand at 2.7x, compared to the 3x net debt to EBITDA we had in 3.19x and 2.86x in 2020. We were able to reduce the ratio by further 5%. And we are continuing in our optimization process allowing us to have the flexibility we need, when it comes to looking at future developments in a very confident way.

Well, I think we've said everything we had to say. We are very confident. I think these figures not only show how good the quarter was. I think it's also proof that we are almost

beyond a situation everybody was scared of. At the same time, we were able to continue to have the right energy to continue to work in the same way in the forthcoming quarters too. As you heard, as far as our investments are concerned, without taking any steps back compared to what our company intends to achieve, as far as development is concerned.

That's all as far as I'm concerned. And I'll now open the floor to any questions you may have.

Questions And Answers

Operator

(Question And Answer)

This is the chorus call operator. We will now begin our Q&A session. (Operator Instructions) The first question is from the Italian conference call, Javier Suarez, Mediobanca.

Q - Javier Suarez {BIO 1700016 <GO>}

Good afternoon, everybody, and thank you for the presentation. I have three questions for you. The first is just as far as the general context is concerned, the second two refer to the quarter results. As far as the context is concerned, has Hera had to see in the Italian government's recovery plan drafting? And how does the company management see the recovery plan? Does it see it as a further opportunity for the company? And linked to this, do you think that the simplification decree drafting has a chance to support the company, structurally speaking, in many of your businesses? So this is the first question on context.

Moving on to the results. First of all, I'm interested in understanding the expansion of your customer base, because despite the difficult situation the companies continued to grow the customer base. I'm interested in your commercial policy and what impact is it having on your development with gas and electricity customers? Of course, the context did help to a certain extent, but it also wanted to speak about the underlying business development and electricity and gas supply. The third question, the CFO mentioned the positive contribution of the net working capital in Q1, that's something I was quite surprised with positively. Can you tell us when are the manager elections allowing you to obtain these results on the operating cash flow which is so positive? Thank you.

A - Luca Moroni {BIO 17372407 <GO>}

Let me answer your questions in the order you asked them. As far as a context is concerned and do we have a part in drafting the recovery plan? Well, we certainly participated, because I think I read 10 different diversions, 10 different drafts. So I spent a lot of hours reading them. We also contributed both through our categories association with the number of ideas and projects, we also contributed with some ideas or remarks which especially in the second phase was considered. Now, so far we have the strategic guidelines and the various items regarding the resources to allocate, the resources are available at this point and the next phase will be to understand what will be done after the

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European commission approves the recovery plan. It's a matter of understanding how these funds will be used. What we've heard from a few different context is that, some resources will be devoted to flag projects, but as utility company we won't e seeing a major impact from that, there may be one or two larger projects which may have an impact on some of our utilities, but again the interesting part of the project will be linked to the tenders to access the resources. And I think that from this point of view it will be important to create a system with the regional governments or the regional entities involved, especially when it comes to the water cycle and when it comes to the energy sector.

And in fact in the energy sector there is a reference to resources made available for hydrogen activities, Something we're already working on in a partnership with other companies in the sector, beginning with (inaudible) but also with the few industrial companies that are in the sector such as Savio [ph] or companies which use hydrogen like Yara for instance, or other companies like (inaudible) which produce tiles. But we're also working with local entities, specifically, with the (inaudible) with the municipality of Ravenna, and the municipality of Modena.

In those areas, we will be receiving essential resources. Then when it comes to the production of electricity or actions which can be taken in the water sector. We do have some projects in the pipeline, which are of course, projects which are added on top to the ones that we have already drafted and planned for the upcoming four year or five years within our business plan investments. And given the fact that there will be other resources available, they can't give us a further boost. Then of course there's the indirect effect. I've mentioned in the past and that too will inevitably bring benefits. I was reading today that (inaudible) GDP forecast has been reviewed and that sounds at 4.5% and that of course is a flow of resources which will bring about, request for further services, electricity, traditional commodities, and waste treatment too. These are all services, which of course, are things we do for our customers, for new connections and new businesses.

But in a nutshell, this is all new demand, which of course, sees us as primary players on the territory, and this is yet another indirect effect of the recovery plan. The simplification decree you mentioned, I've already read two or three drafts, I think we are still in a phase during which the decree has been fine-tuned, but when it comes to few items, such as simplification for the implementation of the super-ego bonus for refurbishment works and condominiums or when it comes to renewable energy linked equipment or bio-methane plants. It seems to me that there is the will to have a clear time frame for these activities.

Of course, we'll have to wait and see. I have to wait for the final draft and then we'll have to see how the various institutions will act on a local level so that this central effort can be successful, so that these resources will be used locally. And of course, it's not just us, there are plenty of companies waiting for these opportunities. As far as the supply side of the business is concerned, we are, of course, evolving progressively when it comes to our supply policy. Of course, we are a company which is expanding, it is growing. It is still easier to grow with our electricity customers compared to our gas customer base where we have a situation with we are the former incumbent and therefore we have a larger market share and a lower possibility to grow.

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And with (inaudible) we had essentially a customer base, a gas customer base that we look to within that deal, meaning, that there are great opportunities for electricity. And electricity effect there is a better chance to offer value added services. We began as, we've already mentioned in the past, we began with some value added services for energy efficiency, those services were very simple. Then we started offering electrical mobility services on four and two wheels. And then we added household systems. And in a few days time we'll also be launching an offer for photovoltaic electricity production. We made the acquisition of a company in this business at the end of last year. We have a few months to get our activities in line and in a few days time, we'll be making our commercial offer in the photovoltaic sector, which for the time being we are advertising with a specific channel on the market.

And how are we doing? Well, I have a slightly different opinion compared to what you were saying. 2020 was a complex year for our supply businesses, the lockdown, limited activity to work on a door-to-door basis which is one of our traditional channels. Although it did help to consolidate our digital channels. So what we're currently trying to do is to continue growing in the digital sphere as we revitalize our efforts when it comes to the physical channels so that we can go back to the pace we had in the past.

Then of course, linked to these we also have opportunities which stem from the last instance markets, or the concept market, for instance in which there is a more opportunistic approach and that's something we're always ready to look at. In January, in fact we won nine concept catchment areas, the last one was for gas distribution for the upcoming 18 months that will offer another boost. It will be an on-top opportunity compared to the trend line that we have been maintaining for quite some time now. Then the last question on our working capital. Maybe Luca wants to reveal our secrets to you.

Well, let me just say that, I think our strength lies in the numbers. We have been working on our numbers for a very long time, this has become one of our strengths in fact, we're able to extract a great deal of value from those numbers and that allows us to be one step ahead of the pack. Allowing us to invent new things once we're able to consolidate the more efficient ways to manage our credits and that of course I think is bringing about some very positive results indeed.

Q - Javier Suarez {BIO 1700016 <GO>}

Thank you very much.

Operator

The next question is Enrico (inaudible) Stifel.

Q - Analyst

Good afternoon, everybody. I have some questions for you. Going back to the supply side of the business, can you give us some update on the cross-selling activities for the (inaudible) customer base, but you also commented the gas business and the new supply stemming from the TAP pipeline? Can you quantify this impact a little bit more? And a

like-for-like basis. Can we expect further improvement in Q4 this year. Although I do believe that TAP pipeline was already up and running last year.

Then a question on the water sector. Can you give us some details referring the lower EBITDA in Q1? And then you also mentioned, the tender you were awarded in (inaudible). Does that imply a CapEx growth compared to what was implicitly included in the previous concession. Then a final question, you've mentioned EUR27 million growth in EBITDA linked to value-added services and the ecobonus. Do you think this growth will be structural even in the upcoming quarters? When it comes to the cross-selling activities for the (inaudible) customer base. Of course, last year things were conditioned by the things I mentioned earlier.

In Q4 last year, we got back on our feet and we are obtaining results which are in line with our expectations. Of course, you can't do everything overnight. At the end of the 2020, we were able to obtain EUR million and synergies for the first year alone, a small portion of that was brought about by a further cross-selling activity to those customers. The rest was at had better margins and other linked things. So, we're quite pleased with how things are going, our partners are pleased as well. The results were trending up very good. In fact, they are slightly above our expectations, As I mentioned. So for the time being things are going quite well.

As far as the TAP pipeline, yes. We have to count further three months, because Q2 was already included in the previous projections. Keep in mind that the procurement is flat and we obtain 300 million cubic meters, it's roughly 75 million per quarter. So, this quarter we have 75 million cubic meters from that source there. And in economic terms it is a contribution worth EUR1 million maybe, if I were to give you a value.

The water sector. Yes, the dip is linked to higher costs for electricity, and partly also due to a number of operational costs, which are the highest we had in this quarter.

Of course, all companies have to have certain criteria when it comes to complying with personal protection equipment, and of course, that implies higher costs, and we had to recognize these costs to the companies. We have some of these costs ourselves that's just the way it is. So these are the two more significant elements which had an impact on the quarter.

And as far as the CapEx is concerned and for Rimini, as we mentioned, even less time, we're waiting for the formal decision of the tender to be made. This is taking up more time than expected due to a few administrative elements. I don't think we're far from the final decision to be formalized. And as far as CapEX -- our CapEx committing is concerned (inaudible) also already included in the business plan. There was a growth, of course, compared to the business plan. The project which had been open to tender envisage investments for the five or six historic years, and keep in mind in the Rimini area we still have the final phase of the so-called PSPO plan, the plan for the safeguarding of the coastal area, the seawater which required some EUR80 million.

But again, all those figures are already included in the business plan, nothing different. Then there was a final question which I can't remember. The super ecobonus. Yes. We have capitalized on that, and that's something, of course, that we will be continuing to use during the year, because of course, we have included the part pertaining to Q1 in our figures, we have a remaining three quarters of the year. So on a yearly basis, we will be seeing a benefit which is larger than the one we saw for Q1 of course. Thank you very much.

Operator

Mr. Tommasi di Vignano, gentleman there are no further questions for the time being.

A - Tomaso Tommasi di Vignano {BIO 1449180 <GO>}

Well, thank you very much then and we'll see you next time then. Thank you. Goodbye.

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