



REPORTS AND FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2016



TABLE OF CONTENTS

1 REPORT ON OPERATIONS

Corporate bodies	4
Company description	5
Strategy	6
Key operating and financial data	7
Operating data	8
Comments on the year's performance	9
Significant events during the year	16
Regulatory framework: main changes	18
Business segment	22
Management and coordination	23
Risks and uncertainties	25
Health, Safety and Environment	34
Human Resources	36
Financial Statements	38
Relations with parent companies, subsidiaries, associates and companies controlled by the parent companies	43
Treasury shares	44
Branch offices and offices	44
Research and development activities	45
Business outlook	45

2 FINANCIAL STATEMENTS

Statement of Financial position	47
Income Statement	49
Statement of cash flows	50
Explanatory notes	52
Statement of Financial position analysis	64
Income Statement analysis	78

BOARD OF DIRECTORS' PROPOSAL	91
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REPORT OF THE STATUTORY

AUDITORS	92
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AUDITORS' REPORT	96
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Report on Operations

CORPORATE BODIES

BOARD OF DIRECTORS ⁽¹⁾

Chairman
PIETRO TITTONI

Directors
LUCIA BORMIDA
ANDREA NAVARRA
MICHELE PEDEMONTE

BOARD OF STATUTORY AUDITORS ⁽¹⁾

Chairman
LELIO FORNABAIO

Standing Auditors
LUISELLA BERGERO
GIOACCHINO MESSINA

INDEPENDENT AUDITORS ⁽¹⁾

DELOITTE & TOUCHE S.p.A.

¹ Appointed with deed of 30 November 2015 and in office until approval of the financial statements for the period ended 31 December 2017.

COMPANY DESCRIPTION

The company ERG Hydro S.r.l., formerly Hydro Terni S.r.l., was established on 22 July 2015, now with registered office in Genoa at Via De Marini, 1 - and with share capital of EUR 50 million.

Hydro Terni S.r.l. was founded with a share capital of EUR 10,000, fully underwritten and paid up by E.On Italia S.p.A. Following the partial demerger of the company E.On Produzione S.p.A., held entirely by E.On Italia S.p.A., with notary deed of 5 November 2015 and effective from 30 November 2015, the company Hydro Terni S.r.l. acquired the aforementioned company division, consisting of the hydroelectric branch that was at the time owned by E.On Produzione S.p.A. and the corresponding assets which resulted in a share capital increase from EUR 10,000 to EUR 50 million. At the same time, E.On Italia S.p.A. sold its entire shareholding in this company to ERG Power Generation S.p.A., whose Shareholders' Meeting resolved to change the company name to ERG Hydro S.r.l.

The Company's purpose involves the development, construction and management of hydroelectric plants for the production of electric power, as well as the marketing of any related products.

As of 1 December 2015, the Company began activities for the production and sale of electricity.

The Company is subject to management and coordination by ERG S.p.A.

STRATEGY

As of 1 December 2015, the Company began activities for the production and sale of electricity, through the hydroelectric plants acquired following the demerger of company E.On Produzione S.p.A.

The hydroelectric complex is a highly flexible system, given that it is an integrated unit composed of 16 plants, 7 dams, 3 reservoirs and a pumping station.

The strategic plan envisages implementation of all necessary measures to promote better integration between personnel and assets and maximise the value of the Company.

During 2016, the project for the Group's new organisational layout was launched, with a strong focus on process logic and a willingness to "reunite" the entire organisation towards a single common vision, thereby leading to the name "ONE Company", characterised by the definition of the two macro-roles. That of corporate ERG S.p.A., which ensures the strategic direction and management of all business support processes, and that of company ERG Power Generation S.p.A., which is assigned responsibility for the Group's industrial and commercial processes.

The Company's business model was modified within the scope of this project and, starting from 1 July 2016, the electricity generated by its hydroelectric plants, with the exception of those regarding the plants for which there are agreements in place with the GSE for dedicated withdrawal, is sold to the company ERG Power Generation S.p.A., rather than to the electricity market.

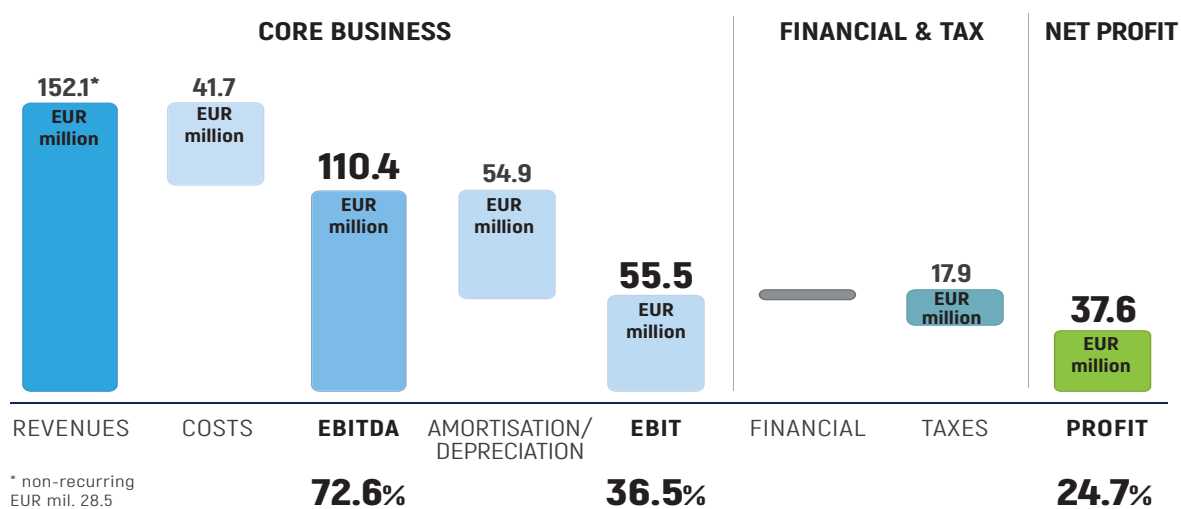
KEY OPERATING AND FINANCIAL DATA

The operating and financial data as at 31 December 2016 reflect operations for the entire year, as opposed to those of 2015 provided for comparative purposes, which only represent one month of operations of the Company.

(EUR thousand)	2016	2015
Profit and loss data		
Total revenues ^(*)	152,058	10,875
Gross operating margin (EBITDA)	110,386	7,826
EBIT	55,499	3,224
Profit for the year	37,640	1,783
Financial data		
Cash flows from operating activities	209,231	(6,924)
Investments/divestments	3,564	259
Changes in shareholders' equity	(39,361)	2
Net cash flows	128,666	(7,326)
Financial data		
Net fixed assets	610,027	661,350
Net invested capital	623,639	791,666
Shareholders' Equity	744,982	784,343
Net financial position	121,343	(7,323)

(*) of which non-recurring 28.5 EUR/million

Calculation of results by area of responsibility



The gross operating margin (EBITDA) amounts to 72.6% of revenues, less operating costs, which amounted to 27.4%; EBIT amounts to 36.5%, less amortisation/depreciation, which amounted to 36.1% of revenue.

The following key economic indicators are highlighted:

ROS - Return on sales ^(*)	21.8%
ROI - Return on investment ^(*)	4.3%
ROE - Return on equity ^(*)	2.6%

(*) net of non-recurring revenues regarding prior years' GCs.

OPERATING DATA

Electricity generated by the company during the year amounted to 1,357.6 GWh, of which 505.5 GWh with feed-in premiums (formerly Green Certificates).

The electricity generated in the first half of the year was sold on the electricity market; starting from 1 July 2016, under the agreement signed with ERG Power Generation S.p.A., the electricity was sold to the parent company, which has also been assigned the task of managing the dispatching agreements regarding the hydroelectric plants.

		2016	2015
Capacity	MW	526.5	526.5
Net electric power generation	GWh	1,357.6	83.9 ^(*)
Net sales of electricity	GWh	1,432.3	87.6 ^(*)
Feed-in premium (formerly GC)	EUR thousand	50,586	4.6 ^(*)
Capital expenditure	EUR thousand	3,564	0.3 ^(*)
Employees	number	90	91

(*) the figures refer to the month of December 2015

COMMENTS ON THE YEAR'S PERFORMANCE

The financial statements as at 31 December 2016 show a net profit of EUR 37.6 million.

More specifically, an analysis of performance during the year shows a gross operating margin of EUR 110.4 million.

Revenues, equal to EUR 152.1 million, regard sales of electricity for EUR 69.4 million, at the feed-in premium (former green certificates) for EUR 50.5 million, green certificates recognised during the year but referring to prior years for EUR 28.6 million and other revenues for EUR 3.5 million.

Costs, equal to a total of EUR 41.7 million, are predominantly attributable to concession fees of EUR 12.2 million, personnel costs of EUR 7 million, and services, purchases and operating costs for approximately EUR 21.9 million.

The average sales prices reflect the sales price of the electricity, higher than the Single National Price thanks to the modulation of the plants, and the value of the feed-in premium (former green certificate), acknowledged on around 40% of the generation and for a value of about EUR 100.08/MWh.

The Company's overall production (1,357.6 GWh) therefore benefited from an average unit revenue, considering the sales price of the energy and that of the replacement incentives, equal in total to around EUR 90/MWh.

The gross operating margin (EBITDA) for the year amounted to 72.6%, while net of non-recurring revenues, with regard to the green certificates of prior years, this figure amounted to 66.2%.

The final load factor in the period came to 29% and was affected by the scarce water availability in the period (production of 1,357.6 GWh compared to a ten-year historical average of 1,478 GWh); in 2015, the load factor was 21%, but this referred solely to the month of December.

The level of the reservoirs of Lakes Turano, Salto and Corbara were respectively approximately 524, 524 and 127 metres above sea level, slightly lower than the historical average.

PRODUCTION PLANTS

The Company has a generation facility comprising 16 hydroelectric plants, 7 dams, 3 reservoirs and a pumping station, located geographically throughout Umbria, Marche and Lazio, with an installed operating capacity of 526.5 MW.

The hydroelectric plants are located along three rivers: Nera, Tevere and Velino.

The dams are those of Salto, Turano, Corbara, Alviano, Aia, La Morica and Marmore.

The reservoirs are those of Corbara along the Tevere, and Salto and Turano along the Velino river.

The majority of hydroelectric plants are situated in the Umbria region, with a capacity of 468.8 MW, followed by the Lazio region with 57.5 MW and the Marche region with 0.2 MW of capacity.

The total capacity of 526.5 MW regards large offtakes for 512.4 MW and small offtakes for 14.1 MW.

The plants of Galletto Monte S. Angelo, Preci, Triponzo, Ponte Sargano, Monte Argento, Narni, Nera Montoro-Stifone branch, Baschi and Alviano are qualified as "IAFR – Impianto Alimentato da Fonti Rinnovabili - Plant Powered by Renewable Sources" which benefit, for the electricity generated, from access, starting from 1 January 2016, to an incentive in the form of a feed-in premium for the remaining period of entitlement as a replacement of the green certificates.

Added to these plants is the hydroelectric plant of Cotilia, Salto branch, with respect to which the National Grid Operator (GSE), following the appeal filed by the Company, recognised on 4 October 2016 the above-mentioned qualification of "IAFR", thereby granting it the right to recognition of the Green Certificates for electricity generated starting from the date of completion of renovation works on the plant (22 October 2009) and the feed-in premium from January 2016.

The plants of Altolina, Cervino, Corbara, Cotilia (Canetra branch), Ponte Sargano, Sersimone, Sigillo and Triponzo benefit from dedicated withdrawal for the production of energy.

The plants of Cotilia (Peschiera branch) and Visso benefit from the feed-in tariff for energy generated from renewable sources (Ministerial Decree 6/7/2012).

The list of individual plants and respective capacity is provided below:

Plant	Capacity (MW)
Velino River Course	
Sigillo	5.0
Cotilia	48.0
Cotilia Canetra	2.3
Cotilia Peschiera	2.2
Galletto/Monte S. Angelo	210.0
Galletto Pennarossa	2.1
Total Velino River Course	269.6
Nera River Course	
Visso	0.2
Preci	10.0
Triponzo	6.4
Ponte Sargano	3.0
Cervino	0.6
Sersimone	0.6
Monte Argento	64.0
Narni	40.0
Nera Montoro	28.0
Nera Montoro Stifone	2.9
Total Nera River Course	155.8
Tevere River Course	
Altolina	2.4
Baschi	86.0
Corbara	0.8
Alviano	12.0
Total Tevere River Course	101.2
TOTAL MW	526.5

CONCESSIONS

Concessions to utilise public water for hydroelectric use are under regional or provincial responsibility (depending on the type and location of the relative plant), following decentralisation of the administrative responsibilities in terms of management of the government-owned water resources.

The Company owns the concessions on a number of branches of public waters, located in the Lazio, Marche and Umbria regions, which are used as the source for production of electricity by hydroelectric plants.

The current concessions are valid until 2029 (Legislative Decree no. 79 of 16 March 1999, Article 12, paragraph 6) for all branches used by the hydroelectric plants, except for the one relative to the Corbara plant, which expires on 31 December 2035.

Each concession is accompanied by a “concession regulation” that sets out the rules governing the concession and sets the maximum and average quantity of water than can be withdrawn. The average value is used, based on the usable head, to determine the nominal power.

Concessions for the use of public waters are subject to the payment of government rents, watershed rents and coastal rents.

The annual **Government** rent is determined by the Region and calculated based on the nominal concession power as follows:

- Marche Region: annual fee of 15.50 EUR/kW from 2014, resolved with Regional Law no. 49 of 23 December 2013;
- Lazio Region: annual fee of 30.39 EUR/kW for the year 2016, pursuant to Decision no. G03459 of 8 April 2016 of the Lazio Region;
- Umbria Region: annual fee of 31.02 EUR/kW, pursuant to Regional Council Resolution no. 1067 of 22 September 2015. The Umbria Region increased the amount of the fee in effect until the year 2015, rising from 15.60 EUR/kW to 31.02 EUR/kW.

On 11 December 2015, ERG Hydro S.r.l. presented an appeal to the Higher Court of the Public Waterways in Rome to request the cancellation of the aforementioned resolution.

The results for the period prudently reflect the aforementioned increase.

The **Mountain Watershed** rents are due to the Municipalities within the basin into which the waters of their areas flow to the river subject of the concession. The fee is due for concessions with average nominal power of over 220 kW.

Specific decrees issued by the Ministry of Public Works defined the percent fee owing to each individual Municipality. The unit fee for Mountain Watersheds is set via decree by the Ministry for the Environment and Territorial and Marine Protection and is valid for two years.

The rent in effect for the period 2016/2017 is equal to EUR 22.90 per kW for plants with average nominal power of over 220 kW and up to 3,000 kW and equal to 30.43 EUR/kW for plants with average nominal capacity of over 3,000 kW (Prot. 559/STA of 1 December 2015 of the Ministry for the Environment and Territorial and Marine Protection).

With further decree by the Ministry for the Environment and Territorial and Marine Protection, Prot. 6/STA of 26 January 2016, the fee on concessions with average nominal power of over 220 kW was increased starting from February 2016 and up to 31 December 2017 from EUR 22.90 to EUR 30.43 per kW, essentially equating the fee for all plants.

The **Coastal** rents are due to the Municipalities and Provinces in which the branch works are situated and those in which a waterway flows in the section between the intake point and the water outlet point.

The percent rent owing to the individual beneficiaries are set by the Ministry of Finance.

State Property Office Decree of 2 December 2015 determined that the rent in effect for the period 2016/2017 for concessions with average nominal power of over 220 kW and up to 3,000 kW is equal to 5.73 EUR/kW and for concessions with average nominal power of over 3,000 kW, 7.61 EUR/kW.

Italian Law Decree no. 134 of 7 August 2012 modified the issue with regard to the hydroelectric concessions governed by Royal Decree no. 1775 of 11 December 1933. Five years prior to the expiry of the concession, the Regions will draw up, for the renewal, a tender with bid for the acquisition of use of the water resource, together with the offer for improvement and environmental revitalisation of the relevant watershed. Moreover, upon expiry of the concession, set for the Company's hydroelectric plants for the year 2029, the transfer of ownership of the so-called "wet assets" to the State will not be on a "free" basis.

PRODUCTION AND SALE OF ELECTRICITY

Electricity generation during 2016 amounted to 1,357.6 GWh (compared to 83.9 GWh in 2015), of which:

- 1,260.4 GWh by major Production Units (>10MW) (year 2015 - 78.1 GWh);
- 97.2 GWh by minor Production Units (year 2015 - 5.8 GWh).

Production for the year 2015 is also provided, but the comparison is not significant, as the Company's production began on 1 December 2015 and therefore represents only one month of operation.

The quantity of energy purchased on the Intraday Market, for dispatching and imbalancing, amounts to 74.7 GWh.

Electricity sold amounted to 1,432.3 GWh, of which:

- 609.7 GWh offered on the Day Before Market (MGP);
- 65.5 GWh offered on the Intraday Market (MI);
- 76.7 GWh sold to the National Grid Operator (GSE);
- 72.5 GWh as network services;
- 36.9 GWh as positive imbalance;
- 570.9 GWh bilateral contract with ERG Power Generation S.p.A.

Starting from 1 July 2016, the electricity generated, with the exception of those regarding the plants for which there are agreements in place with the GSE for dedicated withdrawal, is sold to the company ERG Power Generation S.p.A.

FEED-IN PREMIUM (FORMERLY GC) FOR THE “IAFR” PLANTS

The hydroelectric plants qualified as “IAFR” (Impianto Alimentato da Fonti Rinnovabili - Plant Powered by Renewable Sources), with a total qualifying power of 505.5 MW, are the plants of Alviano, Baschi, Cotilia (Salto branch), Galletto Monte S. Angelo, Monte Argento, Nera Montoro (Stifone branch), Narni, Preci, Ponte Sargano and Triponzo.

Until 2015, green certificates were recognised for these plants, replaced from January 2016 by the feed-in premium defined with the same formula used to measure the green certificates, with the sole significant exception being that they refer to the price of electricity in the year prior to the year in question.

The production eligible for incentive is calculated based on the type of plant intervention and the net energy generated by the plant, possibly multiplied by a specific coefficient and rounded to the nearly MWh using the commercial criterion.

The value of the incentive is determined based on the effective energy introduced into the network, up to the achievement of a threshold quantity comparable to the “fixed” amount recognised for works on renovation of the hydroelectric plant; further recognition is a result of greater allowable production under the incentive scheme, solely with regard to the amount exceeding historic production.

The incentives are now determined on a monthly basis, and are disbursed by the GSE every quarter by the second quarter following the reference quarter.

The feed-in premium was defined by the Italian Regulatory Authority for Energy and Gas and the Water System (AEEGSI) for 2016 as 100.08 EUR/MWh, with Resolution of 28 January 2016, provision 29/2016/R/efr.

Based on the eligible amount of energy generated during the course of the year and the tariff defined above, the Company's revenue for the current year amounts to EUR 50.6 million.

The value of the feed-in premium for 2017 has been defined as 107.34 EUR/MWh, applicable only on the production eligible for incentive.

During the course of the year, the GSE recognised the plant of Cotilia (Salto branch) has having the qualification of “IAFR” plant and assigned the Company the Green Certificates relative to the electricity generated from 2009 to 2015 and, for the energy generated from 1 January 2016, the right to the feed-in premium for the remaining period of entitlement.

Similarly, on 13 January 2017, the GSE annulled the revocation of the qualification according to which there existed a pending dispute before the Lazio TAR (Regional Administrative Court), and recognised the qualification of “IAFR” to the Sigillo plant, authorising the plant to recover the green certificates for the period between 2010 and 2015, in addition to the replacement incentive system from 2016.

SIGNIFICANT EVENTS DURING THE YEAR

The main events that occurred during the year are summarised below.

- In February 2016, the formal transfer of ownership of the concession for hydroelectric use with respect to the various plants situated within the regional territory by the Umbria Region was completed.
- On 7 March 2016, the Company received from E.On Produzione S.p.A. the amount of EUR 75,128 thousand, in relation to the balance adjustment between the accounting situation as of the spin-off date, namely 30 June 2015, and that of the date of effectiveness of the demerger and conferment of the hydroelectric segment, namely 30 November 2015.
- In April 2016, the procedure to change ownership of the water diversion concession for hydroelectric use in the municipality of Visso (MC) for the Preci (PG) plant by the Marche Region was completed.
- On 21 April 2016, the Shareholders' Meeting approved the 2015 financial statements, resolving to distribute the entire profit of EUR 1,782,683.
- On 11 May 2016, the Board of Directors deliberated on the adoption of the Organisation and Management Model, in line with the provisions arising from application of Italian Legislative Decree no. 231/01, and appointment of the Supervisory Committee, consisting of one external member and two internal ones, assigned the task of verifying respect and proper application of the aforementioned Model and Code of Ethics.
- On 30 May 2016, the Company, as implementation of the resolution of the Board of Directors' meeting of 21 March 2016, signed with the company ERG S.p.A. the regulation on participation in the "Domestic Tax Consolidation" for Companies of the ERG Group, based on which it exercised the option for group taxation pursuant to Articles 117 to 129 of the Consolidated Law on Income Taxes (Italian Presidential Decree no. 917/86). The option has a three-year duration, for the years 2016-2018.
- On 21 June 2016, the Shareholders' Meeting resolved to distribute to the sole Shareholders a portion of the paid-in capital in excess of par for EUR 75 million and of the exchange rate gains reserve for EUR 217 thousand.
- Starting from 1 July 2016, as part of reorganisation of the Group's business model, the electricity provision contract according to which the Company sells the electricity generated by its own hydroelectric plants, with the exception of those regarding the plants for which there are agreements in place with the GSE for dedicated withdrawal, to ERG Power Generation S.p.A. and simultaneously grants the purchaser authorisation to act as dispatching user, has been effective.
- On 18 July 2016, the AEEGSI was sent the data on the accounting separation, drawn up pursuant to Resolution 11/07 (so-called "accounting unbundling") with respect to the 2015 accounting statements, certified by independent auditors Deloitte & Touche S.p.A..
- In August 2016, the procedure to change ownership of the water diversion concession for hydroelectric use for the plants of Cotilia and Sigillo by the Lazio Region was completed.

- On 4 October 2016, the National Grid Operator (GSE), following the appeal filed by the Company, recognised the qualification of "IAFR" to the hydroelectric plant of Cotilia (Salto branch), thereby granting it the right to recognition of the Green Certificates for electricity generated starting from the date of completion of renovation works on the plant (22 October 2009). Following said deed, the GSE recognised to the Company the Green Certificates relative to the electricity generated from 2009 to 2015, and for that generated from 1 January 2016, the right to the feed-in premium for the remaining period of entitlement.
- In December 2016, the agreement was formalised for the assignment of receivables owed to the Company from ACEA AT02, in favour of Unicredit Factoring SpA. The assigned credit, referring to invoices from October 2012 to October 2016, was paid to the Company on 15 December 2016.
- The Company has submitted to the Italian Revenue Agency, on a quarterly basis, the applications for reimbursement of VAT with regard to the VAT credit generated respectively in the first, second and third quarter of 2016.
- During the course of the year, in light of the changes introduced by the 2016 Italian Stability Law in relation to calculation of the cadastral income of production properties, which include the so-called "imbullonati", literally bolted items, referring to the system components (equipment, machinery, special systems, etc.), the Company submitted, for each property, the updated building register deeds, with subsequent recalculation of the income based on the new criteria. In fact, the changes envisage that, starting from 1 January 2016, said items be excluded from the calculation of cadastral income. With the resulting calculation of a lower cadastral income, the IMU and TASI municipal tax costs were lower already from the year 2016.
- The Company assigned to an independent expert the task, completed in December, of conducting a physical inventory of the hydroelectric plants, also aimed at identifying the major components, as well as determining the economic-technical duration and fair value of the assets. In addition to identifying and classifying the individual components, the expert carried out an analysis of the useful lives adopted by the Company for accounting purposes, considering them to be reasonable and representative, on average, of the groups of assets comprising the subject categories of the analysis. However, it was specified that the analysis carried out at the "asset class" level, particularly if involving assets as detailed and complex as the subject assets, is relatively approximate, due to the breadth of the analysis itself and to the composition of said classes. Further specific analyses could increase the precision of the estimated values, although this would require longer and more complex procedures, and the durations of the useful lives could vary over time according to technological turnover and many other factors, both internal or external to the subject "productive habitats".

The Fair Value was determined based on the assumption of continuity of use, assigning a value to the subject assets based on their size, characteristics and residual life, assuming their use in the current productive context, if the expected income is sufficient to simultaneously ensure a fair return on net working capital, as well as on the estimated assets. Given the unique nature of the plants in terms of geographical location, technology and construction characteristics, the Cost Method was used, expressing the cost ("Reconstruction Cost" or "Replacement Cost") that would be incurred to replace an asset with a new one having the same characteristics and use as the subject asset, reduced to take into account various factors, such as physical deterioration and functional obsolescence. The outcome of said analyses identified a higher value for tangible fixed assets compared to the carrying value.

REGULATORY FRAMEWORK: MAIN CHANGES

The most significant regulatory changes that characterised the energy industry in the first half of 2016 are described below.

GENERAL

Paris Agreement on Climate Change

On 4 October 2016, the European Parliament approved the ratification of the Paris Agreement in the presence of European Commission President Jean-Claude Juncker, the United Nations Secretary General Ban Ki-Moon and of the President of COP 21 Ségolène Royal.

On 5 October 2016, since 94.41% of the countries had already signed the agreement (including the EU), the 30-day deadline envisaged by the regulation became effective, making the Agreement formally effective from 4 November 2016.

On its behalf, Italy ratified the agreement on 27 October 2016, with publication of the law in the Official Journal on 10 November 2016.

United Kingdom referendum on membership in the European Union (Brexit)

On 23 June, voters in the UK voted in favour of the United Kingdom leaving the European Union, the first case of a member state and signing party of the Treaty of Maastricht leaving the Union.

Once the negotiations with London for the effective implementation of the United Kingdom's exit from the European Union, the entire legal framework of the Union must be adapted to the new situation of 27 member states.

European Commission Regulatory Calendar – Winter Package

On 30 November 2016 the European Commission announced that by the end of 2016 it would publish a package of regulatory measures on EU climate-energy policy for the period following 2020.

The main measures concern the revision and issue of directives and regulations on renewable energy, on energy efficiency and on the electric system, to allow the Union to achieve the climate-energy targets for 2030, adopted in October 2014 and presented to the COP 21 of December 2015.

The approved documents also include the Commission's guidelines on drawing up the action plans by the member countries.

The approval process for the final measures, which should be completed by the end of 2018, involves a joint decision process between the European Parliament and Council of the EU for the Directives, while Parliament solely provides an opinion with regard to the regulations. All measures should become effective starting from 2021.

Environment – Efficiency – Safety

In January 2016, Italian Law 221/2015 was published, to promote green economy measures and contain the use of national resources, the so-called “environmental addition”, already approved by the parliament last 22 December 2015. The key regulations contained in the law include the Enea reform, a number of amendments to the regulations on use of excavated earth and rock, support for sustainable mobility and revision of the incentive on the production of electricity from biomass.

The regulations on damage to and restoration of national priority sites have also been amended, providing the possibility to operators involved to propose a settlement. Lastly, the District Water Basin Authorities are established for each hydrographic district, which will replace the current Inter-regional, Regional and National Priority Water Basic Authorities.

In March 2016 the Ministry of the Environment approved the Water and Flood Risk Management Plans for six out of the eight hydrographic districts in the country, including the Central Apennine district.

In July 2016, the “2015-2016 European Law” was published, which also contains provisions on the classification, labelling and packaging of substances and mixes. This measure extends the administrative fine, already envisaged for violations of the provisions of the European regulations on hazardous substances and mixes, applicable to anyone using packaging containing a hazardous substance or mixes not compliant with the provisions of the relative European regulations.

“Annual Extensions Act” Law Decree

Italian Law Decree no. 244 of 30 December 2016 regarding the extension and definition of the legal conditions (so-called “Annual Extensions Act”) was published in the Official Gazette, General Series no. 304 of 30 December 2016.

For issues of interest, mention goes to the extension up to 31 December 2017 of the reduced taxation of fuels used in cogeneration plants such as the CCGT of Priolo; therefore, the rates identified by the Authority for Energy, reduced by 12%, shall continue to be applied. Effectiveness of the reform on general expenses of the system for non-domestic consumers has been postponed to 1 January 2018, while the variable portions of the general system expenses will be applied to electricity taken from the public grids starting from 1 January 2017, with the requirement of third-party connection.

HYDROELECTRIC POWER

Feed-In Premium (FIP), former Green Certificates

With Resolution 29/2016, the Italian Regulatory Authority for Energy and Gas (AEEGSI) established that the average value of the sales price of electricity for 2015 amounted to 51.69 EUR/MWh. As a result, the GSE announced the withdrawal price for “green certificates” issued for 2015 output, equal to EUR 100.08 per certificate.

In the resolution, it is specified that the sale price of electricity for 2015 is also used to determine the value of the incentives which will replace green certificates from 2016.

Also with regard to “green certificates”, at the end of October 2015, the GSE announced the timeline for the disbursement of the incentives for plants holding “green certificates”, which from 2016 will be converted into Feed-In Premiums (FIP). Starting on 1 January 2016, these incentives are now determined on a monthly basis, and are disbursed by the GSE every quarter by the second quarter following the reference quarter, in line with the timelines for withdrawing green certificates.

At the end of April 2016, the GSE provided operators with the scheme of the agreement it intends to use to settle payment of the feed-in premium (FIP) to entitled operators.

The majority of operators, including ERG, submitted an appeal against the GSE for forcing operators to sign a deed that was not envisaged under the regulations in force.

Increase in the cost of electricity dispatching services: resolution 342/2016 and subsequent provisions

Significant increases in the cost of dispatching services for end customers were recorded in the second quarter of 2016 (with particular reference to the uplift price). These events were subject to measurement and examination by the Government and by consumer associations, with the concern that some key electricity market operators carried out abusive conduct on the energy and dispatching services market.

On 27 June 2016 the Authority published Resolution 342/2016/E/eel, through which it launched a process for the timely adoption of prescriptive measures and/or asymmetric regulation and the assessment of potential abuse on the electricity market, pursuant to Regulation (EU) no. 1227/2011 (REMIT), potentially committed in the recent past by several electricity market operators; for ERG Hydro S.r.l., only for the period 1 January - 30 June 2016.

According to the intentions of the AEEGSI, the measures aim to combat conduct which could constitute market abuse.

The AEEGSI deems that the planning and supply strategies of several users, owners of consumption or production units fuelled by non-programmable renewable sources cannot be considered consistent with the principles of diligence, prudence, expertise and forecasting set out in the regulations in force on electricity dispatching.

The list of relative parties was then expanded last August 2016 through publication of resolution 459/2016/R/eel. With this resolution, the Authority also extended the time available for completion of the entire procedure. Following the AEEGSI inquiry, last September 2016, the parties involved were sent, via certified mail, the notifications containing the results of the investigation and potential abuse profiles identified by the Authority.

ERG Hydro S.r.l. and the company ERG Power Generation S.p.A. submitted an appeal before the Administrative Court of Lombardy for partial annulment of the aforementioned deeds, considering the conditions for their issuance to be entirely non-existent.

On 7 October, the Authority published resolution 477/2016/E/eel, with which it undertook the initial measures as part of said proceedings with respect to users authorised for the dispatching services market, also involving the Italian Antitrust Authority for interventions under its scope with regard to competition rights (Italian Law 287/90).

Moreover, pursuant to the European regulations on integrity and transparency of the wholesale energy markets

(REMIT), the Authority notified the European Commission and ACER of the aforementioned potential violations of antitrust law in the national electricity markets.

Last 19 October, the Authority published resolution 575/2016/R/eel, with which it envisages automatic redistribution to final customers of the amounts that will be recovered from Terna as a result of the prescriptive measures and asymmetric regulation measures adopted as a result of the above-mentioned proceedings.

EVOLUTION OF THE REGULATORY SCENARIO

Hydroelectric: concession fees

The Regional Council of the Umbria Regional Authority by means of resolution no. 1067 dated 22 September 2015 took steps to re-calculate the concession fees for the large water offtakes for hydroelectric purposes. The new unit tariff of 31.02 EUR/kW per module, which applies as from 1 January 2016, comes to double that in force until 31 December 2015. In December 2015, ERG Hydro S.r.l. presented an appeal to the Higher Court of the Public Waterways in Rome, to request the cancellation of the afore-mentioned resolution. The results for the period prudently reflect the aforementioned increase.

Italian Stability Law no. 208/2015

By means of the approval of Italian Stability Law no. 208/2015, new regulations were launched, as from 1 January 2016, for the determination of the cadastral income of the real estate property units used for generation purposes. Specifically, in Article 1, Paragraphs 21-24, the 2016 Italian Stability Law prescribes that system components in electricity generation plants are no longer subject to taxation, with a consequent positive impact in terms of lower tax costs.

BUSINESS SEGMENT

The scenario in the Italian electricity market is summarised in the following table.

	Year	
	2016	2015
Italian electricity market (GWh)⁽¹⁾		
Demand	310,251	316.897
Pumping consumption	2,424	1.909
Import/Export	37,026	46.378
Net internal generation ⁽²⁾	275,649	272.428
of which:		
<i>Thermoelectric</i>	187.461	182.861
<i>Hydroelectric</i>	42.323	46.451
<i>Other renewable energy sources</i>	45.865	43.116
Sale prices (EUR/MWh)		
PUN⁽³⁾	42,8	52,3
Centre North zone price	47,6	57,9

(1) Source: Terna S.p.A. monthly report on the electrical system. Estimated data, subject to correction

(2) Output net of consumption for auxiliary services

(3) Single National Price. Source: GME S.p.A.

MARKET SCENARIO IN ITALY

Demand for electricity from the Italian electricity system in 2016 amounted to 310.3 TWh, down (-2.1%) from 2015 levels.

In the group of regions including Abruzzo-Lazio-Marche-Molise-Umbria, where ERG was active at the end of 2015 with its hydroelectric plants, the request for electricity came to 43.6 TWh (-2.3%).

In the same period, net internal electricity generation amounted to 275.6 TWh, up by 1.2% compared to 2015, whilst the net balance of trading with foreign countries recorded net imports of 37.0 TWh (-20.2% compared to 2015). 68% of (net) domestic production was guaranteed by thermoelectric power plants and the remaining 32% by renewable sources. Compared to the prior year, there was higher production from thermoelectric sources (+3%) and a decrease in hydroelectric power (-9%), with higher production from other renewable sources (+6%), particularly due to higher wind power generation (+19%) and essential stability in geothermal power and photovoltaic output.

The average value of the PUN (Single National Price) in 2016 was 42.8 EUR/MWh, down by 18.2% compared with the value recorded in 2015 (52.3 EUR/MWh).

CAPITAL EXPENDITURE

Investments for EUR 3,564 thousand were made during the year, of which EUR 260 thousand referring to intangible fixed assets regarding software for the control centre and EUR 3,304 thousand to tangible fixed assets regarding the production plants.

More specifically, the key capital expenditure regarded the Galleto plant for EUR 929 thousand, the Cotilia plant for EUR 868 thousand, the Nera Montoro plant for EUR 268 thousand, the Narni plant for EUR 228 thousand, the Corbara dam for EUR 190 thousand and the control centre for EUR 180 thousand. Moreover, an investment of EUR 145 thousand was made for the design and authorisation of mini-hydro plants.

MANAGEMENT AND COORDINATION

The Company - while retaining full managerial and operational autonomy - is subject to management and coordination by ERG S.p.A. This generates advantages, synergies and economies of scale that derive from being a member of the ERG Group.

This is represented, inter alia, by the following:

- definition of the business strategies and the corporate governance systems and corporate structure;
- determination of shared general policies with respect to human resources, accounting, financial statements, taxes, information & communication technology, procurement, finance, investments, risk management, communications, institutional relations, and corporate social responsibility.

More specifically, the following decisions were made by ERG Hydro S.r.l., within the scope of management and coordination by ERG S.p.A.:

- Board of Directors meeting of 21 March 2016:
 - item 5: Domestic Tax Consolidation: exercise of the option for the three-year period 2016-2018; inherent and consequent resolutions.
- Board of Directors meeting of 11 May 2016:
 - item 2: Quarterly forecast for the annual budget of investments.

- Board of Directors meeting of 3 August 2016:
item 3: Quarterly forecast for the annual budget of investments.
- Board of Directors meeting of 8 November 2016:
item 3: Quarterly forecast for the annual budget of investments;
item 4: Contract for the provision of electricity with ERG Power Generation S.p.A.
- Board of Directors meeting of 13 December 2016:
item 1: Investments budget for 2017;
item 2: Long-term contract for the supply of electricity between ERG Power Generation S.p.A. and ERG Hydro S.r.l.;
item 4: Calendar of meetings of corporate bodies for 2017.

MAIN TAX CHANGES

Domestic Tax Consolidation

During the year 2016, the company ERG Hydro S.r.l., together with ERG S.p.A., subscribed the option for group taxation pursuant to Article 117 et seq. of the Consolidated Law on Income Taxes (Presidential Decree no. 917/86).

The aforementioned optional regime for group taxation consists of calculating an overall total taxable income comprising the algebraic sum of the total net incomes of the participating companies, with the consequent determination of a single group IRES tax.

The option has a three-year duration and was subscribed for the years 2016-2018.

Super amortisation/depreciation of 140%

Article 1, paragraphs 91-94 and 97 of Italian Law 208 of 28 December 2015 (2016 Stability Law) contains the provisions aimed at providing incentives for investments in new capital goods, via a percent increase in the cost recognised from a fiscal standpoint for said assets (so-called “super-amortisation/depreciation”).

For the purposes of determination of IRES, for parties that made investments in new capital goods during the period between 15 October 2015 and 31 December 2016, the purchase cost is increased by 40%, exclusively with regard to determination of the amortisation amount for tax purposes and of the finance lease instalments.

In 2016, the company ERG Hydro S.r.l. made investments that were eligible for the tax incentives described above.

Italian Stability Law no. 208/2015 (IMU and TASI)

By means of the approval of Italian Stability Law no. 208/2015, new regulations were launched, as from 1 January 2016, for the determination of the cadastral income of the real estate property units used for generation purposes. Specifically, in Article 1, paragraphs 21-24, the 2016 Italian Stability Law prescribes that for electricity generation plants, the so-called “imbullonati” (system components) are no longer subject to taxation, with a consequent positive impact in terms of lower tax costs.

RISKS AND UNCERTAINTIES

Risk management is an integral and fundamental part of the strategies of any organisation: it is the process whereby companies handle the risks linked to their activities, with the objective of obtaining long-lasting benefits over time and thereby ensuring the sustainability of their business. The basis of good risk management consists in identifying and managing risks in a way that allows for the understanding of the possible positive and negative aspects of all factors which may influence an organisation.

The ERG Group has implemented an Integrated Risk Management (IRM) Model that is a key part of the Internal Control and Risk Management System, aimed at making a proactive contribution to safeguarding the assets of the ERG Group and to an efficient and effective management of the Group, in line with the corporate strategies defined by the Board of Directors.

In this respect, during 2016 and as part of the more general “OneCompany” project of reorganisation of the ERG Group, the Enterprise Risk Management Team was created (hereinafter also: ERM Team), organisationally situated under the CFO.

The objectives of the ERM Team include those of ensuring performance of risk assessment activities, monitoring of the key risks of the Group and reporting to top management, supporting Group Management in:

- identifying, quantifying and managing the key risks to which the Group is exposed, as part of normal company operations as well as in extraordinary projects/transactions;
- drawing up strategic plans, with analysis of the underlying risk profile.

In this respect, the IRM Model is implemented through:

- identification and assessment of the main risks tied to the Business Plan, as well as definition of the respective management policies, also through market benchmarks to adopt the relative best practices;
- continuous verification of the operation and effectiveness of the risk management process.

The new IRM Model takes into account the characteristics of the Group and of the businesses in which it operates, and it is updated periodically to take into account changes in the scenario in which the ERG Group operates; it is also defined on the basis of benchmark international best practices (ERM CO.S.O Framework) and is an integral part of the Internal Control and Risk Management System.

Implementation of the new IRM model has already enabled the achievement of the following objectives, illustrated in the figure below, in 2016:

- supporting the Board of Directors and management in making decisions that are consistent with the company's risk profile and with the corporate objectives;
- providing an integrated overall vision of the company risks across all areas (Strategic, Financial, Operational, Compliance);
- strengthening the culture of Risk Management at all levels of the organisation;
- defining a unique Risk Management method for the Group.

The adopted methodology is characterised by periodic assessments of the primary risks to which the Group is subject, both current and forecasted. The assessment aims to determine the most significant risks as well as verify whether the management and oversight strategies that serve to mitigate risk are adequate, in addition to identifying action plans to strengthen the internal control and risk management system. At the basis of the Integrated Risk Management system is the creation of a culture of attention to risk, at all levels of the organisation.

The document "Risk Management Policy of the ERG Group" identifies the risks to which the Group's activities are exposed, outlines the relative responsibilities (so-called Risk Owners) and defines the rules for their correct management, as well as monitoring and reporting activities. This document is periodically subject to review in order to render it compliant with the internal changes, as well as with the highly dynamic external scenario. The latest edition dates back to October 2016.

With regard to the activities of the Company ERG Hydro S.r.l., the main risks identified, monitored and managed were:

- Renewable resource availability risk (Water)
- Regulatory risk
- New investment risk
- Business interruption risk
- Health, Safety and Environment (HSE) Risk
- Anti-corruption compliance risk
- Human capital risk
- Liquidity risk
- Credit risk
- Information & Communication Technology risk
- Counterparty risk

Renewable resource availability risk (Water)

This risk consists of the possibility that the Company suffer from economic damage resulting from volatility in electricity production volumes, particularly with regard to the renewable production of its hydroelectric plants and to the availability of the natural resource water.

The risk tied to the natural variability in the availability of renewable sources, which are known to vary according to the weather conditions of the sites where the plants are located, is mitigated by the ERG Group through:

- technological diversification of the renewable plants (e.g., Wind and Hydro) implemented at Group level and geographical diversification of the production farm in order to reduce both the impact as well as probability of occurrence;
- planning of renewable plant shutdowns based on periods with low use of renewable sources, thereby reducing their impact;
- use of more accurate weather forecasting tools to further improve the Volume risk management strategies at Group level.

The risk management strategies are carried out in accordance with company policies.

Regulatory Risk

This risk is related to developments in the local scenario of the countries in which the Group conducts its business. Considering the strict regulations that govern the business in which the Company operates, these developments could have significant impacts on the value of the assets. The risk factors therefore include the constant and not always predictable development of the regulatory context of reference.

ERG Hydro S.r.l. continuously monitors the development of the applicable regulatory framework to prevent and/or promptly evaluate the impact of the regulatory changes on the business areas. This is implemented through a structured oversight system with multiple levels, which involves collaboration with institutions as well as with governance bodies in addition to regulation of the sector through active participation in trade associations and work groups that are established within these entities; changes in regulations and provisions by the sector authority are also reviewed and specific position papers are drawn up in order to communicate our position in this regard.

For this purpose, ERG Hydro S.r.l. has established specific Organisational Units dedicated to the continuous monitoring of the evolution of national and international regulations.

The risk management strategies are carried out in accordance with company policies.

New Investment Risk

This refers to the set of uncertain events originating from various factors, for example, scenario-related (micro/macro-economic, political, regulatory, business), technical, operational, financial or organisational, which may impact the decision of a new investment and its success.

These risks are predominantly attributable to the impossibility of making accurate economic/financial forecasts during the period of the plan or life of the project, with consequent economic and equity losses.

To minimise risk, specific structured processes are defined for the selection of investments, which envisage a series of consecutive levels of examination and approval carried out also on the basis of internal and external support studies, benchmark analyses, legal-regulatory analyses, sustainability models and financial valuation/planning models. The Company minimises possible risks linked to new investments by assessing potential associated risks for all relevant projects.

The risk management strategies are carried out in accordance with company policies.

Business Interruption Risk

This involves the risk of occurrence of natural, accidental or catastrophic (i.e. earthquakes, floods, tidal waves, fires, etc.) events during the exercise of the business activities, with negative financial consequences or negative consequences with respect to conservation of the company assets, to the extent of seriously compromising routine operations or undermining the stability and balance of the Company to a significant, long-lasting extent.

With regard to the risk of non-availability of plants, the ERG Group, which includes the company ERG Hydro S.r.l., implements within all of its production units strategies for preventive mitigation in order to reduce their probability, in addition to strategies which aim to mitigate their impact. More specifically, the ERG Group, which includes ERG Hydro S.r.l., mitigates these risks through:

- plant management policies aimed at pursuing high levels of safety and operating excellence, in line with the best industrial practices;
- the adoption and continual updating of programmed maintenance procedures, both of ordinary and extraordinary nature, and in accordance with the best practices of the sector; these procedures aim to identify and prevent potentially critical factors, even on the basis of specific engineering analyses conducted by specialised personnel;
- periodic audits of the plants are planned, as well as the use of control and remote control instruments in order to monitor technical parameters and promptly detect any potential anomalies; moreover, where possible, redundant systems are utilised in order to guarantee the continuity of business processes;
- continual supply of specialised training courses for technical personnel working on the plants.

In addition, the gradual adoption of advanced software and sensors for calculating the effective performance of the plants is planned, in order to add a further element of prediction compared to the past when scheduling and executing maintenance operations. As regards production processes, particular attention is paid to the prevention and control of the related risks, through the implementation of risk assessments, business impact analyses and a business continuity management activity, with the aim of ensuring the operational continuity of industrial production plants.

Moreover, specific monitoring activities are underway by the Company in order to assess the seismic safety of the dams, of the production plants and of the relative infrastructures, linked to the exceptional situation in central Italy, which has been impacted by severe earthquakes in recent months. The activities have been conducted under the supervision of the Ministry of Infrastructure and Transport - Dams Department, and coordinated alongside Civil Protection. At the current time, the controls have confirmed the seismic safety of all of the dams, infrastructures and

production plants. To cover risks of natural disaster or catastrophic events, the ERG Group, which includes ERG Hydro S.r.l., uses the insurance market to transfer its own industrial risk and risk in relation to third parties, and to cover residual risk, thereby providing a high level of protection for its facilities, even in the event of an interruption of activity. The contractual conditions which characterise these insurance policies are revised periodically. The risk management strategies are carried out in accordance with company policies.

Health, Safety and Environment (HSE) Risk

The HSE Risk is mainly linked to the operation of industrial assets that have an impact on the health and safety of workers and on environmental matters.

Health risks are those with potential impact and impairment of the biological equilibrium of personnel tasked with performing operations or work processes, as a result of emission into the environment of environmental risk factors, of a chemical, physical and biological nature.

Safety risks are those related to the occurrence of accidents or injuries, or of physical harm or impairment (more or less serious) suffered by staff working at the various jobs.

Environmental risks are connected to the possibility of occurrence, due to the business activities of ERG Hydro S.r.l., of an event that alters the physical-chemical parameters of the environmental matrices (water, air, soil), with negative repercussions on the natural habitat and/or on the health of people, such as to require the adoption of extraordinary emergency measures having negative consequences for the Company, from an economic, equity and/or reputation standpoint.

The ERG Group, which includes ERG Hydro S.r.l., is strongly committed to reducing these risks by adopting specific guidelines on matters of health, safety and the environment that, in accordance with the relevant best practices, envisage that all Companies of the Group: (i) comply with all laws and regulations in effect; (ii) pursue specific performance targets; (iii) continuously train staff; and (iv) certify specific integrated HSE management systems.

Moreover, ERG Hydro S.r.l. adopts safety standards and operating practices having high quality and reliability in order to assure regulatory compliance, continuous improvement of environmental performance and the effectiveness of the actions taken in terms of prevention and containment of potential environmental impacts.

In particular, Companies that manage industrial assets, such as ERG Hydro S.r.l., which by their nature are more exposed to the HSE risk, are all provided with an OHSAS 18001 and ISO 14001 certified Management system, as well as achievement of EMAS certification on the main plants. During the course of 2016, the periodic inspections by the certification bodies were carried out, resulting in the issuance and/or confirmation of the certifications held by the Company.

Moreover, the Company pursues the goal of zero injuries, through a structured oversight of health and safety issues and the development of numerous programmes for prevention and for spreading a "safety culture", directed both at internal personnel and at suppliers operating in the plants. Care for people is also expressed through initiatives directed at personal development, performance assessment at all levels and sharing best practices.

The adoption of the best available technology, the application of increasingly rigorous and exacting work practices

in terms of prevention and reduction of pollution, and the correct management of the waste produced allow the industrial activity and related Health, Safety and Environment issues to be managed efficiently.

The ERG Group, which includes the Company ERG Hydro S.r.l., currently publishes its Sustainability Report, which contains important information and data pertaining to HSE and social factors linked to the activities of the Group itself.

The risk management strategies are carried out in accordance with company policies.

Anti-corruption compliance Risk

This risk regards the possibility of an employee and/or a Company being involved in a proceeding for crimes committed in violation of the anti-corruption laws in effect and which may involve sanctions.

The ERG Group, which includes ERG Hydro S.r.l., condemns the use of any corruptive practice with the utmost rigour and without exception. To prevent corruption crimes, the Company has adopted a system of rules and controls defined in relation to the national and international regulatory context in which it operates. In particular, for Companies of the ERG Group:

- a system of behavioural rules adopted by Companies of the Group (Code of Ethics, 1, and Anti-corruption Guidelines) has been defined, based on the respective characteristics, which all employees are required to respect in carrying out their activities and which prohibit any form of corruption, active or passive, involving not only public officials but private parties as well;
- specific employee training programmes are defined and implemented, aimed at describing the regulatory framework on anti-corruption (and the relative sanctions system), along with the behavioural rules adopted by the Group (e.g., Code of Ethics and Anti-corruption Guidelines).

The risk management strategies are carried out in accordance with company policies.

Human Capital Risk

These are risks regarding the management of Human Capital, with potential negative consequences on the achievement of objectives by the Company. This category comprises Human Capital Development risk and Compensation and Retention risk.

Human Capital Development risk

This risk is defined as the risk that human capital, defined as the set of skills, knowledge, education, information and technical ability that give rise to the human ability to create value for the company, could be quantitatively or qualitatively inadequate with respect to the objectives of the Business Plan.

As human capital is a key factor in its business model, the ERG Group, which includes ERG Hydro S.r.l., monitors and manages such risk through a structured approach centralised at Group level, overseen by a specific committee (the Human Capital Committee) involving specific organisational units that guarantee the planning process for Human Capital, its promotion and constant alignment to the business objectives.

Development of the management culture is governed through a structured process of assessment of the divergence between the skills necessary to perform a specific skill and those effectively possessed by those performing the skill (Skill Gap Analysis), constant monitoring of the indicator  (Human Capital Coverage - registered trademark) and activation of any adjustment measures.

In addition, the Human Capital Committee defines and monitors the main programs and activities for human resource development and supports the Executive Vice President and CEO of Parent Company ERG S.p.A. in decisions relating to personnel management and remuneration systems.

Compensation and Retention risk

This refers to the risk that rewarding systems are inconsistent with market benchmarks and with the strategies, with a consequent economic impact for the Company caused by the loss of key professional figures.

The ERG Group, which includes ERG Hydro S.r.l., mitigates this risk through the development of remuneration strategies and policies based on weighting and matching of positions, in line with market benchmarks, in order to ensure optimal balancing of the reward components (monetary and non-monetary) and respect of the retention objectives. The Group uses instruments that are differentiated based on the level of strategic relevance and seniority of its personnel. In this respect, the fixed remuneration component ensures retention through constant market benchmarks, while the variable component ensures alignment of the company's objectives with those of individuals.

The risk management strategies are carried out in accordance with company policies.

Liquidity Risk

The risk resulting from the lack of financial resources to meet both short term and medium/long term commercial and financial commitments is called liquidity risk. This type of risk considers the possibility that the company is not capable of meeting its payment commitments because of difficulties in obtaining funds (funding liquidity risk), liquidating assets on the market (asset liquidity risk) or due to inadequate management of company liquidity.

More specifically, Hydro S.r.l. implements a risk mitigation strategy that involves the pursuit of a balanced financial structure in terms of duration and composition, constant monitoring of the financial balance and systematic generation of cash by its business activities.

The financial planning process has the following objectives:

- allowing the Company to be solvent under normal operating conditions as well as crisis conditions, optimising on the relative cost-opportunity;
- ensuring an adequate liquidity level for the Company, optimising on the cost of funding in relation to the current and future market conditions;
- guaranteeing an adequate distribution of credit lines, cash deposits and the relative financial assets among the major banks;

The risk management strategies are carried out in accordance with company policies.

Credit risk

This is the risk of unexpected changes in creditworthiness of a counterparty with respect to which there is an exposure that could lead to potential negative consequences in economic-financial terms.

ERG Hydro S.r.l. applies a credit risk mitigation strategy with the aim of optimising the risk profile in the pursuit of its commercial and business targets, through:

- a structured process in which specific Organisational Units and a Credit Committee assess the creditworthiness of each commercial counterparty, assigning to each a specific level of credit that can never be exceeded or, alternatively, carrying out sale transactions upon presentation of a suitable guarantee (e.g. letter of credit, bank guarantee, etc.);
- constant monitoring of the overall exposure and exposure by counterparty, and definition and implementation of any corrective measures.

The risk management strategies are carried out in accordance with company policies.

Information & Communication Technology Risk

This risk involves the inadequacy of all the technical and organisational measures aimed at ensuring protection of the completeness, availability and confidentiality of the automated information and the resources used to acquire, store, process and communicate this information.

In particular, the following main risks are associated with IT systems:

- risk of unsupervised access to networks, systems and data processing centres: this refers to the possibility of unauthorised personnel accessing systems, information or the rooms containing the processors and compromising their use, jeopardising the integrity and security of the systems and of the information contained within them;
- risk of vulnerability of the IT systems: this risk is related to the possibility that the architecture/framework of the ICT systems will be vulnerable to internal/external attacks or exposed to associated events due to defects in the design, implementation, configuration and/or the management of the systems or due to a lack of awareness of ICT risks on the part of corporate personnel;
- risk of technological disaster: this risk identifies the possibility that the technological infrastructures serving corporate operations may be dramatically compromised by accidental events.

The activities of the ERG Group, which includes the Company ERG Hydro S.r.l., are managed using ICT systems that support the main corporate processes, both operational and administrative and commercial. ERG Hydro S.r.l. reduces risks related to ICT systems through the following main control objectives, in line with the ISO 27001:2013 standards and the Cobit 5 Model:

- constant protection of the confidentiality, integrity and availability of the information on the ICT systems;
- adoption of specific behavioural models to be adopted when using the work stations and ICT tools, aimed at ensuring adequate security levels for the information;

- outsourcing of management of the main systems with a supplier equipped with data centres having high physical security levels and standards, formally certified;
- adoption of tools to manage logical and physical accesses, as well as verify and record them, based on the relevant best practices;
- use of automatic tools to identify and manage accidents and anomalies;
- implementation of processes for the design, development, operation, maintenance, assistance and disposal of ICT infrastructures, of network services and of applications for mitigating the vulnerability of the ICT systems, in line with reference best practices.

The process of integration and consolidation of IT systems within the ERG Group, designed based on the changes in the company structure in previous years, currently in the finalisation phase, will yield considerable benefits and a consequent reduction in associated ICT risks thanks to an approach based on risk management.

To mitigate the potential risks of interruption of business activities on ICT processes regarded as strategic, ERG Hydro S.r.l. has a Disaster Recovery system in place which ensures continuity of services and data through an alternate Data Centre, whose efficiency is subject to regular checks.

The risk management strategies are carried out in accordance with company policies.

Counterparty Risk

This risk refers to the possibility that ERG Hydro S.r.l. could suffer from damage in terms of image or economic loss as a consequence of dealings with inadequate or unreliable counterparties with bad reputations or included on the international Black Lists.

The Company does not establish relationships with counterparties that do not adhere to the same values as the Group, which are based on the highest ethical and moral standards.

Moreover, with regard to supplies, a structured process has been designed and envisages the following: qualification (economic-financial, technical and HSE) and selection of suppliers according to formally defined parameters and criteria; use of tenders for the provisioning of goods and/or services; definition of a cumulative purchasing threshold with regard to a single supplier; development of specific internal contracts that include safeguarding clauses.

The risk management strategies are carried out in accordance with company policies.

HEALTH, SAFETY AND ENVIRONMENT

Protecting persons' health and safety and the environment is a priority that has always characterised the ERG Group's enterprise culture: the prevention and management of the connected risks are therefore central in the implementation of the Group's strategic guidelines.

Redefinition of the Group's organisational and corporate structure and the strategic choices, ever more focused on the renewable energies business, supports the necessary revisions to the management of health, safety and environmental issues and, more in general, to the Group's corporate social responsibility (CSR).

In accordance with the principles and guidelines set out in the Code of Ethics, the activities of ERG Hydro S.r.l. in 2016, first year of ERG management, were directed at achieving the business objectives, while protecting the environment in which it operates and safeguarding the internal and external stakeholders with whom it interacts.

The principles with regard to health, safety and the environment were adopted at the beginning of 2016 in the Group's new Sustainability Policy, which outlines the values, commitments and objectives that ERG aims to pursue in terms of sustainability with respect to all stakeholders. This Policy is applied together with the laws and regulations in force in all Countries where ERG operates, with the principles of behaviour defined in the Code of Ethics, with the other policies and rules adopted by the Group.

In 2016, the individual Organisational Units responsible for HSE matters handled the legal provisions connected to operations: updating of the appointments and delegated powers pertaining to HSE, training at all organisational levels, particularly with regard to refresher training for the heads of the emergency teams, fire-fighting personnel and first aid personnel.

With a view to sensibility and attention that goes beyond the legal requirements, as stated in the Code of Ethics, activities connected to the management and maintenance of certified systems of the business units continued within the Group, and new important steps were also taken towards excellence.

MANAGEMENT SYSTEMS AND CERTIFICATIONS

Starting from 2005, the Hydroelectric Complex in Terni achieved certification of its Environmental Management System according to ISO 14001 standards, while the first EMAS Registration pursuant to EC Regulation 1221/2009 dates back to 2006. This commitment represents an important result that required a cultural change in all employees and a significant effort in organisational terms, as well as in terms of personal commitment. Issuance of the first ERG Hydro S.r.l. Environmental Declaration in 2016 allowed the Terni Complex to present to its stakeholders the results obtained from operation of the plants, from the technical-organisational standpoint as well as in terms of environment and safety.

Continuation of ERG Hydro S.r.l.'s voluntary participation in a community eco-management system is further confirmation of the importance of the environmental sustainability issue for our Group, in order to make one of the objectives of "corporate social responsibility" (CSR) even more effective: open dialogue with the public. In fact, we believe that it is only through open dialogue with stakeholders and through the application of a sustainable development model that we can ensure continuity and quality of results, combining with total respect for the environment and communities.

ERG Hydro S.r.l. also pursues, with a full sense of responsibility, the "zero accidents" objective, to protect all workers, giving priority and central importance to the respect and safety of people. An important tool in implementing these principles is the Health and Safety Management System, in compliance with the OHSAS 18001 international standard that the Terni Complex has adopted since 2011.

During the course of the two certification processes, confirmed in 2016, no significant evidence emerged, only observations for improving certain processes, thereby confirming the efficacy of the management of corporate processes pertaining to workplace environment and safety.

HUMAN RESOURCES

The objectives of the Group, which includes ERG Hydro S.r.l., present important challenges, in terms of consistency and incisiveness, for the management of people and processes. The activity that also involves the human capital and organisational development model is based on an increase in the value of human capital (PEOPLE), alignment and motivation of management (MBO), orientation towards the creation of value and retention over time (LTI) and continuous refining of the organisational structure.

During 2016, the project for the Group's new organisational layout was launched, with a strong focus on process logic and a willingness to "reunite" the entire organisation towards a single common vision, thereby leading to the name "ONE Company", characterised by the definition of the two macro-roles. That of corporate ERG S.p.A., which ensures the strategic direction and management of all business support processes, and that of company ERG Power Generation S.p.A., which is assigned responsibility for the Group's industrial and commercial processes.

At 31 December 2016, ERG Hydro S.r.l.'s staff number totalled 90 units (compared to 91 at 31 December 2015), consisting of 1 executive, 11 managers, 57 office workers and 21 blue collar workers.

The Company's staff consists of employees acquired on 30 November 2015, following transfer of the hydroelectric segment as a result of the demerger of E.On Produzione S.p.A.

During the course of the year, staff numbers declined by 4 units, due to transfer to another company of the ERG Group, and increased by 3 units, of which two new hires in August 2016 in the Energy Management area and 1 unit from E.On Italia.

The average age of the workforce is about 50; compared to the general population, about 73% of the staff have secondary school diplomas and about 12% are graduated.

During 2016, an Onboarding process was planned and developed, involving all personnel on site, with the objective of integrating the Hydroelectric Complex with the ERG world, through direct involvement of people and people managers. Management, technical and safety training activities were carried out for the entire corporate population of the Terni Hydroelectric Complex.

A process of talks and meetings with the national and regional Trade Union Organisations was also undertaken in 2016, in accordance with the Group policies on union relations, with the objective of harmonising management and second-level bodies on site with the policies of the ERG Group.

ORGANISATION AND MANAGEMENT MODEL AND SUPERVISORY COMMITTEE PURSUANT TO ITALIAN LEGISLATIVE DECREE 231/2001

On 11 May 2016, the Board of Directors of ERG Hydro S.r.l. approved the Organisation and Management Model pursuant to Italian Legislative Decree 231/01 ("231 Model") and simultaneously appointed a collective Supervisory Committee consisting of one external member, as Chairman, and two internal members (of which the Head of Internal Audit), assigned the task of oversee compliance with the Code of Ethics and verifying the effectiveness and adequacy of the aforementioned 231 Model in preventing crimes pursuant to the Decree. Classroom training was conducted in this respect for all Company personnel. Following its appointment, the Supervisory Committee adopted a Regulation to govern its functioning and approved a Plan of verification measures, also proposing a budget to the Company's Board of Directors, which was regularly approved. The verification activities were carried out by the Supervisory Committee, with the support of the Internal Audit function of ERG S.p.A. The analysis of information flows and reports received, as well as the verifications conducted, did not identify any anomalies with respect to compliance with the Code of Ethics and the effectiveness and adequacy of 231 Model. As part of these verifications, limited margins for improvement were identified, with respect to which specific resolution plans were agreed upon with Management. The Company utilises - for all processes that are not strictly core business operations - services from other Group Companies through service contracts, in particular with ERG Power Generation S.p.A., ERG Services S.p.A. and ERG S.p.A.

PRIVACY

In 2016, the ERG Group again invested adequate resources and skills on compliance with regard to privacy; the internal regulatory system as well as the system for appointments and proxies were systematically updated, aligning them to the external regulatory changes and internal organisational changes, to guarantee compliance with the provisions of the Privacy Code (Italian Legislative Decree no. 196/2003) and with the Provisions issued by the Authority for the protection of personal data.

With regard to the regulatory restrictions arising from the introduction of the European regulation on the protection of personal data (24 May 2016), the ERG Group is preparing to adopt all of the regulatory aspects which, in any case, will become definitively and directly applicable in all EU countries starting from 25 May 2018.

FINANCIAL STATEMENTS

INCOME STATEMENTS

The economic results for the year 2016 are summarised in the statement below, obtained by reclassifying the income statement data based on management criteria.

The income statement at 31 December 2016 reflects operations for the entire year, while the 2015 values only refer to the month of December 2015, which is the month in which the Company began operating, and comparability is of little significance.

(EUR thousand)	2016	2015	Change
Revenues from ordinary operations	69,423	5,988	63,435
Other revenues and income	54,080	4,886	49,194
Non-recurring revenues	28,555	–	28,555
TOTAL REVENUES	152,058	10,875	141,183
Cost of purchases	(2,885)	(374)	(2,511)
Change in inventories	–	–	–
Costs for services and other operating costs	(31,818)	(2,075)	(29,743)
CONTRIBUTION MARGIN	117,355	8,426	108,929
Personnel costs	(6,969)	(600)	(6,369)
GROSS OPERATING MARGIN (EBITDA)	110,386	7,826	102,560
Economic-technical amortisation, depreciation and write-downs	(54,887)	(4,602)	(50,285)
EBIT	55,499	3,224	52,275
Net financial income (expenses)	64	(4)	68
NET PROFIT (LOSS) FROM ORDINARY OPERATIONS	55,563	3,220	52,343
Income taxes	(17,923)	(1,437)	(16,486)
PROFIT (LOSS) FOR THE YEAR	37,640	1,783	35,857

Operations recorded a value of production of EUR 152,058 thousand, including revenues from the sale of electricity for EUR 69,423 thousand, revenues relative to the Feed-in premium for EUR 50,585 thousand, and Green Certificates for EUR 28,555 thousand, plus EUR 2,231 thousand for water diversion and revenues of EUR 1,264 thousand from other services provided by the Company.

Production costs comprise energy purchased and other purchases of material for EUR 2,885 thousand. Service costs amount to EUR 17,243 thousand, in addition to state property rent of EUR 12,165 thousand and other operating expenses of EUR 2,410 thousand.

The Contribution Margin amounts to EUR 117,355 thousand, which, net of personnel costs, results in an EBITDA of 72.6% of revenues.

Net of the depreciation/amortisation amount for the period, which amounts to EUR 54,887 thousand, EBIT amounts to EUR 55,499 thousand and represents 36.50% of the value of production.

The year 2016 closes with a profit of EUR 37,640 thousand, after taxes of EUR 17,923 thousand, mainly comprising the repayment of deferred tax assets.

Note that the comparability of data between the current year and the prior one is not significant, as the year 2016 represents a full year of operations, while the 2015 figures only refer to the month of December.

STATEMENT OF FINANCIAL POSITION

The Company's financial position is summarised in the statement below, obtained by reclassifying, based on management criteria, the statutory financial statements drawn up pursuant to Italian Legislative Decree 127/91.

For complete disclosure, for every item of the Statement of Financial Position, the values at 31 December 2015 are presented, essentially representing the values of transfer of the hydroelectric complex by E.On Produzione to ERG Hydro S.r.l. on 1 December 2015.

(EUR thousand)	31/12/2016	31/12/2015	Change
Fixed assets	610,027	661,349	(51,322)
Net working capital	4,821	11,209	(6,388)
Employees' severance indemnities	(1,654)	(1,715)	61
Other assets	23,336	132,024	(108,688)
Other liabilities	(12,891)	(11,202)	(1,689)
NET INVESTED CAPITAL	623,639	791,665	(168,026)
Shareholders' equity	744,982	784,343	(39,361)
Short-term net financial position	(121,343)	7,323	(128,666)
SHAREHOLDERS' EQUITY AND BORROWINGS	623,639	791,666	(168,027)

At 31 December 2016, net invested capital amounted to EUR 623,639 thousand and the net financial position increased due to cash flows from operations.

Fixed Assets

(EUR thousand)	31/12/2016	31/12/2015	Change
Intangible fixed assets	123,281	154,077	(30,796)
Tangible fixed assets	486,577	507,103	(20,526)
Financial fixed assets	169	169	–
Total	610,027	661,349	(51,322)

Intangible fixed assets mainly refer to goodwill for EUR 122,062 thousand, generated by the merger by incorporation which took place in 2001 and 2003, and to software costs regarding the sale of hydroelectric energy.

Tangible fixed assets included the hydroelectric complex comprising 16 hydroelectric plants, 7 dams, 3 reservoirs and a pumping station, located geographically throughout Umbria, Marche and Lazio, with an installed operating capacity of 526.5 MW.

Financial fixed assets, such as financial receivables, consist of security deposits.

Net working capital

(EUR thousand)	31/12/2016	31/12/2015	Change
Inventories	–	–	–
Trade receivables	15,919	25,411	(9,492)
Trade payables	(11,098)	(14,202)	3,104
Total	4,821	11,209	(6,388)

(*) current ratio 1.4

The breakdown of trade receivables is mainly as follows:

- receivables from the sale of electricity to parent company ERG Power Generation S.p.A. and operators of the electricity market (GSE and Terna);
- receivables from third parties for compensation from diversion of water.

The receivables are recognised net of the bad debt provision.

Trade payables mainly refer to payables for the supply of material and equipment, tenders and services.

Other assets

(EUR thousand)	31/12/2016	31/12/2015	Change
Deferred tax assets	9,086	22,691	(13,605)
Tax receivables	3,469	269	3,200
Short-term accrued income and prepaid expenses	5,742	5,716	26
Other short-term receivables	5,038	103,348	(98,310)
Total	23,336	132,024	(108,688)

Tax receivables consist of the VAT credit accrued during the year.

Short-term accrued income and prepaid expenses refer to hydroelectric rent and insurance.

Other short-term receivables essentially refer to the feed-in premium and to an adjustment of the green certificates of prior years for a plant.

Other liabilities

(EUR thousand)	31/12/2016	31/12/2015	Change
Short-term tax payables	(2,746)	(198)	(2,548)
Other short-term payables	(3,154)	(3,019)	(135)
Medium/long-term tax payables	(5,130)	(5,281)	151
Medium/long-term payables due to social security institutions	(413)	(421)	8
Short-term accrued expenses and deferred income	–	1	(1)
Other provisions for liabilities and charges	(1,448)	(2,284)	836
Total	(12,891)	(11,202)	(1,689)

The main items are:

- “Short-term tax payables” essentially regard the IRAP payable;
- “Other short-term payables” mainly comprise payables for concessions and to employees;
- “Medium/long-term tax payables” represent the deferred tax provision;
- the item “Other provisions for liabilities and charges” consists of allocations for water lease expense and other agreements with public entities for EUR 263 thousand, employee expenses for EUR 861 thousand, tax expenses for EUR 120 thousand and contractual charges for EUR 204 thousand.

Net financial position - Cash and cash equivalents

The net financial position went from a debt position to a credit position, thanks to the positive cash flow generated during the year by operations.

(EUR thousand)	31/12/2016	31/12/2015	Change
Short-term bank borrowings	–	–	–
Other short-term financial payables	–	(7,604)	7,604
Short-term financial liabilities	–	(7,604)	7,604
Cash and cash equivalents	1,784	281	1,503
Other short-term financial receivables	119,559	–	119,559
Short-term financial assets	121,343	281	121,062
TOTAL	121,343	(7,323)	128,666

The item “other financial receivables” refers exclusively to the receivable from ERG Power Generation S.p.A. for the positive balance of the intra-group current account through which the cash flows are managed.

Analysis of the change in net financial position during the period in question highlights the following:

(EUR thousand)	2016	2015
CASH FLOW FROM OPERATING ACTIVITIES		
Cash flow from current operations	110,652	(23,743)
Change in operating assets and liabilities	98,579	133,828
Total	209,231	110,085
CASH FLOW FROM INVESTING ACTIVITIES		
Capital expenditure	(3,564)	665,129
Divestments	–	–
Total	(3,564)	665,129
CASH FLOW FROM SHAREHOLDERS' EQUITY		
Transfer	–	(782,543)
Paid-in capital in excess of par and other distributed reserves	(75,218)	–
Distributed dividends	(1,783)	–
Total	(77,000)	(782,543)
TOTAL NET FINANCIAL CHANGE	128,666	(7,329)
Initial net financial indebtedness	(7,323)	–
Financial debt from transfer		3
Change in the period	128,666	(7,326)
FINAL NET FINANCIAL POSITION	121,343	(7,323)

RELATIONS WITH PARENT COMPANIES, SUBSIDIARIES, ASSOCIATES AND COMPANIES CONTROLLED BY THE PARENT COMPANIES

With regard to the information required by Article 2428, paragraph 3, number 2) of the Italian Civil Code, the main relations between the Company and the companies that form part of the ERG Group are set out below, with transactions settled on an arm's length basis.

Intra-group relations in 2016 are closely correlated to the Company's operations and specifically regard:

- "Centralised Financial Management Agreement" with parent company ERG Power Generation S.p.A. to manage treasury flows and use the financial services. Financial transactions between the parties are settled through an intra-group current account and remunerated based on the 1-week Euribor rate plus a spread. Interest is tallied on a quarterly statement and paid via the intra-group account.
- "Services Contract" with parent company ERG Power Generation S.p.A., based on which the Company receives the administrative, legal and corporate, finance and treasury, information technology and human resource services.
- "Contract for the provision of electricity", according to which, starting from 1 July 2016, the Company sells the electricity generated by its own hydroelectric plants, except for the plants with agreements in place with the GSE for dedicated withdrawal, to parent company ERG Power Generation S.p.A. and simultaneously grants the latter authorisation to act as dispatching user.
- "Domestic Tax Consolidation", signed on 30 May 2016 with parent company ERG S.p.A., based on which the Group taxation option was exercised. Participation of ERG Hydro S.r.l. in the Domestic Tax Consolidation involves the transfer of its taxable income to parent company ERG S.p.A., with subsequent recording in the financial statements of costs or revenues from the consolidation, as well as payables or receivables to/from parent company ERG S.p.A. for the consolidation. The option has a three-year duration, for the years 2016-2018.

The table below summarises the financial and equity items for the year 2016 with the Group Companies:

(EUR thousand)	Receivables	Payables
ERG S.p.A.	–	(1,916)
Trade	–	–
Financial	–	–
Tax	–	(1,916)

ERG Power Generation S.p.A.	133,317	(939)
Trade	13,758	(939)
Financial	119,559	–
Tax	–	–

(EUR thousand)	Revenues	Costs
ERG Power Generation S.p.A.	(30,547)	7,272
Sales/Purchases	(30,464)	7,237
Financial	(83)	35
Tax	–	–
TotalErg S.p.A.	–	3
Sales/Purchases	–	3
Financial	–	–
Tax	–	–

TREASURY SHARES

The Company does not have any shares of its parent companies.

BRANCH OFFICES AND OFFICES

The registered office of ERG Hydro S.r.l. is in Genoa, with branches in:

- Province of Macerata: Visso
- Province of Perugia: Cerreto di Spoleto, Foligno and Preci
- Province of Rome: Rome
- Province of Rieti: Cittaducale and Posta
- Province of Terni: Alviano, Baschi, Orvieto, Narni and Terni.

RESEARCH AND DEVELOPMENT ACTIVITIES

The company did not conduct R&D activities during the period.

BUSINESS OUTLOOK

The Company will continue to develop the potential of the hydroelectric plants, with optimisation of their management, enabling maximisation of profitability from assets, with an increase in economic results and generation of cash, in accordance with the generation programmes and environmental regulations.

Growth in results is envisaged, thanks to the higher price of the incentive from which approximately 40% of production benefits, together with measures for constant improvement of efficiency.

Genoa, 7 March 2017

On behalf of the Board of Directors

The Chairman

Pietro Tittoni





Financial Statements

STATEMENT OF FINANCIAL POSITION

ASSETS

(EUR)	31/12/2016	31/12/2015
(A) SUBSCRIBED CAPITAL, UNPAID	–	–
(B) FIXED ASSETS		
I. Intangible fixed assets		
1) Start-up and expansion costs	2,390	3,000
3) Industrial patents and intellectual property rights	1,215,327	1,626,800
5) Goodwill	122,062,993	152,447,063
Total	123,280,710	154,076,863
II. Tangible fixed assets		
1) Land and buildings	52,425,981	54,666,191
2) Plant and equipment	432,930,839	451,386,843
3) Industrial and commercial equipment	208,114	247,859
4) Other assets	117,153	130,486
5) Fixed assets under construction and advances	895,092	672,906
Total	486,577,179	507,104,285
III. Financial fixed assets		
2) Receivables	of which within 12 months:	of which within 12 months:
e) Due from others	150,000	–
Total	168,718	168,738
TOTAL FIXED ASSETS (B)	610,026,607	661,349,886
(C) CURRENT ASSETS		
II. Receivables	of which beyond 12 months:	of which beyond 12 months:
1) Due from customers	–	–
4) Due from parent companies	–	–
4) _{bis} Tax receivables	–	–
4) _{ter} Deferred tax assets	5,244,940	9,300,480
5) Due from others	–	–
Total	33,512,766	151,718,492
III. Short-term financial assets		
7) Financial assets - centralised treasury management in respect of parent companies	119,559,072	–
Total	119,559,072	–
IV. Cash and cash equivalents		
1) Bank and postal deposits	1,782,116	280,741
3) Cash and notes on hand	2,233	578
Total	1,784,349	281,319
TOTAL CURRENT ASSETS (C)	154,856,187	151,999,811
(D) ACCRUED INCOME AND PREPAID EXPENSES		
Prepaid expenses	5,741,527	5,716,416
TOTAL ACCRUED INCOME AND PREPAID EXPENSES (D)	5,741,527	5,716,416
TOTAL ASSETS	770,624,321	819,066,113

LIABILITIES

(EUR)	31/12/2016	31/12/2015		
(A) SHAREHOLDERS' EQUITY				
I. Share capital	50,000,000	50,000,000		
II. Paid-in capital in excess of par	252,010,000	327,010,000		
III. Revaluation reserves	226,616,169	226,616,169		
IV. Legal reserve	64,867,941	64,867,941		
V. Statutory reserves	–	–		
VI. Other reserves:				
1) reserve for exchange rate gains	–	217,634		
2) alignment reserve	113,848,348	113,848,348		
VII. Reserve for transactions to hedge expected cash flows	–	–		
VIII. Retained earnings (losses)	–	–		
IX. Profit (loss) for the year	37,639,853	1,782,663		
X. Negative reserve for treasury shares in portfolio	–	–		
TOTAL SHAREHOLDERS' EQUITY (A)	744,982,311	784,342,755		
(B) PROVISIONS FOR LIABILITIES AND CHARGES				
2) Tax provision	5,129,757	5,280,527		
3) Other	1,448,190	2,283,923		
TOTAL PROVISIONS FOR LIABILITIES AND CHARGES (B)	6,577,947	7,564,450		
(C) EMPLOYEES' SEVERANCE INDEMNITIES	1,653,718	1,715,204		
(D) PAYABLES				
	of which beyond 12 months:	of which beyond 12 months:		
7) Trade payables	–	10,159,060	–	14,104,899
11) Payables due to parent companies	–	2,855,262	–	7,701,088
11) ^{bis} Payables due to companies subject to control by parent companies	–	470	–	–
12) Tax payables	–	828,981	–	197,756
13) Payables due to social security and pension institutions	–	412,954	–	421,200
14) Other payables	–	3,153,618	–	3,018,761
TOTAL PAYABLES (D)	17,410,345	25,443,704		
(E) ACCRUED EXPENSES AND DEFERRED INCOME				
TOTAL ACCRUED EXPENSES AND DEFERRED INCOME (E)	–	–		
TOTAL LIABILITIES	25,642,010	34,723,358		
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	770,624,321	819,066,113		

INCOME STATEMENT

(EUR)	2016	2015
(A) VALUE OF PRODUCTION		
1) Revenues from sales and services	69,422,502	5,988,467
5) Other revenues and income	82,635,030	4,886,164
TOTAL VALUE OF PRODUCTION (A)	152,057,532	10,874,632
(B) COSTS OF PRODUCTION		
6) For raw, ancillary and consumable materials and goods	(2,885,356)	(373,779)
7) For services	(17,242,581)	(1,198,748)
8) For leased goods	(12,495,563)	(733,584)
9) For employees:		
a) Salaries and wages	(4,858,217)	(434,627)
b) Social security contributions	(1,530,633)	(133,073)
c) Employees' severance indemnities	(325,034)	(25,045)
e) Other costs	(255,092)	(7,670)
	(6,968,976)	(600,415)
10) Amortisation, depreciation and write-downs:		
a) Amortisation of intangible fixed assets	(31,056,464)	(2,587,751)
b) Depreciation of tangible fixed assets	(23,830,924)	(2,014,114)
	(54,887,388)	(4,601,865)
12) Provisions for risks	(224,624)	–
14) Miscellaneous operating expenses	(1,853,129)	(142,562)
TOTAL COSTS OF PRODUCTION (B)	(96,557,617)	(7,650,954)
DIFFERENCE BETWEEN COSTS AND VALUE OF PRODUCTION (A-B)	55,499,915	3,223,678
(C) FINANCIAL INCOME AND EXPENSES		
16) Other financial income:		
d) other income:		
- from parent companies	82,584	–
- others	17,993	–
	100,577	–
17) Interest and other financial expenses:		
- to parent companies	(34,565)	–
- others	(5,736)	(4,312)
	(40,301)	(4,312)
17) ^{bis} Exchange rate gains and losses		
- exchange rate gains	3,299	–
TOTAL FINANCIAL INCOME AND EXPENSES (C)	63,575	(4,312)
PROFIT (LOSS) BEFORE TAXES	55,563,488	3,219,364
20) Income taxes for the year, current taxes and deferred tax assets and liabilities	(17,923,635)	(1,436,701)
21) PROFIT (LOSS) FOR THE YEAR	37,639,853	1,782,663

The **comparability** of data between the current year and the prior one is not significant, as the year 2016 represents a full year of operations, while the 2015 figures only refer to the month of December.

STATEMENT OF CASH FLOWS

	2016	2015
A. FINANCIAL FLOWS FROM OPERATING ACTIVITIES (INDIRECT METHOD)		
Profit (loss) for the year	37,639,853	1,782,663
Income taxes	17,923,635	1,436,701
Interest expense/interest income	(23,729)	4,312
1. Profit (loss) for the year before income tax and interest	55,539,759	3,223,676
Allocations to provisions	224,624	–
Amortisation/depreciation of fixed assets	54,887,388	4,601,865
2. Cash flows before changes in net working capital	55,112,012	4,601,865
<i>Changes in net working capital</i>		
Decreases/(increases) in customer trade receivables	23,249,791	(25,410,527)
Increases/(decreases) in trade payables	(3,945,839)	(18,343,591)
Decreases/(increases) in accrued income and prepaid expenses	(25,111)	234,008
Other changes in net working capital	80,572,821	113,023,555
3. Cash flows after changes in net working capital	99,851,662	69,503,445
<i>Other adjustments for non-monetary elements</i>		
(Use of employees' severance indemnities provision)	(61,486)	(1,748,776)
(Use of the provisions)	(1,211,127)	(7,615,664)
4. Cash flows after other adjustments	(1,272,613)	(9,364,440)
CASH FLOW FROM OPERATING ACTIVITIES (A)	209,230,820	67,964,546
B. CASH FLOWS FROM INVESTMENT ACTIVITIES		
<i>Tangible fixed assets</i>		
(Capital expenditure)	(3,303,818)	(509,118,399)
<i>Intangible fixed assets</i>		
(Capital expenditure)	(260,311)	(156,664,614)
<i>Financial fixed assets</i>		
(Capital expenditure)	20	(168,738)
CASH FLOW FROM INVESTMENT ACTIVITIES (B)	(3,564,109)	(665,951,751)

	2016	2015
C. CASH FLOWS FROM FINANCING ACTIVITIES		
<i>Borrowings</i>		
Increase (decrease) in financial payables due to parent companies	(7,604,312)	7,604,312
<i>Shareholders' equity</i>		
Paid share capital increases	–	(49,980,000)
Distribution of reserves	(75,217,634)	–
Distributed dividends	(1,782,663)	–
CASH FLOW FROM FINANCING ACTIVITIES (C)	(84,604,609)	(42,375,688)
Increase (decrease) of cash and cash equivalents (A ± B ± C)	121,062,102	(640,362,892)
Transfer	–	640,641,711
Opening cash and cash equivalents	281,319	2,500
Bank deposits	280,741	
Notes on hand	578	2,500
Net cash flows during the year	121,062,102	278,819
FINANCIAL POSITION AT YEAR-END	121,343,421	281,319
Financial receivables due from parent companies	119,559,072	–
Closing cash and cash equivalents	1,784,349	281,319
Bank deposits	1,782,116	280,741
Notes on hand	2,233	578
TOTAL CASH FLOW AT YEAR-END	121,343,421	281,319

EXPLANATORY NOTES

THE COMPANY

On 22 July 2015, Hydro Terni S.r.l. was founded with a share capital of EUR 10,000, fully underwritten and paid up by the company E.On Italia S.p.A.

The Company's purpose involves the development, construction and management of hydroelectric plants for the production of electric power, as well as the marketing of any related products.

On 26 August 2015, the partial spin-off project of the company E.On Produzione S.p.A., wholly-owned by E.On Italia S.p.A. was approved, with simultaneous transfer of the relative business branch in favour of Hydro Terni S.r.l.

On 5 November, the spin-off deed that defined the set of asset and liabilities to be transferred to Hydro Terni S.r.l. was drawn up, comprising the hydroelectric complex consisting of 16 hydroelectric plants, 7 dams, 3 reservoirs and a pumping station, located geographically throughout Umbria, Marche and Lazio, with an installed operating capacity of 526.5 MW and 91 employees.

On 30 November 2015, the date of effectiveness of the spin-off, the Company acquired the aforementioned hydroelectric plant as well as the corresponding assets which resulted in a share capital increase from EUR 10,000 to EUR 50 million.

On the same date, transfer of the 100% investment in favour of ERG Power Generation S.p.A. became effective, and the Shareholders' Meeting of 30 November 2015 deliberated in favour of the modification of the company name to ERG Hydro S.r.l., as well as the transfer of the registered office to Via De Marini 1, Genoa, and adoption of new Articles of Association. The Meeting also appointed the member of the Board of Directors and Board of Statutory Auditors, and granted the auditing assignment to Deloitte & Touche S.p.A.

Following the aforementioned conferment as of 1 December 2015, the Company has begun activities for the production and sale of electricity.

FORMAT AND CONTENT OF THE FINANCIAL STATEMENTS

The financial statements for the year ended on 31 December 2016 were drafted in accordance with prevailing law governing drafting financial statements, interpreted and added to the accounting standards issued by the National Board of Chartered Accountants and the Italian Accounting Body, and take account of the revisions and updates of prevailing Italian accounting standards.

The financial statements were drawn up under the assumption of the company as going concern, as there are no significant uncertainties in this regard.

The financial statements comprise the Statement of Financial Position, the Income Statement, and the Statement of Cash Flows, prepared according to the formats specified in Articles 2424, 2424-bis, 2425, 2425-bis and 2425-ter of the Italian Civil Code and in these Explanatory Notes.

The Explanatory Notes aim to illustrate, analyse and in certain cases supplement the financial statements data, and they contain the information required by Articles 2427 and 2427-bis of the Italian Civil Code, by other provisions of the Italian Civil Code on financial statements and by other previous laws. In addition, they contain all the supplementary information considered necessary to provide the most transparent and complete representation possible, even if not required under specific legal provisions. The amounts in the Statement of Financial Position and the Income Statement have been rounded off to the nearest whole Euro.

For a clearer disclosure, it was deemed preferable to show all amounts rounded off to the nearest EUR thousand in the Explanatory Notes; consequently, in some statements, totals may differ slightly from the sum of the amounts that comprise it.

Note that the Statement of Financial Position and Income Statement do not indicate items whose amount is equal to zero, both during the current year and in the prior year (OIC 12).

Auditing of the financial statements was assigned, for the three-year period 2015-2017, to Deloitte & Touche S.p.A., by resolution of the Shareholders' Meeting of 30 November 2015.

ITALIAN LEGISLATIVE DECREE 139/2015 - UPDATE OF ACCOUNTING STANDARDS

The main new aspects introduced by the Italian Legislative Decree 139/2015 with regard to updating of the accounting standards mainly regarded, for the Company, changes to the financial statement formats, with elimination of the extraordinary income components that are currently recognised by nature, the measurement of receivables, securities and payables at amortised cost and the amortisation process for goodwill based on estimated useful life.

Application of the updated accounting standards did not have any impact on the Company's Statement of Financial Position and Income Statement items at 1 January 2016 and, consequently, it was not necessary to draw up the reconciliation statements and financial statements for the year 2015.

ACCOUNTING STANDARDS AND MEASUREMENT CRITERIA

The accounting standards and valuation criteria below comply with the aim of providing a true and fair view of the financial position and operating performance of the Company and the net profit for the year as required under Articles 2423 et seq. of the Italian Civil Code.

The items were assessed in accordance with the general principle of prudence, on an accruals basis, considering that the company will continue to operate on a going concern basis, with the substance prevailing over the form principle as introduced by Italian Legislative Decree no. 6 of 2003.

Italian Legislative Decree 139/2015 also specifies that compliance with the obligations of relevance, measurements, presentation and disclosure is not mandatory if such compliance is irrelevant in providing a true and accurate representation, without prejudice to the obligations with regard to regular bookkeeping.

The accounting principles indicated below have been adapted by changes, supplements and new aspects introduced to the regulations of the Italian Civil Code by Legislative Decree 139/2015, which implemented accounting directive 34/2013/EU in Italy. In particular, the national accounting standards have been reworded by the Italian Accounting Body (OIC) in the version issued on 22 December 2016.

Exceptions

There were no exceptional situations requiring recourse to legally permitted exceptions relating to financial statements pursuant to Article 2423, paragraph 4 of the Italian Civil Code.

Intangible fixed assets

Intangible fixed assets are recognised at their historic acquisition cost, net of amortisation applied over the years, and attributed directly to the individual items. The cost includes ancillary charges and direct and indirect costs for the portion reasonably attributable to the asset, with respect to the period of construction and up until the moment in which the asset may be used, and the financial charges incurred to finance construction (internal or through third parties) until use of the asset is possible.

These amounts are reduced on an annual basis and recognised on the income statement using an amortisation process, on a straight line basis in accordance with their useful lives and considering also any residual possibility of use.

Start-up and expansion costs are recognised with agreement of the Board of Statutory Auditors and are amortised over five financial years on a straight-line basis.

Goodwill includes amounts paid in this respect with regard to company purchase transactions or other corporate transactions and is amortised based on useful life. The useful life figure is estimated upon initial recognition of goodwill and it not changed in subsequent years. If it is not possible to estimate useful life, goodwill is amortised over a period of ten years.

In view of the faculty envisaged by the final transitional provisions pursuant to Article 12 of Italian Legislative Decree no. 139 of 18 August 2015 to not apply the new regulations (amortisation over ten years), as the effects in the financial statements have not yet terminated, goodwill is amortised on a straight-line basis over twenty years, in line with the same calculation methods used previously.

Industrial patents and intellectual property rights essentially comprise application software amortised on a straight-line basis over three years.

At year end, any intangible fixed assets that were consistently worth less than the amount determined using the amortisation process were written down by the corresponding amount; this write-down was eliminated in following years if the conditions that had led to its write-down were no longer valid.

Note that the values at 31 December 2016 include the carrying amounts that were transferred from the books of the transferor and the amortisation processes continued in accordance with the rates used previously. These rates are fully consistent with the residual useful lives of the assets.

Tangible fixed assets

Tangible fixed assets are recognised at the cost of acquisition, including directly attributable ancillary charges and costs incurred to use the asset, net of any commercial discounts and cash discounts of a significant amount.

The values recorded are adjusted annually based on the corresponding accumulated depreciation and any write-downs. The depreciation amounts recognised in the income statement are calculated on a straight-line basis, using rates considered to be representative of the estimated economic-technical useful life of the assets to which they refer. Tangible fixed assets recorded in the financial statements were revalued exclusively in accordance with the legal provisions and within the limits of the higher of current value and value in use.

Rates of depreciation are determined in accordance with prudential criteria and the estimated residual possibility of use of each asset in accordance with rates of use in previous years.

If, at year-end, regardless of the depreciation already recognised, impairment occurs, the fixed asset is written down accordingly. If the reasons for impairment cease to exist in subsequent years, the original value is restored, adjusted solely based on the depreciation.

Note that the values at 31 December 2016 include the carrying amounts that were transferred from the books of the transferor and the amortisation processes continued in accordance with the rates used previously. These rates are fully consistent with the residual useful lives of the assets.

In the depreciation of hydroelectric plants, the annual amount was calculated based on the economic-technical life and not based on expiry of the concessions. Italian Law Decree no. 134 of 7 August 2012 radically modified the issue with regard to the hydroelectric concessions governed by Royal Decree no. 1775 of 11 December 1933, which envisaged, upon expiry of the concession, transfer of ownership to the State, free of charge, of assets such as collection systems, regulation systems, pressure pipes and outlet channels.

The Italian Law Decree in question drastically changed this scenario, envisaging, among other things, that 5 years prior to the expiry of a concession on a large branch for hydroelectric use and, in cases of renouncement, forfeiture or revocation, where there is no overriding public interest in another use for the waters, the relative Administration shall issue a public call for tenders, for the paid assignment of the concession for a period of 20 years and up to a maximum of 30 years. In this respect, regulation of the method for transfer of the concession by the outgoing holder to the new holder, which envisages the initial assignment of consideration to be determined between the outgoing party and administration and based on specific elements that vary according to the asset in question, also become important. Therefore, to calculate the amount subject to depreciation, the value attributable to said consideration which, as part of the normal depreciation process, is referred to as the “residual value”, is of significant importance.

It is however necessary to point out that the current identification/determination of the elements at the basis of calculation of said consideration presents a significant amount of uncertainty, with difficulty in estimated the

consideration amount. Therefore, the use of economic-technical rates was considered to be the most appropriate method in calculating the depreciation amounts.

In detail, the depreciation rates applied are as follows:

	Rate Economic-technical
Buildings	2.5%
Fixed hydraulic works	1.0%
Pressure pipes	2.5%
Hydraulic and electrical equipment	3.3%
Automation and control systems	10.0%
Plant and equipment	5.0%
Remote operation systems	10.0%
Telecommunication systems	10.0%
Transport lines	5.0%
Various equipment	10.0%
Other assets	from 10% to 20%

With regard to useful life, the Company assigned an independent expert the task of determining the economic-technical duration of the assets. The analysis indicated the useful lives adopted by the Company for accounting purposes as reasonable and representative, on average, of the groups of assets comprising the subject categories of the analysis. Note that an analysis carried out at the "asset class" level is relatively approximate, due to the breadth of the analysis itself and to the composition of said classes. Further specific analyses could increase the precision of the estimated values, although this would require longer and more complex procedures, and the durations of the useful lives could vary over time according to technological turnover and many other factors, both internal and external.

Write-downs for impairment of tangible and intangible fixed assets

On the basis of the OIC 9 document, the Company subjects its intangible assets and property, plant and equipment to impairment testing to determine whether there are indications that they may have suffered impairment at the dates of the financial statements. If such an indication exists, it is necessary to estimate the recoverable value of the asset to determine the amount of any write-downs.

When it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount of an asset is the greater figure between the current amount net of sale costs and its value in use, determined as the current value of estimated future cash flows.

Impairment is recognised if the recoverable amount is lower than the carrying amount. Should the impairment of a fixed asset, other than goodwill, subsequently no longer apply or be reduced, the carrying value of the asset or cash-generating unit is increased up to the new estimate of the recoverable value, without exceeding the value that would have been determined if no impairment had been recognised.

At each reporting date, the Company assesses the existence of any indication that an asset may have undergone

impairment. If such an indication exists, the Company estimates the recoverable value of the asset and writes it down only if the latter is lower than the corresponding carrying amount.

In accordance with the requirements of OIC 9, in order to assess the recoverability of the value of assets, the Company assigned an independent expert the task of defining the fair value of the assets, and this was completed in December. The fair value was determined, given the unique nature of the plants in terms of geographical location, technology and construction characteristics, using the Cost Method, which expresses reconstruction or replacement cost that would be incurred to replace an asset with a new one having the same characteristics and use as the subject asset, reduced to take into account physical deterioration and functional obsolescence. The outcome of said analyses identified a higher value for tangible fixed assets compared to the carrying value, thereby avoiding potential impairment.

Financial fixed assets

Financial fixed assets exclusively comprise financial receivables recognised at presumed realisable value.

Inventories

Inventories of ancillary materials and consumables are measured at the lower between weighted average cost and replacement cost.

In the event of obsolescence or slow turnover of the materials, the carrying amount is written down accordingly with a provision used to directly cut the inventory values.

Receivables

Receivables are recorded in the financial statements based on the amortised cost method, taking into account the time factor and the estimated realisable value. The amortised cost method is not applied when the effects are immaterial, or when the transaction costs, commissions paid by the parties and any other difference between initial and final value are of limited significance, or if the receivables are short term (with maturity of less than 12 months). Trade receivables with expiry beyond 12 months from initial recognition, without payment of interest, or with interest significantly different from the market interest rates, and the relative revenues, are initially recognised at the value determined by discounting the future cash flows at the market interest rate. The difference between initial recognition value of the receivable determined in this manner and the final value is recorded in the income statement as financial income throughout the duration of the receivable, using the effective interest rate method.

Moreover, the receivables are recognised at estimated realisable value.

The value of receivables is adjusted to the estimated realisable value through the allocation of an appropriate bad debt provision.

Receivables include, in addition to tax receivables, the value of deferred tax assets, calculated on the temporary differences between the values of assets and liabilities determined according to statutory criteria and the corresponding values recognised for tax purposes. Recognition of deferred tax assets is subject to the reasonable certainty of their future recoverability.

Financial assets

As indicated in OIC 14, receivables generated by centralised treasury management (i.e. cash pooling) are recognised, if permitted by the terms of collection, under "Short-term financial assets", as "Financial assets for centralised treasury management in respect of the parent company". If the short-term collection terms are not satisfied, these receivables are recorded under financial fixed assets.

Cash and cash equivalents

These are recorded at nominal value with a separate indication for bank and postal deposits and cash and notes on hand.

Accruals and deferrals

The item accruals and deferrals includes the portions of costs and revenues accrued during the year but collectible in subsequent years, and the portions of costs and revenues incurred within the end of the year but relating to subsequent years, based on the accrual principle.

Employees' severance indemnities

Employees' severance indemnities corresponds to the amounts accrued during the period of employment by employees, and is calculated in accordance with the laws and labour contracts in effect.

Following the introduction of the provisions of the 2007 Financial Act and relative implementation decrees, starting from 1 January 2007, the accrued employees' severance indemnities have been designated to pension funds or to the treasury fund established with INPS (the Italian National Social Security Institute). The accounting treatment of amounts accruing from 1 January 2007 is therefore considered as equivalent to contributions of other nature, with regard to the supplementary pension option as well as in the case of designation to the Treasury Fund established with INPS.

The item includes liabilities accrued in respect of all employees prior to the date indicated and not yet paid, revalued based on ratios envisaged by the relative legislation, net of any advances paid pursuant to the law, any prepaid taxes and any amounts allocated to Pension Funds.

Employee benefits

Based on contracts stipulated with a number of employees, the Company has certain obligations with regard to loyalty rewards, additional monthly pay and electricity discounts.

With respect to the first two cases, they are additional monthly salaries that are paid upon achievement of specific parameters of company seniority. With regard to the electricity discount, it is essentially the right to obtain a discount on electricity bills, during active employment and in periods subsequent to retirement; under specific conditions, the discount is also given to direct heirs (spouse).

The above cases are considered to be defined benefit plans for employees, and the amount of the benefit provided to the employee is quantifiable only after termination of the employment relationship and is linked to one or more

factors, such as age, years of service, and remuneration. Therefore, the relative cost is recognised in the income statement on an actuarial basis. The liability is recognised in the financial statements at the present value of the obligation at the reporting date.

The obligations for defined benefit plans are determined by an independent actuary through the projected unit credit method. The present value of the defined benefits plan is determined by discounting the future cash flows.

Provisions for liabilities and charges

Provisions for liabilities and charges are allocated against liabilities of a calculable nature, certain or probable, for which nevertheless at year end the total or contingency date is not yet known.

Potential liabilities are recognised on the financial statements and registered under the provisions when their realisation has become probable and when the amount of the relative charge can be reasonably estimated.

Measurement of the charge complies with the general prudence and accrual principles which, vice versa, do not allow the allocation of provisions that are generic or without economic justification.

Any risks for which a liability is only possible or for which no objective forecast can be made of the amount payable are indicated in the Explanatory Notes without the allocation of provisions for liabilities and charges.

Risks whose likelihood of occurrence is remote are not taken into consideration.

Payables

Payables are recorded based on the amortised cost method, taking into account the time factor. The amortised cost method is not applicable to payables if its effects are irrelevant. The effects are considered irrelevant for short-term payables (namely those due in less than 12 months). For the amortised cost method, see the description for receivables. Payable operations carried in foreign currencies are converted into Euros at the exchange rate on the date of the operation, and the difference between the amount and the amount actually paid is recognised under the income statement under financial charges and income.

The exchange rate differences resulting from adjustment of the payables in foreign currency to the exchange rate at year-end with respect to the date of the operation are recognised in the income statement.

Tax payables for current taxes are estimated by applying the rate in effect at 31 December 2015. If the taxes to be paid are lower than the tax credit and advances paid, the difference is recognised as a tax credit and recorded under the relative asset item of the Statement of financial position.

Foreign currency items

Non-monetary assets and liabilities originally stated in foreign currency are recognised in the statement of financial position at the exchange rate in effect upon their purchase, or at the initial recognition cost.

Monetary assets and liabilities originally stated in foreign currency are converted in the financial statements at the spot exchange rate as at the end of the year; the relative exchange rate gains and losses are recognised in the income statement and any net profit is allocated to a specific non-distributable reserve until realisation.

Memorandum accounts – Guarantees and Commitments

Following the amendments made by Italian Legislative Decree no. 139 of 18 August 2015 to Article 2424 paragraph 3) of the Italian Civil Code, the guarantees issued and commitments are no longer stated in the footnotes of the Statement of financial position, but are described in detail in the Explanatory Notes.

In particular, guarantees given are recorded at the value of the commitment or for an amount equal to the debt to which they refer, and commitments to third parties are highlighted based on the contracts stipulated.

Revenues and costs

Revenues and costs are recognised, net of returns, discounts and rebates, in the income statement when the actual and not merely formal transfer of risks and benefits has taken place, in accordance with the accrual principle, regardless of the date of collection and payment.

Revenues for the sale of electricity are recognised upon disbursement of the supply or service, are determined based on stock market prices and/or contractual prices taking into account, where applicable, the tariffs and criteria envisaged by the legal provisions and by the resolutions of the Authority for Electricity and Gas.

Revenues relating to the feed-in premiums are recognised in the year in which the right accrues.

Operations with the parent company and other ERG group companies are carried out on an arm's length basis.

Financial income and expenses

Financial income and expenses are recognised on an accruals basis. Costs relating to receivables factoring transactions for any reason (with or without recourse) and of any nature (trade, financial or other) are recognised in the year in which they arose.

Current taxes and deferred tax assets and liabilities

Current taxes are calculated based on the estimated taxable income in compliance with tax regulations in force and applying the rates in effect at the reporting date, taking into account the effects of inclusion in the national tax consolidation with the consolidating entity ERG S.p.A.

Deferred tax assets and deferred tax liabilities are calculated on the basis of the temporary differences between the value attributed to a certain asset or liability in accordance with statutory criteria and the respective value attributed by applying the tax regulations in effect, in accordance with the accrual principle and the principle of prudence.

Deferred tax assets are accounted for if there is a reasonable certainty that they will be recovered by creating sufficient taxable income in the years in which the repayment of the temporary differences that had given rise to them will take place.

The tax benefit related to retaining any tax losses will be recorded when there is the reasonable expectation of its realisation in the tax period in which the losses are reported.

On the other hand, deferred tax liabilities are not recorded if there is not much chance of the relative debt arising.

Deferred tax assets or deferred tax liabilities are calculated by using the tax rate in effect in the year in which the

temporary differences are repaid. If it is difficult to calculate the average rate, the rate expected for the following year will be applied.

In accordance with the provisions of Article 2424 of the Italian Civil Code, deferred tax assets are indicated in the statement of financial position under "Deferred tax assets" of current assets, while the deferred tax liabilities are indicated under "Provisions for liabilities and charges" under "Provision for taxes, including deferred".

IRES tax payments are arranged by the Consolidating entity, as per the Company's participation in the Domestic Tax Consolidation system.

Each company adopting the tax consolidation transfers its taxable income (or tax loss) to the consolidating entity. If taxable income is transferred, the consolidating entity then records a receivable in respect of the consolidated company equal to the IRES payable (the consolidated company instead records a payable due to the consolidating company). Conversely, for companies recording a tax loss, the consolidating company will recognise an IRES tax payable on the portion of the loss actually offset at Group level (the consolidated entity will record a tax receivable due from the consolidating company).

Italian Law no. 208 of 28 December 2015 (2016 Stability Law) reduced the IRES rate from 27.5% to 24% as of 1 January 2017.

The rate used to calculate deferred tax assets is therefore the same as the nominal IRES (corporate tax) rate of 27.5% for those income items that will be recognised for tax purposes by 31 December 2016 and the rate of 24% for those that will give rise to tax changes starting on 1 January 2017 plus, if required, the IRAP rate (3.9%).

Use of estimates

Preparation of the financial statements requires estimates and assumptions to be made that affect the values of assets and liabilities shown in the financial statements and the information provided concerning potential assets and liabilities. To obtain these estimates, available information had to be used and subjective evaluations had to be adopted based on experience.

By their very nature, estimates and assumptions used may vary from year to year, and therefore, it cannot be excluded that in subsequent years the current financial statement values may differ as a result of the change in the subjective assessments used.

The main financial statement items for which the use of subjective valuations was required are:

- determination of the useful life of the assets, the relative depreciation/amortisation rates and any write-downs for impairment;
- allocations to provisions for bad debt and for risks of liabilities related to legal and tax disputes for which a financial outlay is deemed likely and the amount of the resulting charges can be reasonably estimated;
- deferred tax assets, recognised on the basis of the future taxability of expected profits generated in accordance with business plans as well as of the expected renewal of tax consolidation regimes.

Estimates and assumptions are revised periodically and the effects of each change are reflected in the Income Statement in the period when the change took place.

Intra-group relations and relations with related parties

With regard to the disclosure required by Article 2427, paragraph 22-bis of the Italian Civil Code on intra-group relations and relations with related parties, settled at arm's length, please refer to the relevant chapter in the Report on Operations.

Comparability of data between two years

Note that the comparability of data between the current year and the prior one is not significant, as the year 2016 represents a full year of operations, while the 2015 figures only refer to the month of December.

Statement of Cash Flows

The statement of cash flows includes all cash inflows and outflows during the year.

The single cash flows are presented individually in the following categories of the statement of cash flows:

- a. operating activities;
- b. investment activities;
- c. financing activities.

The categories of cash flows are presented in the order shown above.

The cash flow from operating activities is calculated using the indirect method, i.e. adjusting the profit or loss for the year shown in the income statement.

The algebraic sum of the cash flows of each category mentioned above represents the net change (increase or decrease) of the cash and cash equivalents during the year.

The statement of cash flows is presented in scaled format.

The new OIC 10 introduces the following changes:

- interest paid and collected are presented separately among cash flows from operating activities, except special cases in which they refer to investing or financing activities;
- dividends received and paid are presented separately, respectively, under operating activities and financing activities;
- cash flows relating to income taxes are indicated separately and classified under operating activities.

Management and coordination

The Company is subject to management and coordination by parent company ERG S.p.A., with registered office at Via De Marini 1, Genoa.

Pursuant to Article 2497-bis, paragraph 4 of the Italian Civil Code, the key data of the latest financial statements of ERG S.p.A. are provided.

STATEMENT OF FINANCIAL POSITION

(EUR thousand)	31/12/2015
Intangible Fixed Assets	106
Property, plant and equipment	2,662
Equity investments	1,173,337
Other financial assets	822,996
Deferred tax assets	13,120
Other non-current assets	5,024
Non-current assets	2,017,244
Trade receivables	14,380
Other current receivables and assets	68,588
Current financial assets	52,591
Cash and cash equivalents	616,555
Current assets	752,114
TOTAL ASSETS	2,769,358
Shareholders' Equity	1,748,702
Employees' severance indemnities	63
Deferred tax liabilities	1,633
Provisions for non-current liabilities and charges	82,736
Non-current financial liabilities	694,960
Other non-current liabilities	4,425
Non-current liabilities	783,816
Provisions for current liabilities and charges	9,781
Trade payables	57,130
Current financial liabilities	110,989
Other current liabilities	58,940
Current liabilities	236,840
TOTAL LIABILITIES	2,769,358

INCOME STATEMENT

(EUR thousand)	2015
Revenues from ordinary operations	58,264
Other revenues and income	11,045
Cost of purchases	(48,871)
Costs for services and other costs	(38,773)
Personnel costs	(17,025)
GROSS OPERATING MARGIN (EBITDA)	(35,360)
Amortisation, depreciation and write-downs of fixed assets	(282)
Financial income	27,323
Financial expenses	(2,579)
Net income (loss) from equity investments	8,586
PROFIT (LOSS) BEFORE TAXES	(2,311)
Income taxes	4,338
NET PROFIT (LOSS) FOR THE PERIOD	2,027

STATEMENT OF FINANCIAL POSITION ANALYSIS

ASSETS

(EUR thousand)	31/12/2016	31/12/2015	Change
B - FIXED ASSETS	610,027	661,350	(51,323)
C - CURRENT ASSETS	154,856	152,000	2,856
D - ACCRUALS AND DEFERRALS	5,742	5,716	25
TOTAL ASSETS	770,624	819,066	(48,442)

B) FIXED ASSETS – EUR 610,027 THOUSAND (YEAR 2015, EUR 661,350 THOUSAND)

(EUR thousand)	31/12/2016	31/12/2015	Change
I - Intangible assets	123,281	154,077	(30,796)
II - Tangible assets	486,577	507,104	(20,527)
III - Financial assets	169	169	–
Total	610,027	661,350	(51,323)

B) I. Intangible fixed assets – EUR 123,281 thousand (year 2015, EUR 154,077 thousand)

The changes per individual category are outlined in the table below:

(EUR thousand)	Start-up and expansion costs	Industrial patents and intellectual property rights	Goodwill	Total
Historical cost	3	2,346	1,303,685	1,306,034
Accumulated amortisation	–	(719)	(837,433)	(838,152)
Bad debt provision	–	–	(313,805)	(313,805)
BALANCE AT 31/12/2015	3	1,627	152,447	154,077
Changes during the period:				
Capitalisations	–	260	–	260
Amortisation	(1)	(672)	(30,384)	(31,057)
Total changes	(1)	(412)	(30,384)	(30,797)
Historical cost	3	2,606	1,303,685	1,306,294
Amortisation	(1)	(1,391)	(867,817)	(869,209)
Bad debt provision	–	–	(313,805)	(313,805)
BALANCE AT 31/12/2016	2	1,215	122,063	123,281

The most significant item of intangible fixed assets is Goodwill, transferred through the demerger operation of E.On Produzione S.p.A., and which arose in respect of the latter following the merger deficit generated by prior mergers by incorporation carried out in 2001 (merger of Elettrogen S.p.A. into Endesa Italia S.r.l. for EUR 1,292,385 thousand) and in 2003 (merger of Endesa Italia S.r.l. into Endesa Holding S.r.l. for EUR 11,300 thousand).

In view of the faculty envisaged by the final transitional provisions pursuant to Article 12 of Italian Legislative Decree no. 139 of 18 August 2015 to not apply the new regulations pursuant to Article 6 of the same Decree, as the effects in the financial statements have not yet terminated, goodwill is amortised on a straight-line basis using the same calculation methods for the annual amount as used previously.

With regard to the requirements of OIC 9, no particular elements or indicators were identified that would make the goodwill value non-recoverable.

Costs relative to establishment of the Company, which took place in July 2015, were capitalised under the item "start-up and expansion costs" and are amortised over five years.

"Industrial patents and intellectual property rights" predominantly comprise costs for the purchase and subsequent adjustments of management application software amortised based on the expected benefits.

The investment during the year of EUR 260 thousand refers to the purchase of software for the Villavalle control centre.

B) II. Tangible fixed assets - EUR 486,577 thousand (year 2015, EUR 507,104 thousand)

The changes per individual category are outlined in the table below:

(EUR thousand)	Land and buildings	Plant and equipment	Industrial and commercial equipment	Other assets	Fixed assets under construction and advances	Total
Historical cost	118,917	861,031	2,007	582	674	983,211
Accumulated depreciation	(64,251)	(409,645)	(1,759)	(452)	–	(476,107)
BALANCE AT 31/12/2015	54,666	451,386	248	130	674	507,104
Changes during the period:						
Capitalisations	437	2,214	11	12	630	3,304
Reclassifications	35	374	–	–	(409)	–
Depreciation	(2,712)	(21,043)	(51)	(25)	–	(23,831)
Total changes	(2,240)	(18,455)	(40)	(13)	221	(20,527)
Historical cost	119,389	863,619	2,018	594	895	986,515
Depreciation	(66,963)	(430,688)	(1,810)	(477)	–	(499,938)
BALANCE AT 31/12/2016	52,426	432,931	208	117	895	486,577

The balance is broken down as follows:

(EUR thousand)	Land and buildings	Plant and equipment	Industrial and commercial equipment	Other assets	Fixed assets under construction and advances	Total
Historical cost	37,612	383,600	2,018	594	895	424,719
Revaluations of residual related values:						
- monetary revaluation pursuant to Italian Law no. 576/1975	2,792	16,799	—	—	—	19,591
- monetary revaluation pursuant to Italian Law no. 72/1983	6,956	42,238	—	—	—	49,194
- monetary revaluation pursuant to Italian Law no. 413/1991	—	—	—	—	—	—
- adjustments pursuant to Italian Law 292/1993	8,914	66,732	—	—	—	75,646
- allocation of 2001 merger surplus	63,116	323,484	—	—	—	386,600
- revaluation pursuant to Italian Law no. 266/2005	—	30,766	—	—	—	30,766
Total revaluations	81,777	480,019	—	—	—	561,797
Original value + revaluations	119,389	863,619	2,018	594	895	986,515
Accumulated depreciation	(66,963)	(430,688)	(1,810)	(477)	—	(499,938)
BALANCE AT 31/12/2016	52,426	432,931	208	117	895	486,577

The changes in tangible fixed assets during the year are summarised below:

(EUR thousand)	Changes during the year
Capital expenditure	3,304
Depreciation	(23,831)
Total	(20,527)

Capital expenditure

Investments for EUR 3,304 thousand were made during the year, mainly referring to the following plants:

- Galleto plant for EUR 929 thousand;
- Cotilia plant for EUR 868 thousand;
- Nera Montoro plant for EUR 268 thousand;
- Narni plant for EUR 228 thousand;
- Corbara dam for EUR 190 thousand;
- Control centre for EUR 180 thousand.

Moreover, an investment of EUR 145 thousand was made for the design and authorisation of mini-hydro plants.

Depreciation

Depreciation recognised during the year was calculated using the economic-technical rates and taking into account the residual lives of the plants.

At 31 December 2016, the statutory accumulated depreciation represents 50.7% of total fixed assets subject to depreciation (48.4% at 31 December 2015).

With regard to the requirements of OIC 9, at each reporting date, the Company assesses the existence of any indication that an asset may have undergone impairment. If such an indication exists, the Company estimates the recoverable value of the asset and writes it down only if the latter is lower than the corresponding carrying amount. In this respect, the Company assigned an independent expert the task of defining the fair value of the assets. The outcome of said analyses identified a higher value for tangible fixed assets compared to the carrying value, thereby avoiding potential impairment.

B) III. Financial fixed assets – EUR 169 thousand (year 2015, EUR 169 thousand)

Receivables due from others – EUR 169 thousand (year 2015, EUR 169 thousand)

The value of financial fixed assets referring to receivables from others exclusively regards security deposits with third parties and, in particular, in favour of the Electricity Market Operator (GME) for EUR 150 thousand and of various companies for the supply of water and gas and for works for EUR 18.9 thousand.

C) CURRENT ASSETS – EUR 154,856 THOUSAND (YEAR 2015, EUR 151,999 THOUSAND)

(EUR thousand)	31/12/2016	31/12/2015	Change
II - Receivables	33,513	151,718	118,205
III - Financial assets	119,559	–	(119,559)
IV - Cash and cash equivalents	1,784	281	(1,503)
Total	154,856	151,999	(2,857)

C) II. Receivables – EUR 33,513 thousand (year 2015, EUR 151,718 thousand)

(EUR thousand)	31/12/2016	31/12/2015	Change
Customer trade receivables	2,161	25,411	(23,250)
Receivables due from parent companies	13,758	–	13,758
Tax receivables	3,469	269	3,200
Deferred tax assets	9,086	22,691	(13,605)
Receivables due from others	5,039	103,347	(98,308)
Total	33,513	151,718	(118,205)

There are no receivables in foreign currency at the reporting date.

C) II. 1) Customer trade receivables – EUR 2,161 thousand (year 2015, EUR 25,411 thousand)

Customer trade receivables mainly comprise:

(EUR thousand)	31/12/2016	31/12/2015	Change
Electricity sales	1,242	10,154	(8,912)
Compensation from water diversion	1,728	15,703	(13,975)
Other receivables	566	947	(381)
Bad debt provision	(1,375)	(1,393)	18
Total	2,161	25,411	(23,250)

The item "Customer trade receivables", equal to EUR 2,161 thousand, includes receivables from the sale of electricity for EUR 1,242 thousand, of which:

- EUR 942 thousand from Gestore dei Servizi Energetici S.p.A. (GSE);
- EUR 300 thousand from Terna S.p.A.

The amount relative to "Compensation from water diversion", equal to EUR 1,728 thousand, regards the use of water for which the Company holds the concession.

Other receivables essentially refer to lease payments and other services.

The Bad debt provision, established based on the individual non-performing receivables, is considered to be in line with the estimated risk.

During 2016, there was a decrease in the item "Customer trade receivables" for EUR 23,250 thousand, mainly due to the fact that the Company, starting from 1 July 2016, sells the electricity generated by its own hydroelectric plants to parent company ERG Power Generation S.p.A. and no longer to the electricity market (except for the plants with agreements in place with GSE for dedicated withdrawal), as well as a decrease in receivables from diversion, following definition and collection of credit positions relating to prior years.

C) II 4) Receivables due from parent companies – EUR 13,758 thousand (year 2015, EUR 0 thousand)

The item comprises trade receivables due from parent company ERG Power Generation S.p.A. for the sale of electricity during the months of November and December 2016. Based on the contract for the provision of electricity, starting from 1 July 2016, the Company sells the electricity generated by its own hydroelectric plants, except for the plants with agreements in place with GSE for dedicated withdrawal, to the parent company.

C) II. 4 bis) Tax receivables – EUR 3,469 thousand (year 2015, EUR 269 thousand)

This item essentially includes the VAT credit for EUR 3,469 thousand. The VAT credit refers to transactions from 1 January to 30 September 2016 for EUR 2,367 thousand, for which a request for reimbursement has already been made. Request for reimbursement of the VAT credit regarding asset and liability transactions carried out in December 2015 and in fourth quarter 2016 for a total of EUR 1,102 thousand will be submitted upon presentation of the annual VAT return.

C) II. 4 ter) Deferred tax assets – EUR 9,086 thousand (year 2015, EUR 22,691 thousand)

The deferred tax assets relate to the tax effect of the temporary differences that will be deductible in future years. The main temporary differences and relative tax effects are presented below:

(EUR thousand)	31/12/2016		31/12/2015	
	Temporary differences	Tax effect	Temporary differences	Tax effect
Write-downs of fixed assets	84,066	5,175	168,151	18,376
Other changes in fixed assets	18,646	3,372	19,209	3,500
Provision for water lease expense	263	73	1,323	368
Provision for pensions and similar obligations	930	226	826	201
Other provisions	153	37	134	32
Other changes	847	203	866	214
Total	104,905	9,086	190,509	22,691

The maintenance of the deferred tax assets in the financial statements for the year ended 31 December 2016 is supported by reasonable certainty of their recoverability in future years.

Deferred tax assets are predominantly broken down as follows:

- EUR 5,175 thousand for the write-down of goodwill;
- EUR 3,372 thousand for tangible fixed assets;
- EUR 226 thousand for provisions for personnel;
- EUR 203 thousand for the bad debt provision.

The change of EUR 13,605 thousand during the period mainly refers to recovery of the write-down of goodwill for EUR 13,200 thousand (of which IRES for EUR 11,561 thousand and IRAP for EUR 1,639 thousand), and to repayment of the risk provisions for EUR 295 thousand, of which IRES for 254 thousand and IRAP for EUR 41 thousand.

Italian Law 208 of 28 December 2015 (the 2016 stability law) provided for the reduction of the IRES rate from 27.5% to 24% beginning from 1 January 2017. Therefore, the rate used to calculate prepaid taxes is equal to the IRES rate of 27.5% for income items recognised for tax purposes by 31 December 2016, and 24% rate for those that give rise to fiscal changes from 1 January 2017, increased, where applicable, by the IRAP rate (3.9%).

C) II. 5) Receivables due from others – EUR 5,039 thousand (year 2015, EUR 103,347 thousand)

This item mainly comprises:

- the residual receivable regarding the Feed-in Premium (formerly GC) for the year 2016 for EUR 3,448 thousand;
- green certificates recognised during the year but regarding prior years for EUR 1,497 thousand;
- guarantees of Origin for the year 2016 for EUR 79 thousand.

The decrease during the period was due to two events:

- the payment by E.On Produzione S.p.A. of EUR 75,129 thousand, as the difference between the accounting situation at 30 June 2015, date of approval of the demerger project, and the accounting situation at 30 November 2015, effective date of the spin-off;
- collection of the receivable regarding the Green Certificates, acquired with the demerger, for EUR 28,193 thousand.

C) III. 7) Short-term financial assets – EUR 119,559 thousand (year 2015, EUR 0 thousand)

This item regards the receivable of a “financial nature” referring to the positive balance of the intragroup account with which the cash flows are managed with the parent company.

The Company stipulated an agreement with ERG Power Generation S.p.A. to manage the treasury cash flows, based on which credit and debit positions between the parties through an intra-group current account and remunerated based on market conditions (1-week Euribor rate plus a spread).

The intragroup current account had a debit balance the prior year.

C) IV. Cash and cash equivalents – EUR 1,784 thousand (year 2015, EUR 281 thousand)

(EUR thousand)	31/12/2016	31/12/2015	Change
Bank and postal deposits	1,782	281	1,501
Cheques	–	–	–
Cash and notes on hand	2	1	2
Total	1,784	281	1,503

The item “bank and postal deposits” refers to the balance at 31 December 2016 of the current bank account with Banca Intesa San Paolo. This amount is the temporary liquidity connected to normal operations.

D) ACCRUED INCOME AND PREPAID EXPENSES – EUR 5,742 THOUSAND (YEAR 2015, EUR 5,716 THOUSAND)

(EUR thousand)	31/12/2016	31/12/2015	Change
Prepaid expenses			
State property rent	3,056	2,946	110
Insurance	2,684	2,768	(84)
Other prepayments	2	2	–
Total	5,742	5,716	26

The subject item exclusively comprises prepayments relative to:

- state property rent for water for EUR 3,056 thousand;
- insurance expenses on the production plants for EUR 2,684 thousand;
- other minor prepayments whose accrual falls in the subsequent year for EUR 2 thousand.

Collection of receivables

The table provides the breakdown of receivables and prepayments, with a separate indication of their collection.

	Within 12 months	Within 5 years	Over 5 years	Total
Receivables under financial fixed assets				
due from others	150	19	–	169
Current receivables				
due from customers	2,161	–	–	2,161
due from associates	–	–	–	–
due from associated companies	–	–	–	–
due from parent companies	13,758	–	–	13,758
deferred tax assets	3,842	5,055	189	9,086
tax receivables	3,469	–	–	3,469
due from others	5,038	–	–	5,038
Financial assets - centralised treasury management in respect of parent companies	119,559	–	–	119,559
Accrued income and prepaid expenses				
prepaid expenses	5,742	–	–	5,742
Total	153,719	5,074	189	158,982

LIABILITIES

(EUR thousand)	31/12/2016	31/12/2015	Change
A - SHAREHOLDERS' EQUITY	744,982	784,343	(39,360)
B - PROVISIONS FOR LIABILITIES AND CHARGES	6,578	7,564	14,142
C - EMPLOYEES' SEVERANCE INDEMNITIES	1,654	1,715	3,369
D - PAYABLES	17,410	25,444	(21,849)
TOTAL LIABILITIES	770,624	819,066	(21,849)

A) SHAREHOLDERS' EQUITY - EUR 744,982 THOUSAND (YEAR 2015, EUR 784,343 THOUSAND)

A) I. Share capital – EUR 50,000 thousand (year 2015, EUR 50,000 thousand)

The share capital, amounting to EUR 50,000 thousand, fully subscribed and paid in, is subdivided into units pursuant to the law and is entirely held by the sole shareholder ERG Power Generation S.p.A.

A) II. Paid-in capital in excess of par – EUR 252,010 thousand (year 2015, EUR 327,010 thousand)

The amount of paid-in capital in excess of par was acquired through the asset transfer following the demerger of E.On Produzione S.p.A.

The decrease of EUR 75 million during the period was due to distribution to the sole shareholder, resolved by the Shareholders' Meeting of 21 June 2016.

A) III. Revaluation reserve – EUR 226,616 thousand (year 2015, EUR 226,616 thousand)

The revaluation reserve refers to the revaluation of tangible fixed assets by E.On Produzione S.p.A. based on Italian Law no. 266 of 23 December 2005 and acquired as a result of the transfer. The reserve is subject to tax in the event of distribution.

A) IV. Legal reserve – EUR 64,868 thousand (year 2015, EUR 64,868 thousand)

The legal reserve was acquired through the transfer of assets following the demerger of E.On Produzione S.p.A. The amount is higher than the value envisaged by Article 2430 of the Italian Civil Code.

A) VI. Other reserves – EUR 113,848 thousand (year 2015, EUR 114,066 thousand)

This item includes the "Alignment reserve" for EUR 113,848 thousand, established pursuant to Article 14 of Italian Law no. 342 of 2000 and extended by Italian Law no. 266 of 23 December 2005 (2006 Financial Act), following adjustment of the tax values of the assets to the higher statutory values. This reserve is subject to taxation in the event of distribution and was acquired through the asset transfer following the demerger of E.On Produzione S.p.A.

The decrease of EUR 271.6 million was due to distribution of the Reserve for exchange rate gains to the sole shareholder, resolved by the Shareholders' Meeting of 21 June 2016.

A) IX. Profit for the year – EUR 37,640 thousand (year 2015, EUR 1,783 thousand)

The year 2016 closes with a profit of EUR 37,639,853.

The table below shows the changes in the Company's shareholders' equity items:

(EUR thousand)	Share capital	Paid-in capital in excess of par	Legal reserve	Revaluation reserve	Other reserves	Profit (loss) for the period	Total Shareholders' Equity
VALUES AT 31/12/2015	50,000	327,010	64,868	226,616	114,066	1,783	784,343
Changes during the period							
Distribution of reserves	–	(75,000)	–	–	(217)	–	(75,217)
Allocation of profits	–	–	–	–	–	(1,783)	(1,783)
Profit (loss) for 2016	–	–	–	–	–	37,640	37,640
BALANCE AT 31/12/2016	50,000	252,010	64,868	226,616	113,849	37,640	744,982

The following table lists shareholders' equity items, indicating the possible utilisation for each of them, as well as any tax restrictions.

(EUR thousand)	Amount	Possibility of utilisation	Amount available
Share Capital	50,000	–	–
Paid-in capital in excess of par	252,010	A, B, C	252,010
Legal reserve	64,868	B	54,868
Revaluation reserve	226,616	A, B, C	226,616
Other reserves (alignment reserve)	113,848	A, B, C	113,848
Retained earnings (losses)	–		
Net profit (loss) for the year	37,640	A, B, C	37,640
Total	744,982		684,982

Key

A) for share capital increase

B) to cover losses

C) for distribution to shareholders

The "revaluation" reserve and "alignment" reserve are considered taxable upon distribution.

B) PROVISIONS FOR LIABILITIES AND CHARGES – EUR 6,578 THOUSAND (YEAR 2015, EUR 7,564 THOUSAND)

(EUR thousand)	31/12/2016	Allocation	Utilisation	31/12/2015
Tax Provision				
- deferred tax liabilities	5,130	–	(151)	5,281
	5,130	–	(151)	5,281
Other provisions				
- water lease expense	263	–	(1,060)	1,323
- pensions and similar obligations	861	105	–	756
- other provisions	324	120	–	204
	1,448	225	(1,060)	2,283
Total	6,578	225	(1,211)	7,564

The provision for deferred taxes, which amounts to a total of EUR 5,130 thousand, refers to the significant assets for IRES purposes of EUR 4,213 thousand and to the bad debt provision under section EC for EUR 917 thousand.

The decrease of EUR 151 thousand in the Provision for deferred tax liabilities regards recovery of excess statutory amortisation compared to amortisation for tax purposes.

The item "Other provisions" mainly includes:

- provision for personnel expenses for EUR 861 thousand, referring to the electricity discounts, additional monthly pay and loyalty rewards;
- provision for agreement expenses, for EUR 263 thousand;
- provision for contractual charges, for EUR 204 thousand;
- tax provision for EUR 120 thousand for which, at the current state, an outlay in future years is likely.

The decrease of EUR 1,060 thousand during the year was due to use of the provisions following definition of the dispute with regard to state property rent amounts.

C) EMPLOYEES' SEVERANCE INDEMNITIES – EUR 1,654 EUR THOUSAND (YEAR 2015, EUR 1,715 THOUSAND)

(EUR thousand)	
BALANCE AT 31/12/2015	1,715
Increase	325
Increases for personnel transfers	10
Decreases for personnel transfers	(59)
Decreases for contributions to pension funds	(320)
Other changes	(17)
BALANCE AT 31/12/2016	1,654

The indemnities increased by the amounts allocated in favour of employees for severance indemnity as required by law and decreased due to payments to Supplementary Funds and to the INPS Treasury Fund for EUR 320 thousand.

Moreover, the following were recorded during the year:

- an increase for the addition of one employee for EUR 10 thousand;
- decreases for the exit of 4 employees for EUR 59 thousand.

D) PAYABLES – EUR 17,410 THOUSAND (YEAR 2015, EUR 25,444 THOUSAND)

The payables can be summarised as follows:

(EUR thousand)	31/12/2016	31/12/2015	Change
Trade payables	10,159	14,105	(3,946)
Payables due to parent companies	2,855	7,701	(4,846)
Tax payables	829	198	631
Payables due to social security and pension institutions	413	421	(8)
Other payables	3,154	3,019	135
Total	17,410	25,444	(8,034)

There are no payables in foreign currency at the reporting date.

D) 7) Trade payables – EUR 10,159 thousand (year 2015, EUR 14,105 thousand)

Trade payables stem from commercial transactions and mostly regard Italian counterparties and the Euro (therefore European currency).

These payables, consisting of invoices received and to be received, essentially regard the supply of materials and equipment, contracts and services.

The following table illustrates the breakdown of trade payables:

(EUR thousand)	31/12/2016	31/12/2015	Change
Payables for invoices received	1,965	3,145	(1,180)
Payables for invoices to be received	8,194	10,960	(2,766)
Total	10,159	14,105	(3,946)

D) 11) Payables due to parent companies – EUR 2,855 thousand (year 2015, EUR 7,701 thousand)

(EUR thousand)	31/12/2016	31/12/2015	Change
Trade payables			
ERG Power Generation S.p.A.	939	97	842
Financial payables			
ERG Power Generation S.p.A.	–	7,604	(7,604)
Tax payable			
ERG S.p.A.	1,916	–	1,916
Total	2,855	7,701	(4,846)

This item includes trade payables due to parent company ERG Power Generation S.p.A. mainly regarding the service agreement for EUR 781 thousand and electricity supply payables for auxiliary plant services for EUR 146 thousand. The item also includes the payable due to indirect parent company ERG S.p.A. for EUR 1,916 thousand with regard to the Company's participation in the IRES Tax Consolidation starting from the year 2016. The total payable to consolidating company ERG S.p.A., equal to EUR 3,802 thousand, is stated net of the receivable for withholdings of EUR 1,886 thousand; this amount mainly refers to withholdings made as advances, by GSE, in the amount of 4%, on the incentives granted by the latter, and to a minimal extent on withholdings made on bank interest income. The decrease of EUR 7,604 thousand refers exclusively to the financial payable which, thanks to the cash flow generated by operating activities, went from a debit position to a credit one.

D) 11 bis) Payables due to companies subject to control by parent companies EUR 0.5 thousand (year 2015, EUR 0 thousand)

This amount refers to the payable to Total ERG for the purchase of fuel.

D) 12) Tax payables – EUR 829 thousand (year 2015, EUR 198 thousand)

This item refers mainly to payables for current IRAP taxes for EUR 673 thousand, as well as to payables accrued in the month of December 2016 and paid in January 2017 for withholdings on the incomes of employees and independent providers.

D) 13) Payables due to social security and pension institutions – EUR 413 thousand (year 2015, EUR 421 thousand)

This value refers to the payable for contributions by the Company, accrued at the reporting date and applicable to the remuneration disbursed, as well as to charges accrued and not paid to personnel for holidays and abolished public holidays, holidays not taken, overtime and other indemnities.

D) 14) Other payables – EUR 3,154 thousand (year 2015, EUR 3,019 thousand)

Other payables are mainly related to payables due to the beneficiaries of water concessions for EUR 1,471 thousand. The item also includes payables due to employees accrued during the period and not yet settled and comprises holidays, unused time off “in lieu” and productivity bonuses for EUR 650 thousand.

Collection of payables

The classification by expiry of the items recognised under liabilities is shown below:

(EUR thousand)	Within 12 months	Within 5 years	Over 5 years	Total
Payables				
- trade payables	10,159	–	–	10,159
- due to parent companies	2,855	–	–	2,855
- tax payables	829	–	–	829
- due to social security and pension institutions	413	–	–	413
- other payables	3,154	–	–	3,154
Accrued expenses and deferred income	–	–	–	–
Total	17,410	–	–	17,410

INCOME STATEMENT ANALYSIS

(EUR thousand)	2016	2015	Change
A - VALUE OF PRODUCTION	152,058	10,875	162,932
B - COSTS OF PRODUCTION	(96,557)	(7,651)	(104,208)
C - FINANCIAL INCOME AND EXPENSES	64	(4)	59
INCOME TAXES	(17,924)	(1,437)	(19,360)
PROFIT	37,640	1,783	39,424

Comparability

Note that the comparability of data between the current year and the prior one is not significant, as the year 2016 represents a full year of operations, while the 2015 figures only refer to the month of December.

A) VALUE OF PRODUCTION – EUR 152,058 THOUSAND (YEAR 2015, EUR 10,875 THOUSAND)

(EUR thousand)	2016	2015	Change
Revenues from sales and services	69,423	5,988	63,435
Other revenues and income	82,635	4,886	77,749
Total	152,058	10,875	141,184

A) 1) Revenues from sales and services - EUR 69,423 thousand (year 2015, EUR 5,988 thousand)

(EUR thousand)	2016	2015	Change
Revenues from sales	69,423	5,988	63,435
Total	69,423	5,988	63,435

Following the change in business model during the year, the revenues item was impacted by the sale of electricity during the first half of the year and by network services for EUR 34,994 thousand in respect of:

- GME (Day Before Market and Intraday Market) for EUR 27,512 thousand;
- Terna (dispatching services market and imbalances) for EUR 7,482 thousand.

During the second half of the year, electricity was sold to parent company ERG Power Generation S.p.A. for an amount of EUR 30,464 thousand.

The item also includes electricity generated by plants with agreements in place for dedicated withdrawal and renewable energy plants by GSE for EUR 3,965 thousand.

Net electricity sold during the year amounted to 1,432.3 GWh.

A) 5) Other revenues and income – EUR 82,635 thousand (year 2015, EUR 4,886 thousand)

(EUR thousand)	2016	2015	Change
Feed-in premium	50,585	–	50,585
Green certificates	28,555	4,614	23,941
Other revenues	3,495	272	3,223
Total	82,635	4,886	77,749

The item mainly includes proceeds of EUR 50,585 thousand relative to the “feed-in premium” recognised for plants qualified as “IAFR” (Impianto Alimentato da Fonti Rinnovabili - Plant Powered by Renewable Sources), which from 1 January 2016 replaced Green Certificates.

It also includes proceeds for the sale of Green Certificates for prior years, made available to the Company by GSE following recognition of the IAFR qualification to the plant of Cotilia Salto for EUR 26,387 thousand, and proceeds for adaptation of the green certificates for the Narni plant for EUR 1,842 thousand and for the Galleto plant for EUR 346 thousand.

The item “Other revenues” includes water diversion revenues for EUR 2,231 thousand and other revenues of EUR 1,240 thousand, of which the main item, equal to EUR 806 thousand, consists of repayment of the provisions relative to the additional rent allocated following formal renunciation by MISE of repayment of the amounts reimbursed for the additional rent and following termination of the proceeding for reimbursement of the amounts disbursed via Ministerial Decree of 4 December 2012.

B) COSTS OF PRODUCTION – EUR 96,557 THOUSAND (YEAR 2015, EUR 7,561 THOUSAND)

(EUR thousand)	2016	2015	Change
For raw, ancillary and consumable materials and goods	2,885	374	2,511
For services	17,243	1,199	16,044
For leased goods	12,496	734	11,762
For employees	6,969	600	6,369
Amortisation, depreciation and write-downs	54,887	4,602	50,285
Miscellaneous operating expenses	1,853	143	1,710
Total	96,557	7,651	88,906

B) 6) Costs for raw, ancillary and consumable materials and goods

EUR 2,885 thousand (year 2015, EUR 374 thousand)

(EUR thousand)	2016	2015	Change
Purchase of electricity	1,927	316	1,611
Ancillary and consumable materials	958	58	900
Total	2,885	374	2,511

Electricity purchases of EUR 1,927 thousand include:

- purchases from GME (EUR 515 thousand);
- purchases from Terna (EUR 110 thousand);
- imbalance costs (EUR 699 thousand);
- energy consumption to fuel the auxiliary plant services (EUR 603 thousand).

The residual amount of the item, equal to EUR 958 thousand, refers to the purchase of consumption material.

B) 7) Service costs – EUR 17,243 thousand (year 2015, EUR 1,199 thousand)

The services received can be broken down as follows:

(EUR thousand)	2016	2015	Change
Maintenance, repairs and operating assistance	2,262	84	2,178
Payments to Directors	4	4	–
Payments to Statutory Auditors	29	28	1
Insurance	3,043	255	2,788
Other services from Group companies	6,631	60	6,571
Other services from third parties	5,272	768	4,504
Total	17,243	1,199	16,043

The item “other services from Group companies” regards the agreement for services provided by ERG Power Generation S.p.A., regarding administrative, legal and corporate, finance and treasury, information technology and human resource services.

Other services from third parties mainly include:

- payments to the electricity market (EUR 512 thousand);
- IT services (EUR 2,858 thousand);
- surveillance, cleaning and heating of properties (EUR 490 thousand);
- other general expenses (EUR 1,413 thousand).

The item “Other services from third parties” also includes payment to the independent auditors Deloitte & Touche S.p.A, of EUR 147 thousand, net of expenses and entirely related to the auditing services provided.

B) 8) Costs for leased goods – EUR 12,496 thousand (year 2015, EUR 734 thousand)

(EUR thousand)	2016	2015	Change
State property rent for water	12,165	707	11,458
Rents and fees paid	331	27	304
Total	12,496	734	11,762

Costs for leased goods mainly regard the rent on water:

- state property rent for EUR 7,900 thousand;
- watershed fees for EUR 2,168 thousand;
- coastal fees for EUR 2,097 thousand.

The item also includes car rental costs for EUR 312 thousand and rent payable for EUR 19 thousand.

B) 9) Personnel costs – EUR 6,969 thousand (year 2015, EUR 600 thousand)

Personnel costs refer to the total cost during the year for 90 employees:

(EUR thousand)	2016	2015	Change
Salaries and wages	4,858	435	4,423
Social security contributions	1,531	133	1,398
Employees' severance indemnities	325	25	300
Other costs	255	7	248
Total	6,969	600	6,369

The following shows the breakdown of the Company's personnel at 31 December 2016:

Staff	2016	2015	Change
Executives	1	1	–
Managers	11	12	(1)
Office workers	57	54	3
Blue collar workers	21	24	(3)
Total	90	91	(1)

B) 10) Amortisation, depreciation and write-downs – EUR 54,887 thousand (year 2015, EUR 4,602 thousand)

Amortisation and depreciation includes amounts allocated during the year based on the economic-technical rates and on the residual lives of the plants.

The item is broken down as follows:

(EUR thousand)	2016	2015	Change
Amortisation of intangible fixed assets	31,056	2,588	28,468
Depreciation of tangible fixed assets	23,831	2,014	21,817
Total	54,887	4,602	50,285

Amortisation of intangible fixed assets regards:

(EUR thousand)	2016	2015	Change
Start-up and expansion costs	(1)	–	(1)
Industrial patents and intellectual property rights	(672)	(56)	(616)
Goodwill	(30,384)	(2,532)	(27,852)
Total	(31,056)	(2,587)	(28,469)

Depreciation of tangible fixed assets regards:

(EUR thousand)	2016	2015	Change
Industrial buildings	(2,712)	(226)	(2,938)
Energy production plants	(20,762)	(1,761)	(22,523)
Other plant and equipment	(281)	(21)	(302)
Industrial and commercial equipment	(51)	(4)	(55)
Other office equipment and furniture	(25)	(2)	(27)
Total	(23,831)	(2,014)	(25,845)

B) 12) Provisions for risks – EUR 225 thousand (year 2015, EUR 3 thousand)

The item includes allocations for adjustments relative to benefits for employees, consisting of the additional monthly pay, loyalty reward and electricity discount for EUR 105 thousand and allocations for taxes for EUR 120 thousand for which, at the current state, an outlay in future years is likely.

B) 14) Miscellaneous operating expenses – EUR 1,853 thousand (year 2015, EUR 143 thousand)

(EUR thousand)	2016	2015	Change
Municipal property tax (IMU)	1,562	109	1,453
Grants and agreements	217	16	201
Other duties and taxes	74	18	56
Total	1,853	143	1,710

Miscellaneous operating expenses mainly refer to IMU and TASI taxes for the year of EUR 1,562 thousand and to contributions for large dams for EUR 158 thousand.

Based on Italian Stability Law 208/2015, the Company has completed the process to review the cadastral incomes of its plants within the deadline for payment of the 2016 IMU/TASI advances, and therefore already benefited from the effects of the new regulations from 1 January 2016.

C) FINANCIAL INCOME AND EXPENSES – EUR 64 THOUSAND (YEAR 2015, EUR (4) THOUSAND)

C) 16) Financial income – EUR 101 thousand (year 2015, EUR 0 thousand)

(EUR thousand)	2016	2015	Change
From parent companies	83	–	83
From others	18	–	18
Total	101	–	101

This item mainly regards:

- interest income accrued at 31 December 2016 on the existing intragroup current account with parent company ERG Power Generation S.p.A. for EUR 83 thousand;
- interest income accrued on the VAT credit for which reimbursement has been requested, for EUR 13 thousand;
- interest accrued on the bank current account for EUR 5 thousand.

C) 17) Financial expenses – EUR 40 thousand (year 2015, EUR 4 thousand)

(EUR thousand)	2016	2015	Change
To Group companies	(35)	(4)	(31)
To others	(5)	–	(5)
Total	(40)	(4)	(36)

This item mainly regards interest expense accrued at 31 December 2016 on the existing intragroup current account with parent company ERG Power Generation S.p.A. for EUR 35 thousand, and interest expense due to others for EUR 5 thousand.

C) 17 bis) Profit (loss) on exchange rate differences – EUR 3 thousand (year 2015, EUR 0 thousand)

The item regards the exchange rate gains (EUR/GBP) achieved during the year.

20) Income taxes for the year – EUR 17,924 thousand (year 2015, EUR 1,437 thousand)

	Current income taxes	Deferred tax assets	Recovery of deferred tax assets	Deferred tax liabilities	Recovery of deferred tax liabilities	Taxes from previous years	Total income taxes for the period
IRES	3,802	(51)	11,965	–	(151)	–	15,566
IRAP	673	(4)	1,689	–	–	–	2,358
Total	4,475	(55)	13,654	–	(151)	–	17,924

Current income taxes

Income taxes for the period were calculated on the basis of expected taxable income.

Current IRES tax for the year amounts to EUR 3,802 thousand. It was calculated to applying the increases and decreases pursuant to the tax regulations in effect to the profit for the year, and applying a tax rate of 27.5%. Note that on 30 May 2016, the Company signed an agreement for participation in the domestic tax consolidation with parent company ERG S.p.A. The IRES tax calculated is therefore transferred to the parent company, with subsequent recognition, in the financial statements of ERG Hydro S.r.l. of the payable with respect to the Parent Company.

Current IRAP amounts to EUR 673 thousand and was calculated as the difference between value and cost of production, pursuant to letters A) and B) of Article 2425 of the Italian Civil Code, excluding the items pursuant to numbers 9), 10), 12) and 13), as per the Income Statement for the year, drawn up in accordance with the accounting standards. This taxable base was adjusted by making the appropriate changes (increases or decreases) in accordance with the tax regulations in effect. The rate of 4.82% was applied, effective at 31 December 2016 for the regions in which income was generated, namely Lazio and Umbria.

Deferred tax assets

Deferred tax assets were recognised in the financial statements based on the reasonable certainty of their recovery in future years.

As envisaged by Italian Law no. 208 of 28 December 2015 (2016 Stability Law), an IRES tax rate of 24% was applied to significant items starting from 2017.

The IRAP rate applied is 3.9%.

IRES deferred tax assets recorded during the year, equal to EUR 51 thousand, refer to the positive difference between the statutory and tax value of the assets for IRES purposes for EUR 7 thousand, to the temporary recovery (increase) of costs for auditing not yet completed and to payments to directors not yet disbursed at 31 December 2016 for EUR 14 thousand, as well as allocations to the provisions for risks for EUR 30 thousand.

IRES deferred tax assets eliminated during the year, equal to EUR 11,965 thousand, refer to recovery of the write-down to goodwill for EUR 11,562 thousand, to repayment of the provision for water lease expense for EUR 254 thousand, to recovery of the differences between statutory and tax value of the assets for EUR 117 thousand, to use of the tax loss for 2015 for EUR 4 thousand, as well as recovery of suspended costs of the prior year and adjustment of the rate from 27.5% to 24% for items to be recovered from 2017, for a total of EUR 27 thousand.

IRAP deferred tax assets recorded in the year, equal to EUR 4 thousand, refer to allocations to the provisions for employees.

IRAP deferred tax assets eliminated during the year, equal to EUR 1,689 thousand, refer to recovery of the write-down to goodwill for EUR 1,640 thousand, to recovery of the difference between statutory and tax value of the assets for IRAP purposes for EUR 5 thousand, to repayment of the provision for water lease expense for EUR 41 thousand, and to recovery of suspended costs of the prior year for auditing services for EUR 3 thousand.

Deferred tax liabilities

IRES deferred tax liabilities during the year, equal to EUR 151 thousand, regard recovery of excess statutory amortisation compared to amortisation for tax purposes.

The tables below show the reconciliation between the theoretical tax charges and the reported charges.

Reconciliation between the tax liability in the financial statements and the theoretical tax liability

	Taxable amount	IRES (corporate tax)	%
Net profit (loss) before taxes	55,563	15,280	27.50%
Permanent changes			
Non-deductible IMU	1,142	314	
Rents and other non-deductible costs	348	96	
Other permanent changes	249	68	
Non-deductible allocations	102	28	
Amortisation/depreciation of 140%	(6)	(2)	
Temporary changes			
Deferred tax assets	(399)	(110)	
Deferred tax liabilities	548	151	
Recovery of write-down on goodwill	(42,043)	(11,562)	
Changes in provisions for risks	(937)	(258)	
Prior years' tax losses and other temporary changes	(35)	(10)	
Transfer of excess ROL (working hours benefit) to "tax consolidation"	(705)	(194)	
Total current income taxes		3,802	
Deferred tax assets		11,914	
Recorded in the year		(51)	
Recovered in the year		11,965	
Deferred tax liabilities		(1,501)	
Recovered in the year		(151)	
Total		15,566	28.01%

	IRAP		%
Difference between costs and value of production	55,500		
Personnel costs, depreciation/amortisation and write-downs	7,194		
Theoretical taxable income (IRAP)	62,694	3,022	4,82%
Permanent changes			
IMU	1,427	69	
Other deductible costs	31	1	
Temporary changes			
Recovery of write-down on goodwill	(42,043)	(2,026)	
Deferred tax assets	(126)	(6)	
Use/repayment of provisions for risks	(1,060)	(51)	
Deductions for personnel costs	(6,960)	(335)	
Total current IRAP		673	
Deferred tax assets			
Recorded in the year		(4)	
Recovered in the year		1,689	
Total		2,358	3,76%

The difference between theoretical IRES (27.5%) and reported IRES (28.01%) is essentially due to the impact of permanent changes (increases). The aforementioned changes are mainly due to the non-deductible nature of IMU costs and telephone expenses, respectively for 80% and 20%, to the total non-deductibility of some allocations to the provisions for risks, and to the nearly total non-deductibility of leasing costs. Moreover, as part of the Tax Consolidation, the Company has transferred the excess ROL to to consolidating company ERG S.p.A., recognising the relative remuneration solely for the purposes of current income taxes.

The difference between theoretical IRAP (4.82%) and reported IRAP (3.76%) is mainly due to calculation of the prepaid tax at the rate of 3.9%, in line with the rate used by the other companies of the ERG Group, to the deduction of costs for personnel hired on a permanent basis and to the total non-deductibility of IMU costs.

Commitments and Guarantees

Following the repeal of Article 2424 paragraph 3, this information is no longer stated in the footnotes of the Statement of financial position under “memorandum accounts” but is described in detail in the Explanatory Notes.

(EUR thousand)	31/12/2016	31/12/2015	Change
Guarantees issued			
Sureties in favour of third parties	6,449	11,216	(4,768)
Commitments			
Commitments to suppliers	8,850	8,405	446
Total	15,299	19,621	(4,322)

Guarantees provided – EUR 6,449 thousand (anno 2015, EUR 11,216 thousand)

Guarantees provided in favour of third parties consist of:

- Bank sureties in favour of the Umbria Region, to guarantee hydroelectric concessions for EUR 3,813 thousand;
- Bank sureties in favour of Terna S.p.A. for EUR 2,601 thousand;
- Bank sureties in favour of the municipality of Visso and the Province of Rieti for EUR 35 thousand.

The decrease compared to the prior year is due to the restitution of sureties by GME and to adjustment of the surety to Terna.

Commitments to suppliers – EUR 8,850 thousand (year 2015, EUR 8,404 thousand)

The item includes commitments to suppliers for contracts for the supply of goods, spare parts and services, with the following expiries:

- within 12 months EUR 2,363 thousand;
- within 3 years EUR 6,487 thousand.

OTHER INFORMATION REQUIRED BY ARTICLES 2427 AND 2427-BIS OF THE ITALIAN CIVIL CODE

Other significant information required by Articles 2427 and 2427-bis of the Italian Civil Code is provided below:

- there are no payables backed by collateral (Article 2427, no. 6);
- no transactions subject to the obligation of retrocession upon completion were carried out (Article 2427, no. 6-ter);
- no financial expenses were posted to the asset values of the Statement of Financial Position during the year (Article 2427, no. 8);
- payments to members of the Board of Directors amounted to EUR 4 thousand; to the member of the Board of Statutory Auditors, EUR 28 thousand; no credits were granted or commitments undertaken on their account (Article 2427, no. 16);
- amounts payable to the auditing firm, excluding reimbursement for expenses, amount to EUR 147 thousand, entirely referring to auditing services (Article 2427, no. 16-bis);
- no bonus shares, bonds convertible into shares or securities or other similar instruments were issued (Article 2427, no. 18);
- no derivative financial instruments were issued (Article 2427, no. 19) and no shareholder loans were received (Article 2427, no. 19-bis);
- no assets were allocated to a specific business (Article 2427, no. 20), and no loans were granted or stipulated with regard to a specific business (Article 2427, no. 21);
- no finance lease transactions involving the transfer to the lessee of the predominant portion of risks and benefits of the underlying asset were carried out (Article 2427, no. 22);
- transactions with related parties (Article 2427, no. 22-bis) are illustrated in the relative section of the Report on Operations;
- there are no known agreements whose effects are not mentioned in the Statement of Financial Position (Article 2427, no. 22-ter).

With regard to the requirements of Article 2427 no. 22 quinquies and 22 sexies, note that the company drawing up the consolidated financial statements of the largest group of companies to which the Company belongs is San Quirico S.p.A., with registered office at Via Ciovasso, 4 in Milan. The consolidated financial statements of San Quirico S.p.A. are available at the registered office.

The company drawing up the consolidated financial statements of the smallest group of companies to which the Company belongs is ERG S.p.A., with registered office at Via De Marini 1, in Genoa. The consolidated financial statements of ERG S.p.A. are available at the above registered office in Genoa.

SIGNIFICANT EVENTS AFTER THE REPORTING PERIOD (ARTICLE 2427, NO. 22-QUATER)

Following the amendments introduced by Italian Legislative Decree no. 139 of 18 August 2015, with the addition of provision no. 22 - quater to Article 2427 and abolition of Article 2428 paragraph 3 - no. 5 of the Italian Civil Code, significant events after the reporting period are stated in these Explanatory Notes and no longer in the Report on Operations.

- On 13 January 2017, the Gestore Servizi Energetici (GSE) annulled the revocation of the qualification according to which there existed a pending dispute before the Lazio TAR (Regional Administrative Court), and recognised the qualification of "IAFR" to the Sigillo plant, authorising the plant to recover the green certificates for the period between 2010 and 2015, in addition to the replacement incentive system from 2016.
- In January 2017, following the "One Company" reorganisation project, the number of employees declined from 90 units to 69 units, with a decrease of 21 units as follows:
A decrease of 25 units, of which 19 employees were transferred to the company ERG Power Generation S.p.A., 3 employees were transferred to ERG S.p.A. and 3 employees terminated their employment with the company.
An increase of 4 units comprised 2 units acquired from ERG Services S.p.A. and 2 acquired from ERG Power Generation S.p.A.
- Starting from 2017, the Company joined the Group's VAT liquidation procedure, governed by the last paragraph of Article 73 of Italian Presidential Decree no. 633 of 26 October 1972 and Ministerial Decree of 13 December 1979. This procedure envisages that the VAT payables and receivables arising from periodic payments be transferred to the parent company, which will make any payments, adding and offsetting the resulting payables and receivables of all participating companies.
- With regard to the application of reimbursement of the quarterly VAT submitted by the Company for first, second and third quarters 2016, note that on 23 February 2017, the Italian Revenue Agency provided the reimbursement for first quarter 2016, with a credit to the Company's current account for EUR 720 thousand, including interest.



Board of Directors' Proposal

BOARD OF DIRECTORS' PROPOSAL

Dear Shareholders,

These financial statements, comprising the Statement of Financial Position, Income Statement, Statement of Cash Flows and Explanatory Notes, provide a true and accurate representation of the Company's financial and economic position, and correspond to the results of the accounting entries.

The financial statements at 31 December 2016 closed with a profit of EUR 37,640 thousand, after allocation to amortisation/depreciation of EUR 54,887 thousand and after taxes confirmed payable of EUR 17,924 thousand.

We therefore invite you to:

- approve the Financial Statements for your Company at 31 December 2016, which closed with a profit of EUR 37,639,853;
- resolve the distribution of profit for the year 2016 for the amount of EUR 37,639,853.

Genoa, 7 March 2017

On behalf of the Board of Directors

The Chairman

Pietro Tittoni



BOARD OF STATUTORY AUDITORS' REPORT TO THE SHAREHOLDERS' MEETING FOR APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016, PURSUANT TO ARTICLE 2429, PARAGRAPH 2 OF THE ITALIAN CIVIL CODE

To the Shareholders' Meeting of ERG Hydro S.r.l.

During the year ended 31 December 2016, we conducted the supervisory activities required of the Board of Statutory Auditors, in accordance with Article 2403 of the Italian Civil Code and Legislative Decree 58/98, as applicable, based on the standards of conduct of the Board of Statutory Auditors in companies controlled by companies with shares listed on regulated markets, issued by the Consigli Nazionali dei Dottori Commercialisti e degli Esperti Contabili (National Board of Chartered Accountants), also taking into account the specific applicable regulations.

The Board states that it was able to verify respect of the legal regulations and of the Company's Articles of Incorporation. The year just ended is the first full year of operation within ERG Hydro of the hydroelectric business unit acquired from EON on 1 December 2015.

With regard to the activities carried out during the period:

- we held 4 meetings of the Board of Statutory Auditors and participated in the Shareholders' Meetings and all of the Board of Directors' meetings held during the period of assessment, monitoring compliance with the Articles of Incorporation and with the laws and regulations that govern the operation of Company bodies;
- we obtained information from the Directors on the overall activities carried out by the Company and on the transactions of greatest economic and financial relevance, verifying that the actions decided on and carried out complied with the law and with the Articles of Incorporation and that they were not openly imprudent or reckless, potentially in conflict of interest or conflicting with the resolutions passed by the Shareholders' Meeting or such as to compromise the integrity of the company's capital;
- we verified the legitimacy of the management decisions made by the Management Body and their economic adequacy, excluding a verification of merit with regard to opportunity and feasibility;
- we checked the adequacy of the internal control system, structured at Group level and constantly updated both within the parent company as well as within the subsidiaries. The Board of Statutory Auditors acknowledges that - based on what was reported - the audit providing an overall evaluation of the adequacy of the internal control system was completed, identifying a number of improvement measures with regard to which management is already working;

- we verified the adequacy of the organisational structure, and we highlight that ERG Hydro S.r.l. had a total of 90 employees at 31 December 2016. The Company's staff predominantly comprises employees acquired on 30 November 2015, following transfer of the hydroelectric segment as a result of the demerger of the company E.On Produzione S.p.A., in addition to a number of new hires for the new operational processes of energy management;
- we have acknowledged that on 11 May 2016, the Company adopted an Organisation and Management Model pursuant to Italian Legislative Decree 231/2001 and simultaneously appointed the Supervisory Committee, consisting of three individuals of which one, the Chairman, from outside of the company. Moreover, we have noted from the report received from the Supervisory Committee that no significant critical aspects were identified during the year for the purposes of implementation and effectiveness of the Organisation and Management Model;
- the administrative-accounting system, to the extent that we verified and assessed through information obtained from the Head of the respective function, from an examination of the corporate documentation and from an analysis of the work carried out by the Independent Auditors, is suitable in accurately representing the operating events. Note that the Company assigned to an independent expert the task, completed in December 2016, of conducting a physical inventory of the hydroelectric plants, also aimed at identifying the major components, as well as determining the economic-technical duration and fair value of the asset;
- we verified the timeliness with which the parent company was provided both the data required to draw up the Financial Statements and the information required to fulfil the disclosure obligations pursuant to Articles 114 and 115 of Italian Legislative Decree 58/98;
- with regard to Safety, we were informed that, consistently with the Group's Sustainability Policy, ERG Hydro S.r.l. obtained the certifications of Integrated Management Systems according to the international standards ISO 14001 Environment, OHSAS 18001 Health and Safety and EMAS.

During the supervisory activity, as described above:

- we monitored compliance with the resolutions of the Shareholders' Meeting of 21 June 2016, which resolved to distribute to the sole Shareholder a portion of the share premium reserve for EUR 75 million and of the exchange rate gains reserve for EUR 217 thousand.
- we did not identify any transaction that was atypical or could be defined as unusual either with respect to third parties or with intra-group companies or related parties, in terms of nature or extent;
- we found that ordinary transactions had been carried out on an intra-group basis and with related parties, confirming the existence of and compliance with procedures to ensure that these operations were duly documented, settled on an arm's length basis and in line with the best interests of the companies. These transactions were adequately illustrated by the Directors in the Financial Statements and in the Report on Operations, to which reference is made. With regard in particular to intra-group service agreements, we agreed with the cost charge-back criteria employed;
- no complaints were made by the shareholders in accordance with Article 2408 of the Italian Civil Code;
- we did not find any omissions or actions liable to censure or unlawful actions to be reported to the competent bodies or to be mentioned in this Report;
- we issued the opinions required by law.

Moreover, we highlight the following:

- the company is subject to management and coordination by parent company ERG S.p.A.: in addition to the definition of business strategies, this activity includes the indication of strategic guidelines from an organisational perspective and personnel policies, as well as management of strategic finance and group treasury with respect to tax-related issues, especially with regard to planning, communication policies, policies regarding the environment, health and safety, and the IT systems.

The obligations with regard to advertising, envisaged by Article 2497-bis of the Italian Civil Code were also respected. In particular, the decisions made as part of the management and coordination activities of ERG S.p.A. were mentioned in the Report on Operations;

- The company participates in the Domestic Tax Consolidation system, pursuant to Articles 117 et seq. of the Consolidated Law on Income Taxes, with the company ERG S.p.A., as consolidating company.

Auditing of the Financial Statements was carried out by Deloitte & Touche S.p.A., already appointed by parent company ERG S.p.A. to audit its own Separate Financial Statements and the Consolidated Financial Statements.

During the year, we communicated regularly with the Independent Auditors, for a mutual exchange of relevant data and information.

The utmost collaboration was always noted, also with regard to the preliminary activities for preparation of the financial statements, and no significant facts or aspects worthy of mention were identified.

Specifically with regard to the supervisory activity for the financial statements, the auditing of which was assigned to the independent auditors Deloitte & Touche S.p.A., we declare that:

- the laws governing the preparation and arrangement of the financial statements and of the Report on Operations were respected. Moreover, the adoption of accounting standards based on the prospect of the company as a going concern is considered to be suitable, given the information illustrated in the Report on Operations with regard to the company's business outlook; the financial statement formats adopted and the accounting standards applied, described in the Explanatory Notes, are compliant with the provisions of the law and adequate in relation to the company's business;
- the Company has drawn up the financial statements in accordance with the Italian accounting standards, as last amended via issuance of the new OICs, for the purposes of lodging with the Business Register, also drawing up the periodic reports for submission of the economic and financial position and consolidated financial statements of ERG S.p.A. in accordance with the IAS/IFRS international accounting standards;
- pursuant to Article 2426, paragraph 5, Italian Civil Code the values recorded under points B-I-1) of assets were subject to our specific examination, with consequent approval for their recognition; note that, for mere information purposes, it will not be possible to distribute dividends using the profit reserves in excess of the net amount of this item capitalised under assets;

- pursuant to Article 2426, paragraph 6, Italian Civil Code the Board of Statutory Auditors acknowledges the existence of the “goodwill” item amortised on a straight-line basis for a period of 20 years. With regard to the requirements of OIC 9, no particular elements or indicators were identified that would make the goodwill value non-recoverable;
- the financial statements correspond to the facts and information of which the Board of Statutory Auditors became aware in the performance of its supervisory duties and in the exercise of its oversight and inspection powers;
- the Report on Operations is consistent with the requirements of Article 2428 of the Italian Civil Code and with the data and entries shown in the financial statements; it provides full disclosure
- on the market, on the regulatory scenario in question and on the company’s activities, as well as adequate disclosure of the significant events that occurred during the year.

The Report also illustrates the following:

- developments of the applicable regulatory framework in 2016, with reference to the matters considered to be of greatest interest or more directly relevant to the activities carried out directly or indirectly by the Company;
- the main risks and uncertainties to which the Company is exposed, in accordance with Article 2428 of the Italian Civil Code.

The Explanatory Notes adequately illustrate any changes in the Equity items, indicating the possibility of use and availability for distribution of each item, along with any tax restrictions.

The Independent Auditors’ Report, issued pursuant to Articles 14 of Italian Legislative Decree no. 39 of 27/1/2010 and 165 of Italian Legislative Decree no. 58 of 24/2/1998, on 27 March 2017, expresses the opinion that *“the financial statements provide a true and accurate representation of the financial and economic position of ERG HYDRO S.r.l. at 31 December 2016 and of the economic results and cash flows for the year ended at said date, in accordance with the Italian standards governing the drafting criteria.”*

The Board of Statutory Auditors, within the scope of its responsibilities, acknowledging the results of the financial statements at 31 December 2016 and of the Independent Auditors’ Report on said financial statements, has no objections with regard to approval of the financial statements and of the proposal for allocation of profit as indicated by the Directors in the Explanatory Notes.

Genoa, 28 March 2017

The Board of Statutory Auditors

(Mr. Lelio Fornabaio)

(Ms. Luisella Bergero)

(Mr. Gioacchino Messina)

AUDITORS' REPORT



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INDEPENDENT AUDITORS' REPORT
PURSUANT TO ART. 14 OF LEGISLATIVE DECREE No. 39 OF JANUARY 27, 2010 AND ART. 165 OF
LEGISLATIVE DECREE No. 58 OF FEBRUARY 24, 1998

To the Quotaholders of
ERG Hydro S.r.l.

Report on the Financial Statements

We have audited the accompanying financial statements of ERG Hydro S.r.l., which comprise the balance sheet as at December 31, 2016, the statement of income and statement of cash flows for the year then ended and the explanatory notes.

Management's Responsibility for the Financial Statements

The Company's Directors are responsible for the preparation of these financial statements that give a true and fair view in accordance with the Italian law governing financial statements.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (ISA Italia) issued pursuant to art. 11 of Italian Legislative Decree 39/10. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Ancona Bari Bergamo Bologna Brescia Cagliari Firenze Genova Milano Napoli Padova Parma Roma Torino Treviso Verona

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2

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of ERG Hydro S.r.l. as at December 31, 2016, and of its financial performance and cash flows for the year then ended in accordance with the Italian law governing financial statements.

Report on Other Legal and Regulatory Requirements*Opinion on the consistency of the report on operations with the financial statements*

We have performed the procedures indicated in the Auditing Standard (SA Italia) n° 720B in order to express, as required by law, an opinion on the consistency of the report on operations, which is the responsibility of the Directors of ERG Hydro S.r.l., with the financial statements of ERG Hydro S.r.l. as at December 31, 2016. In our opinion the report on operations is consistent with the financial statements of ERG Hydro S.r.l. as at December 31, 2016.

DELOITTE & TOUCHE S.p.A.

Signed by
Giorgio Barbieri
Partner

Genoa, Italy
March 27, 2017

This report has been translated into the English language solely for the convenience of international readers.



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ERG Hydro S.r.l. - March 2017

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