Acea

Solid Credit Profile Despite Higher Capex

Around 80% of Acea's EBITDA derives from fully regulated activities (energy networks and water services). This characteristic provides high stability and visibility to the group's cash flows. From a regulatory point of view, we believe that uncertainties regarding the water business (which accounts for around 40% of Acea's EBITDA) are now lower vs the first months of 2019. Acea's net debt is forecast to increase in the next few years, mainly due to the higher capex envisaged in its 2019-2022 Strategic Plan. However, we expect credit metrics (eg, net debt/EBITDA ratio) to remain stable overall, reflecting expected operating growth. We confirm our NEUTRAL Credit View on Acea. We also maintain a HOLD recommendation on Acea bonds.

- **2019-2022 BP**. Acea's 2019-2022 Strategic Plan points to a sharp acceleration of growth, driven by increased investments (+30% vs the previous plan, with around 77% of the total in regulated activities), M&A contribution, and cost efficiencies. Acea indicated EBITDA of EUR 1,270M in 2022 vs EUR 933M in 2018 (vs the previous EUR 1,108M forecast for 2022), equal to an average 8.8% 2017-2022 CAGR (vs the previous 5.9%). Out of the c.EUR 330M total EBITDA growth, EUR 230M should derive from regulated activities, implying limited execution risk, in our view. The net debt/EBITDA ratio is forecast at 2.9x in 2022 vs 2.8x at year-end 2018.
- **2019 EBITDA guidance improved following 1H results.** In 1H19, Acea's EBITDA rose by 12% yoy, to EUR 503M (Bloomberg: EUR 495M), mainly driven by the water division, due to a larger perimeter (mainly Gori, which was consolidated starting from November 2018) and higher tariffs. Acea's net debt amounted to EUR 2,843M vs EUR 2,568M at year-end 2018, mainly due to higher capex (+21% yoy), while leverage (net debt/EBITDA ratio) was 2.9x vs 2.8x. Based on the 1H19 results, Acea raised EBITDA guidance for 2019, now seen to be up by above 7% vs year-end 2018, from the previous guidance of +5-6%. At the same time, Acea confirmed: i) capex up by above 10% vs 2018; and ii) net debt of EUR 2.85-2.95Bn, not including +EUR 57M from IFRS 16 and M&A activity.
- **NEUTRAL Credit View**. Acea's credit profile looks set to remain solid over the next 12-18 months, in our view, primarily benefitting from the high contribution from regulated activities (c.80% of total EBITDA). Net debt is forecast to increase, reflecting the higher capex envisaged in the 2019-2022 BP. Therefore, the stability of group's credit metrics (eg, net debt/EBITDA ratio) should be the result of operating growth. In this respect, we believe that the contribution to growth expected from regulated activities provides good visibility to Acea's targets. From a regulatory point of view, we believe that uncertainties regarding the water business (which accounts for around 40% of Acea's EBITDA) are now lower compared to the first months of 2019. Finally, we consider that the company has recently showed solid improved in terms of working capital management which has historically been an issue for Acea. We confirm our NEUTRAL Credit View on Acea.
- **HOLD Acea bonds.** In light of current spreads, we confirm our HOLD recommendation on Acea bonds.

Investment recommendations on Acea	Sen Secured	Chg	Sen Unsec	Chg	Sub	Chg	Hybrid	Chg
Investment Grade	-	-	**HOLD**	c	-	-	-	-
High Yield	-	-	-	-	-	-	-	-
Unrated	-	-	-	-	-	-	-	-

Note: c = confirmed; d= downgraded; u = upgraded; n = new; NA = not assigned; U/R = under review. Source: Intesa Sanpaolo Research

See page 17 for full disclosures and analyst certification

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CREDIT VIEW NEUTRAL

Multi-Utilities
Company Update

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Credit Ratings	Rating	Outlook
Moody's	Baa2	Stable
Fitch	BBB+	Stable

Source: Bloomberg

Key Results		
EUR M	1H18	1H19
Sales	1,454	1,553
EBITDA	450	503
Margin (%)	30.8	32.4
	31.12.18	30.6.19
Net debt	2,568	2,843
Leverage (x)	2.8	2.9*

*LTM. Source: Intesa Sanpaolo research elaborations on company data

Report priced at market close on day prior to the issue (except where otherwise indicated).

Contents

Credit View NEUTRAL

NEUTRAL Credit View confirmed

We confirm our NEUTRAL Credit View on Acea, expecting its credit metrics to remain overall stable in the next 12-18 months. We primarily factor in the high stability and visibility provided to Acea's results by regulated activities. Acea's net debt is forecast to increase in the next few years, reflecting the higher capex envisaged in the 2019-2022 Strategic Plan. Therefore, the stability of the group's credit metrics leverage (eg, net debt/EBITDA ratio) should be the result of operating growth. In this respect, we believe that the contribution to growth expected to come from regulated activities provides good visibility to Acea's targets.

A fully regulated multi-utility

Acea's operating performance continues to be supported by the sizeable contribution (around 80% of FY18 EBITDA) of water services and electricity networks, businesses which are not exposed to changes in demand. In this respect, the current 2019-2022 Strategic Plan confirmed Acea's focus on regulated activities, to which will be devoted around 77% of the EUR 4Bn total capex (EUR 800M yearly average vs previous EUR 600M).

Potential transfer to public entities of water concessions

On 29 August, *Il Sole 24 Ore* reported that in a potential new government programme, the Five Star Movement could put forward its proposal to nationalise water services (so-called "Daga law"): the draft law is currently under discussion in the Environment Commission of Chamber of Deputies. However, the same article suggested that the Democratic party, the potential partner for a new government, is against these plans. We currently believe that the proposal is unlikely to be approved, and that even if eventually implemented, the final version of the law is likely to have a lower impact on sector players than initially forecast.

Working capital management showed improvement in recent quarters

Working capital management – ie, receivables collection – has historically been an issue for Acea. However, in recent quarters, Acea has shown what we view as solid improvements related to this issue, reducing the negative impact on its cash generation. Acea points to limit working capital volatility to the part related to regulatory effect (eg, regulatory lag), thus to be considered as structural. Management indicated working capital absorption for around EUR 45-50M for full-year 2019.

Rating potentially constrained by Italy, due to very limited geographical diversification

Acea's operations are almost entirely domestic, making it vulnerable to negative developments in Italy's economy, and potentially leading to a contraction in revenues from liberalised activities (waste management, power/gas supply). This exposure to the country results in Acea's ratings potentially being negatively affected by the level of Italy's sovereign rating.

Municipality of Rome is Acea's main shareholder (51% stake)

The Municipality of Rome is Acea's main shareholder (51% stake). In the past, this fact led to some political interference on Acea's governance and strategy. However, we note that current management has been named by the current government of Rome which, in our view, should provide support to the company's strategy.

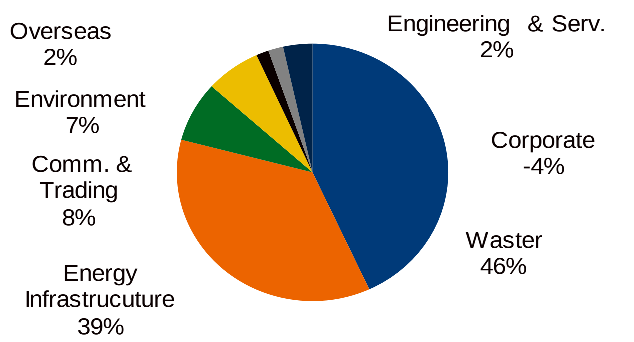
Strengths/Opportunities	Weaknesses/Threats
▪ High contribution from regulated activities (c.80% of FY18 EBITDA) provides predictable revenues and cash flows. ▪ 2019-2022 BP strongly focused on regulated activities, with around 77% of total capex devoted to water services and energy networks. ▪ Long-term concessions in regulated activities.	▪ Risks, albeit decreasing, of intervention by the Italian government in the water regulatory framework. ▪ Increasing competition in liberalised activities could raise pressure on margins (eg, energy supply). ▪ Receivables management issues could weigh on the working capital trend even though recent quarters saw solid improvements. ▪ Governance still potentially affected by the major shareholder, the Municipality of Rome (51%).

Source: Intesa Sanpaolo Research

Operating profile skewed towards regulated activities

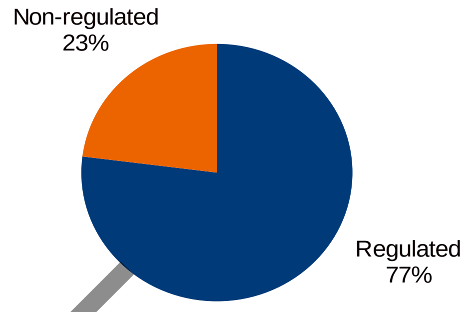
Acea is the largest provider of integrated water services in Italy, serving nearly 9 million customers in the province of Rome and other parts of Lazio, Tuscany, Umbria and Campania. The group is among the leading Italian players in electricity distribution, with around 10 TWh of electricity distributed. It also operates in waste treatment and waste to energy (WTE). Furthermore, in 2019, Acea entered the gas distribution sector with the acquisition of 51% of the share capital of Pescara Distribuzione (around 62,000 redelivery points). Water integrated services, electricity and gas distribution are fully regulated activities, with no exposure to changes in demand. As at March 2019, the Municipality of Rome was Acea's main shareholder, with 51% of voting rights, followed by Suez Environment (23%).

Acea: EBITDA breakdown by business (2018)



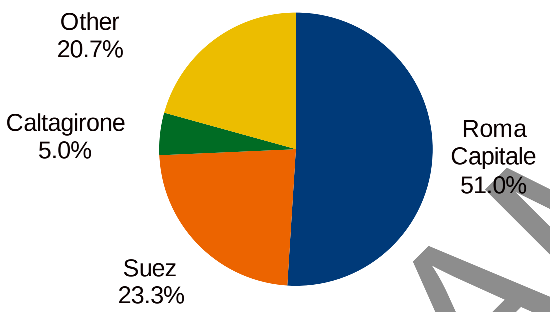
Source: Intesa Sanpaolo Research elaboration on Company data

Acea: EBITDA breakdown (2018)



Source: Intesa Sanpaolo Research elaboration on Company data

Acea: shareholders



Source: Company presentation (April 2019)

Acea: geographical presence

Source: Company presentation (April 2019)

Proposal to nationalise water services

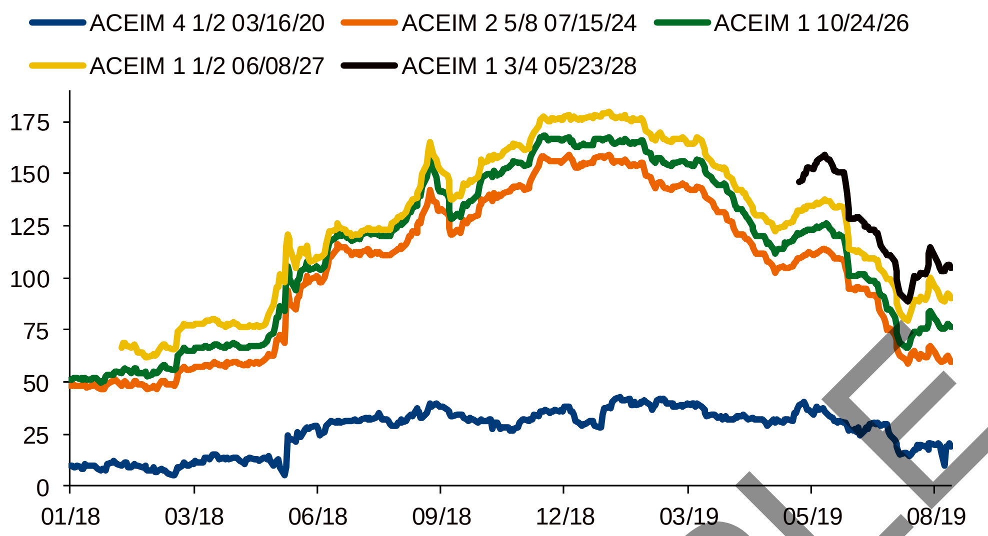
In October 2018, the Italian government started a process to shift the management of the integrated water business into public hands. The aim of the so-called "Daga law" (from the name of the Five Star Movement deputy who proposed the draft law) is to transfer the concessions from the current operators to public entities (namely, the local municipalities). This would drive companies involved in water services to dispose of that type of business with a reimbursement of the RAB (Regulatory Asset Base). The draft law is currently under discussion in the Environment Commission of Chamber of Deputies.

On 29 August, *Il Sole 24 Ore* reported that in a possible new government programme, the Five Star Movement could put forward its proposal to nationalise water services. However, the same article suggested that the Democratic party, the potential partner for a new government, is against such plans. We highlight that the Lega party, the former ally of Five Star Movement, has already stated that it does not share the Five Star Movement's position, and the Italian regional governments and the Italian regulator (ARERA) appear not to as well. We currently believe that the proposal has very little chance of being approved – and that even if eventually implemented, the final version of the law would likely have less of an impact on sector players than initially forecast.

Market Focus

Year to date in 2019, Acea's bonds have posted positive performances, benefitting from both the company's financial results and from market expectations about future ECB monetary policy – ie, potential new corporate bond purchasing programme.

Acea selected bonds (ASW, bps)



Source: Intesa Sanpaolo Research elaboration on Bloomberg data

We currently do not expect the issuer's bonds to overperform their main Italian peers. Therefore, we confirm our HOLD recommendation on Acea bonds.

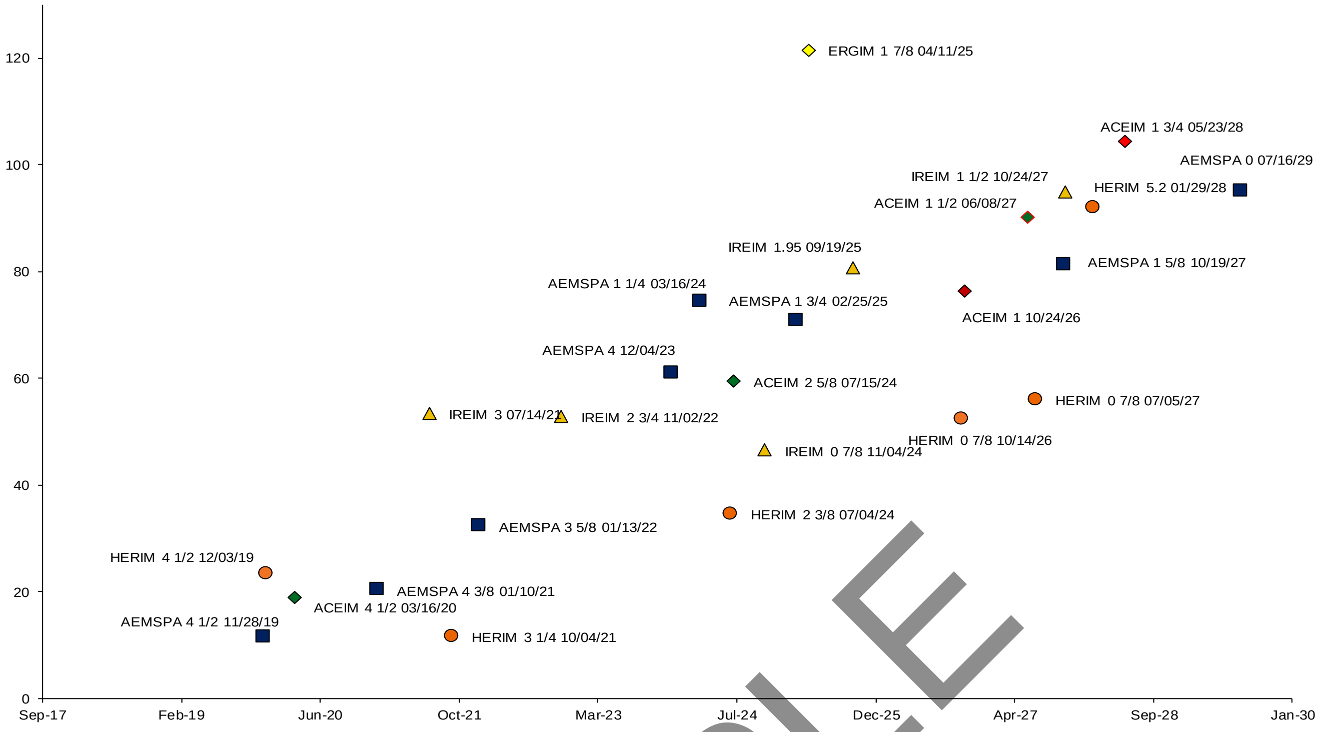
HOLD Acea bonds

ACEA SpA bonds/CDS (ASW, bps)

Bond	Next call and price	Type	Outst. EUR M	Price	YTM %	SPRD TYPE	SPRD 4.9.19	-1W (bps)	-1M (bps)	YTD (bps) 2.1.19	52-week range max	52-week range min	Ratings Mdy	Ratings Fitch	Ratings BBG
ACEA SpA															
ACEIM 4 1/2 03/16/20	-	FX	423	102.5	-0.2	ASW	26	6	10	-9	43	10	-	BBB+	-
ACEIM 2 5/8 07/15/24	04/24 100.0	FX	600	111.8	0.1	ASW	62	-1	-2	-96	159	59	Baa2	BBB+	BBB
ACEIM 1 10/24/26	07/26 100.0	FX	500	104.6	0.3	ASW	77	0	6	-89	168	66	Baa2	BBB+	BBB
ACEIM 1 1/2 06/08/27	03/27 100.0	FX	700	107.5	0.5	ASW	92	-1	7	-87	180	80	Baa2	BBB+	BBB
ACEIM 1 3/4 05/23/28[1]	02/28 100.0	FX	500	108.9	0.7	ASW	106	0	12	-40	159	89	Baa2	BBB+	BBB

Type: FX = Fixed. YTM: yield to maturity or yield to call for callable bonds. SPRD TYPE: ASW=Asset Swap. Ratings: reported in the table refer to individual issues. Notes: 1) YTD from launch date for bonds issued in 2019. Source: Intesa Sanpaolo Research elaboration on Bloomberg data at 09:07.

Selected Italian utilities (ASW,bps)



Note: AEM's 2023 and 2024 notes are private placements. Source: Intesa Sanpaolo Research elaboration on Bloomberg data

2019-2022 BP

Strategy focused on regulated activities

Acea's 2019-2022 Strategic Plan points to a sharp acceleration of growth, driven by increased investments (+30% vs previous plan), M&A contribution, and cost efficiencies.

2019-2022 BP targets. In terms of financial targets, Acea indicated: i) EBITDA at EUR 1,270M in 2022 from EUR 933M in 2018 (vs the previous EUR 1,108M in 2022), equal to an average 8.8% 2017-2022 CAGR (vs the previous 5.9%); ii) by division, out of the c.EUR 330M total EBITDA growth, EUR 230M should derive from regulated activities, implying limited execution risk, in our view, and c.EUR 78M from a less visible contribution from electricity sales (mainly due to the phase-out of the so-called "protected market" in 2020); and iii) a total of EUR 800M in dividends during 2018-2022, up EUR 100M vs the previous plan, with a minimum of EUR 0.75/share in 2019 seen as floor for the following years; management stated a 50-60% payout as "ideal" for Acea. The net debt/EBITDA ratio is forecast to be 2.9x in 2022 vs 2.8x at year-end 2018.

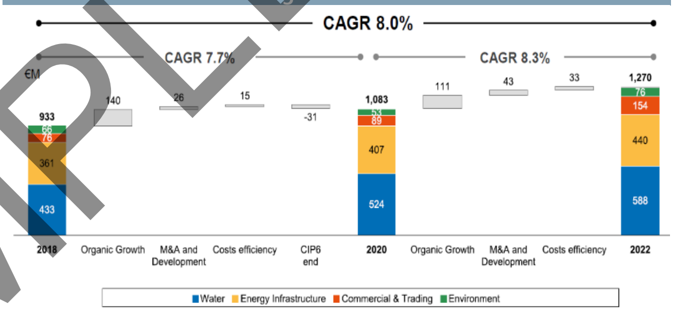
As shown in the chart below, the EBITDA acceleration over the plan period should primarily reflect organic growth of around EUR 250M, M&A activity of around EUR 70M, and cost efficiencies of around EUR 50M. On the negative side, Acea indicated around EUR 31M related to expiring environmental incentives. But, Acea also indicated additional upside, worth EUR 100M-200M up to 2022, from initiatives under study but not included in plan targets (eg, growth in waste treatment, growth in gas distribution, further consolidation of water subsidies).

Acea 2019-2022BP: EBITDA breakdown by division

EUR M	2018A	2020T	2022T	CAGR 2018-22
Water	433	524	588	8.0
Energy infrastructure	361	407	440	5.1
Commercial & trading	76	89	154	19.3
Environment	66	53	76	3.9

Note: A=actual; T= target. Source: Company data

Acea 2019-2022 BP: EBITDA grow drivers

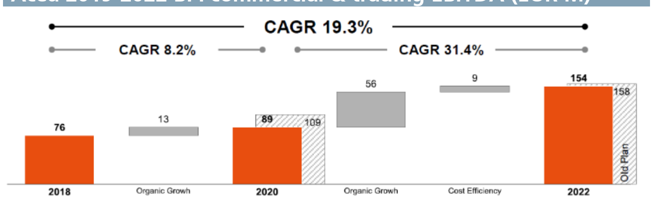


Source: Company data

Commercial division expected to be driven by energy market liberalisation

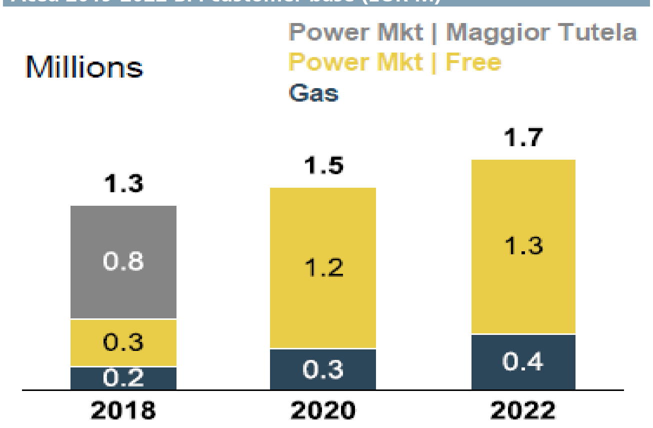
In terms of its contribution to EBITDA growth, the commercial & trading division is forecast to almost double, from EUR 76M in 2018 to EUR 154M in 2022. The end of the so-called "protected market" (Maggior Tutela) in electricity from mid-2020 is expected to be a key driver leading to customers to switch from the regulated market to the more profitable free market.

Acea 2019-2022 BP: commercial & trading EBITDA (EUR M)



Source: Company data

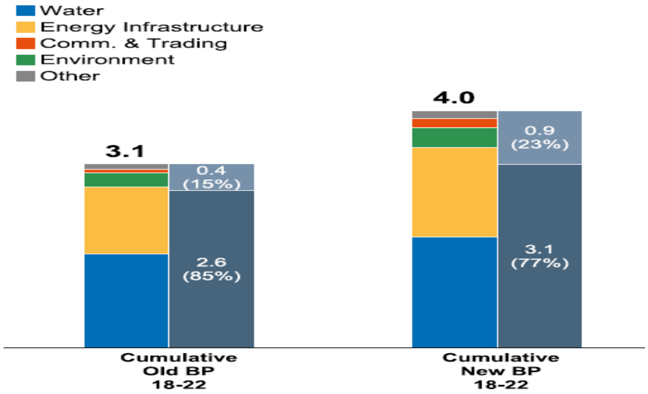
Acea 2019-2022 BP: customer base (EUR M)



Source: Company data

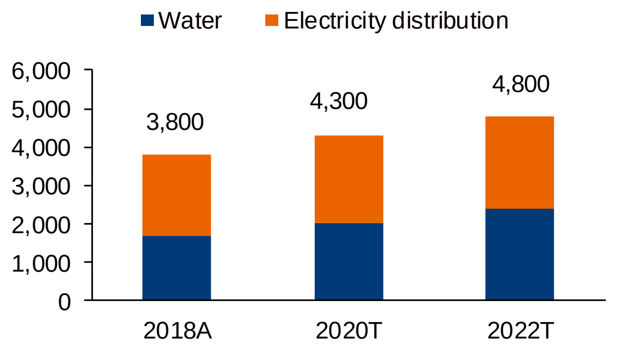
Total capex over 2018-2022 are forecast at about EUR 4Bn (EUR 800M/year vs previous EUR 600M/year), 77% of which will be spent on regulated networks, with the RAB expected to reach EUR 4.8Bn in 2022 vs EUR 3.8Bn in 2018 (+26%).

Acea 2019-2022 BP: capex breakdown (EUR Bn)



Source: Company data

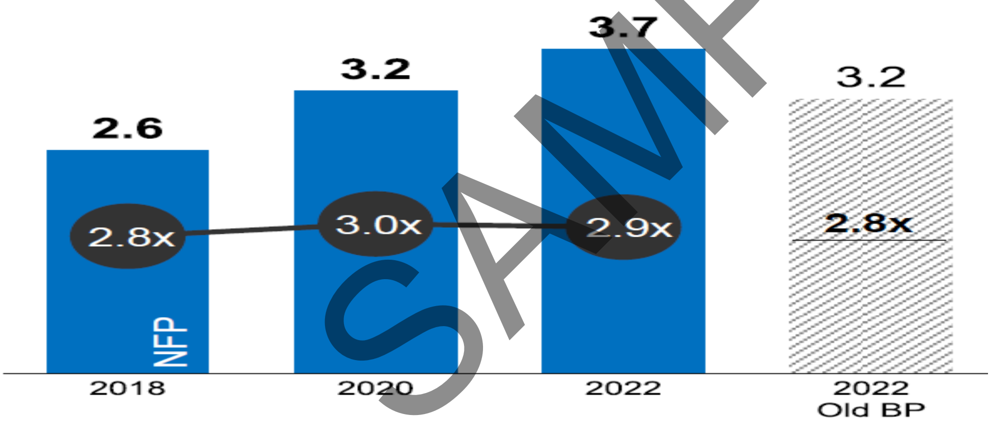
Acea 2019-2022 BP: RAB evolution (EUR M)



Note: A=actual; T= target. Source: Intesa Sanpaolo Research elaboration on Company data

The net debt/EBITDA ratio is forecast to be 2.9x in 2022 (net debt at around EUR 3.7Bn) vs 2.8x at year-end 2018. After the positive results achieved in 2018, Acea expects an overall neutral impact from working capital over the plan period while not taking into consideration an expected c.EUR 30M absorption per year related to regulatory items.

Acea 2019-2022 BP: net debt, net debt/EBITDA ratio



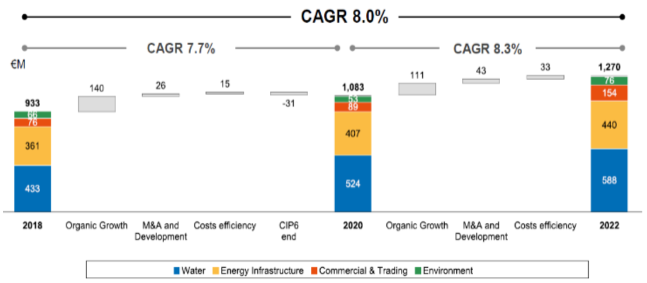
Source: Company data

Outlook

Focus on regulated activities provides visibility to targets

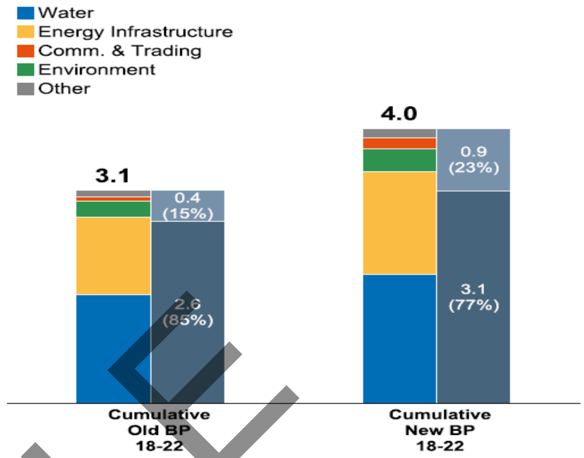
As shown in the charts below, Acea's current strategy confirmed the focus on regulated water services and energy networks. Around EUR 250M of EBITDA growth forecast over 2018-2022 (out of total of around EUR 368M) is expected to come from organic growth mainly related to regulated activities. This should provide a good level of visibility to Acea targets, in our view.

Acea 2019-2022 BP: EBITDA grow drivers



Source: Company data

Acea 2019-2022 BP: capex breakdown



Source: Company data

In our view, lower visibility regarding plan targets could be related to the contribution expected to come from electricity sales following the full liberalisation of energy markets in 2020. The deadline has been postponed previously: the end of the "protected market" was initially set for 2018, and we can't rule out a further delay in the process. At the same time, we believe that the strategic opportunities indicated by Acea, but not included in the BP figures, could help to offset potential headwinds in liberalised activities. In this respect, in July, Acea finalised an agreement regarding the acquisition of a 90% equity stake in Demap srl, which owns a plastics treatment plant with an authorised capacity of 75,000 tons per year. According to the press release, the enterprise value for 100% of the company amounted to around EUR 20M; under the agreement, the seller will have a put option on the remaining 10% stake, exercisable no later than 30 months after the closing upon the achievement of objectives associated with plant performance. Following the transaction, Demap will be fully consolidated by Acea, with an expected annual contribution to EBITDA of approximately EUR 3.5M, according to the press release. Also in July, Acea finalised transactions for the acquisition of photovoltaic plants with an overall installed capacity of around 25 MWp which is eligible for Conto Energia incentives. The transaction, which have an enterprise value of around EUR 75M, is expected to contribute approximately EUR 11M per year towards increasing the group's EBITDA.

Acea 2019-2022 BP: potential initiatives to be implemented

		EBITDA (€M)	Investments (€M)
Gas Distribution	Growth in the gas distribution market with selected acquisition and ATEM tenders	5-20	35-110
Smart Energy Efficiency	ESCO acquisitions and cogeneration / trigeneration pilots and thermal coat installations	5-10	50-70
M&A Waste	Plant development acceleration also evaluating strategic partnership according the market consolidation	40-60	200-350
Clients Acquisition	New clients acquisition consistent with current market consolidation trends	8-12	60-90
Growth in Renewables	Additional growth in the PV market through alternative models (e.g., partnership with investors without society control)	~10	~70
Water Sector Consolidation	Consolidation of water operators in Central Italy (e.g., Tuscany, Umbria)	30-90	60-150
		100-200 (€M)	

Source: Company data

2019 EBITDA guidance improved following 1H results

Based on the 1H19 results, Acea raised its EBITDA guidance for 2019, now seen to be up by above 7% vs year-end 2018 from the previous guidance of +5-6%. At the same time, Acea confirmed: i) capex up by above 10% vs 2018; and ii) net debt of EUR 2.85-2.95Bn, not including +EUR 57M related to IFRS 16 and M&A activity.

2020 consensus aligned to Acea's guidance

Looking at Bloomberg consensus, 2020 EBITDA are forecast to be overall in line with Acea's targets (-2%), reflecting positive effects from the full consolidation of Gori, a higher regulated rate of return for electricity distribution applied starting from 2019, and a negative impact due to CIP6 incentives expiration (-EUR 31M). Regarding the 2022 EBITDA target of EUR 1.3Bn, consensus is currently more conservative, reflecting, in our view, more prudent assumptions regarding the full liberalisation of the power market in Italy.

Net debt is forecast to increase over the plan period, reflecting the impact of higher investments and increased dividends on Acea's cash generation. However, leverage (net debt/EBITDA ratio) is forecast to remain below the 3.0x threshold – higher vs the 2.8x at year-end 2018, but, in our view, still solid when considering the high contribution from regulated activities.

Acea: consensus and guidance

EUR M	2018A	2019C	2019G	2020C	2020G	2021C	2022C	2022G
Revenues	3,028	3,132		3,202		3,257	3,330	
EBITDA	933	1,002	~ 1,000	1,062	1,083	1,123	1,180	1,270
EBIT	479	503		527		562	591	
EBITDA margin (%)	30.8	32.0		33.2		34.5	35.4	
EBIT margin (%)	15.8	16.1		16.5		17.3	17.7	
Net income	285	277		287		304	326	
Capex	617	738	700	772	900	780	820	900
Net debt	2,568	2,910	2,850-2,950	~3,200	3,250	3,292	3,460	~3,700
Net debt/EBITDA (x)	2.8	2.9		3.0	3.0	2.9	2.9	2.9

Note: A=actual; C=consensus; G= guidance. Source: Intesa Sanpaolo Research elaboration on Company and Bloomberg data

Financial Analysis

1H19 results driven by water

In 1H19, Acea's EBITDA rose by 12% yoy, to EUR 503M (Bloomberg: EUR 495M), mainly driven by the performance of the water division, due to a larger perimeter (mainly Gori) and higher tariffs. In contrast, commercial & trading division EBITDA fell by EUR 13M, to EUR 31M, weighed on by a lower tariff in the "protected market". EBIT for 1H19 was EUR 260M (+4% yoy), mainly due to higher depreciation (+24% yoy). Group net profit was flat yoy at EUR 143M, but up by 7% yoy when considering a EUR 9M positive one-off registered in 1Q18.

Acea: 2Q/1H19 results

EUR M	2018	LTM19	% Chg	1H18	1H19	% Chg	2Q18	2Q19	% Chg
Revenues	3,028	3,127	3.3	1,454	1,553	6.8	709	730	3.0
Consolidated operating costs	-2,139	-2,186	2.2	-1,023	-1,070	4.6	498	-487	-197.7
EBITDA	**933**	**986**	**5.6**	**450**	**503**	**11.7**	**221**	**255**	**15.4**
D&A	-455	-498	9.5	-199	-242	21.7	-93	-127	36.3
EBIT	**479**	**488**	**2.0**	**251**	**260**	**3.8**	**123**	**127**	**3.3**
Financial income	18	18	2.8	7	7	7.6	2	3	31.6
Financial costs	-101	-102	0.9	-49	-50	1.8	-25	-26	4.8
Net financial charges	-83	-83	0.4	-42	-43	0.9	-22	-23	1.8
Result from equity investments	13	7	-43.8	9	4	-62.1	1	1	-30.5
EBT	**409**	**412**	**0.8**	**218**	**221**	**1.5**	**102**	**105**	**3.3**
Income taxes	-124	-123	-0.6	-67	-66	-1.1	-32	-32	0.9
Net profit	285	289	1.4	151	155	2.7	70	73	4.4
Minorities	-14	-18	29.2	-8	-12	50.0	-5	-6	19.7
Group's Net profit	**271**	**271**	**0.0**	**143**	**143**	**0.0**	**65**	**67**	**3.3**

Note: NM=not meaningful. Source: Intesa Sanpaolo Research elaboration on Company data

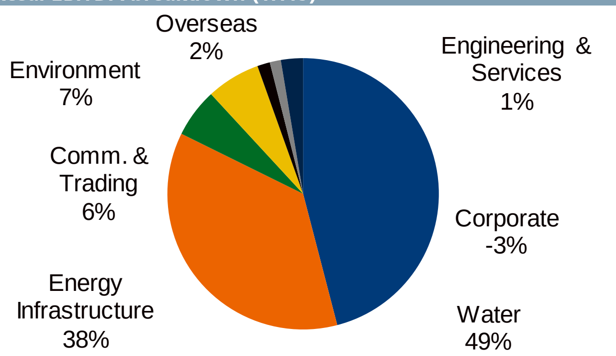
EBITDA analysis by division. The 1H19 EBITDA breakdown showed the following: i) water division (c.49% of consolidated EBITDA) up by 27.0% yoy, to EUR 244M, driven by the consolidation of Gori starting from November 2018 (+EUR 32M) and by higher EBITDA for ATO2 (+EUR 15M). Divisional capex rose by 8% yoy (c.49% of total); ii) energy infrastructure (generation, electricity distribution and public lighting) up by 8% yoy, to EUR 193M, with strong electricity distribution (+8% yoy) driven by tariffs. Capex were up by 26% yoy, at EUR 133M (39% of total); iii) commercial & trading division (energy management and sales) EBITDA was down by 29% yoy (-EUR 13M). The divisional performance was mainly affected by lower margins for the "protected market", due to regulatory changes; and iv) environment division (waste treatment, recovery, recycling and disposal [WTE]) up 5% yoy (+EUR 1.7M), driven by higher volumes and the extension of incentives (CIP6).

Acea: EBITDA (1H19)

EUR M	1H18	1H19	Chg	% Chg
Water	192	244	52	26.9
Energy infrastructure	179	193	14	8.2
Commercial & trading	44	31	-13	-28.9
Environment	32	34	2	5.3
Overseas	7	8	1	8.2
Engineering & services	8	7	-1	-13.3
Corporate	-12	-14	-2	17.9
Total EBITDA	**450**	**503**	**53**	**11.7**

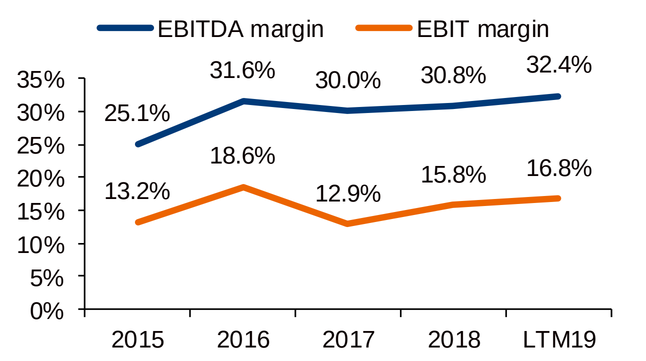
Source: Intesa Sanpaolo Research elaboration on Company data

Acea: EBITDA breakdown (1H19)



Source: Intesa Sanpaolo Research elaboration on Company data

Acea: profitability trend



Source: Intesa Sanpaolo Research elaboration on Company data

Acea: P&L ratios

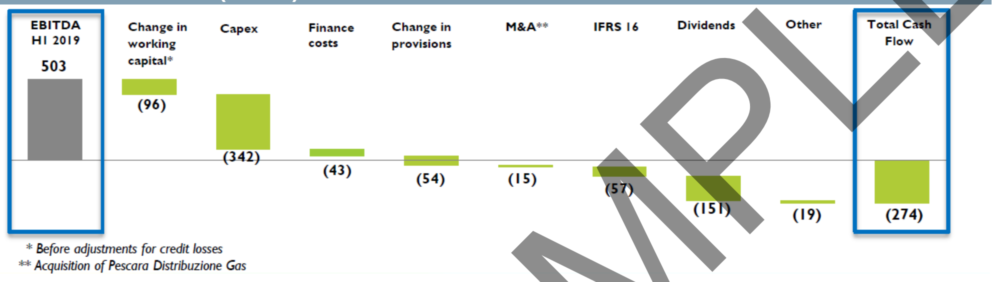
	2014	2015	2016	2017	2018
EBITDA margin (%)	23.6	25.1	31.6	30.0	30.8
EBIT margin (%)	12.8	13.2	18.6	12.9	15.8
Revenues growth (%)	-7.6	-4.0	-2.9	-1.3	8.3
ROE (%)	11.2	11.4	15.5	10.6	15.0
EBITDA /NFC (x)	7.1	8.0	8.0	11.7	11.3
EBIT/NFC (x)	3.9	4.2	4.7	5.0	5.8

Source: Intesa Sanpaolo Research elaboration on Company and Bloomberg data

Higher net debt reflected more investments

At the end of June, Acea's net debt amounted to EUR 2,843M vs EUR 2,568M at year-end 2018. The increase mainly reflected higher capex (+21% yoy), of which around 90% was devoted to regulated activities. The financial position also reflected the impact of M&A activity and effects of IFRS 16 (EUR 15M and EUR 57M, respectively).

Acea: cash flow 1H19 (EUR M)

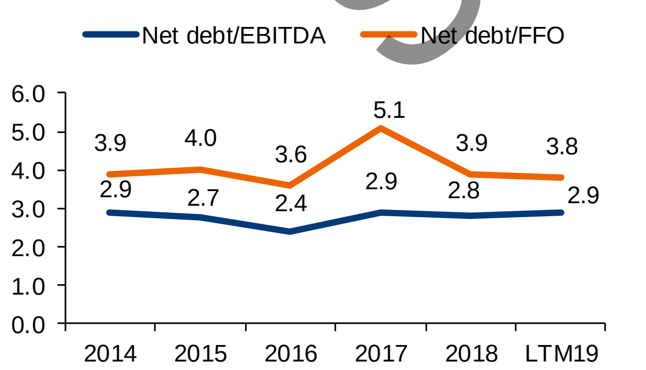


Source: Company data

Working capital impacted by seasonal effects in 1H19

In 1H19, the impact of working capital was negative for EUR 96M, of which around 50% was due to seasonal effects, according to Acea. For full-year 2019, management expects a working capital impact of around -EUR 47-50M, which is considered to be structural in nature.

Leverage trend (x)*



*Calculated on reported data. Source: Intesa Sanpaolo Research elaboration on Company data

Consolidated financial ratios*

	2015	2016	2017	2018
Gross debt (EUR M)	2,895	2,929	3,257	3,755
Net debt (EUR M)	2,010	2,127	2,422	2,568
Net debt/EBITDA (x)	2.7	2.4	2.9	2.8
Net debt/FFO (x)	4.0	3.6	5.1	3.9
Net debt/CFO (x)	3.2	4.0	9.6	4.0
FFO/NFC	5.5	5.3	6.7	8.0
Net debt/Equity (x)	1.3	1.2	1.3	1.3
Dividend payout (%)	60.9	50.2	74.1	55.7

*Calculated on reported data. Source: Intesa Sanpaolo Research elaboration on Company and Bloomberg data

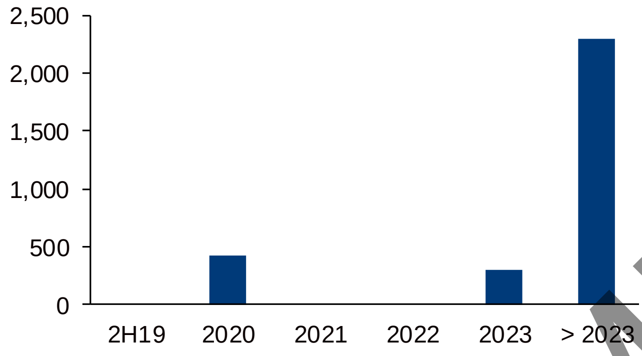
The net debt/EBITDA ratio (LTM) was 2.9x vs 2.8x at year-end 2018 (2.8x at 1Q19) while the net debt/FFO ratio (LTM) stood at 3.8x vs 3.9x at year-end 2018 (3.9x at 1Q19).

At the end of June, Acea's liquidity profile showed around EUR 980M of cash and cash equivalents, and EUR 654M in unused uncommitted credit lines at the parent company level. Acea's total debt had a maturity of approximately six years (5.8), with 80% at fixed rates, and with an average cost of around 2.18% (2.2% at year-end 2018).

Low refinancing risk over 2019-2021

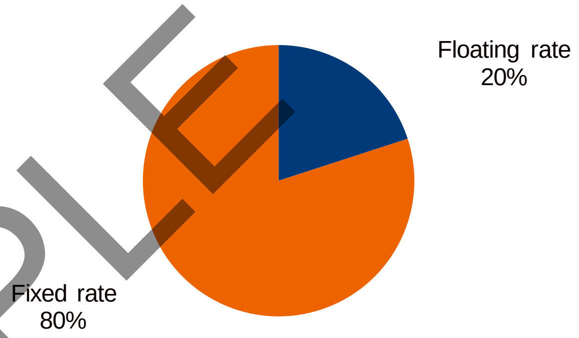
Of the EUR 4.0Bn in gross debt, around 80% was composed of bonds. The first relevant maturity is in March 2020 for a EUR 423M bond. In our view, thanks to its total cash availability and internal cash flow generation, Acea should have low refinancing risk over 2019-2021. In this respect, we also factor in what we see as a solid relationship with capital markets: in May 2019, Acea completed the placement of a non-convertible bond for a total amount of EUR 500M, maturing in 2028 and at a rate of 1.75%. According to Acea, the issuance was 3.75x oversubscribed. On 15 July 2019, Acea completed the update of its Euro Medium Term Note Programme (EMTN), increasing the ceiling of the programme to EUR 4Bn.

Acea: bonds maturity (EUR M, 30.06.19)



Source: Company and Bloomberg data

Acea: gross debt structure (30.06.19)



Source: Company data

Acea: net financial position

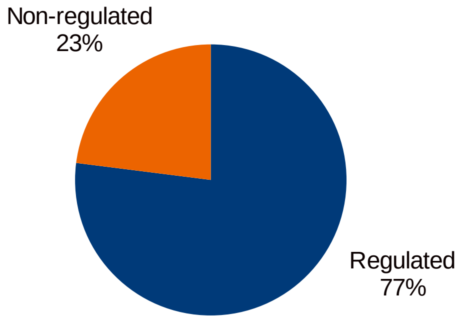
EUR M	31.12.15	31.12.16	31.12.17	31.12.18	% Chg	30.06.19	% Chg
M/l term debt	2,688	2,771	2,745	3,374	22.9	3,462	2.6
Short-term debt	162	157	512	352	-31.2	528	50.0
Total gross financial debt	3,203	2,928	3,257	3,726	14.4	3,990	7.1
Cash and cash equivalents	-1,018	-666	-681	-1,068	56.9	-981	-8.2
Total net financial debt	2,089	2,127	2,422	2,568	6.0	2,843	10.7

Source: Intesa Sanpaolo Research elaboration on Company data

Appendix 1: Regulatory Frameworks

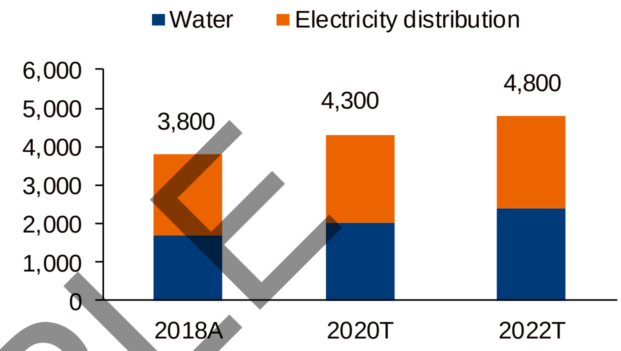
Regulated activities (waters services and electricity distribution) contribute for around 80% of Acea's EBITDA. Furthermore, in 2019, Acea entered the gas distribution sector with the acquisition of 51% of the share capital of Pescara Distribuzione (around 62,000 redelivery points) which is expected to contribute for around EUR 1.8M per year to Acea's EBITDA (EUR 933M in full-year 2018). Water services, gas and electricity distribution are activities that are fully regulated by ARERA (Autorità di Regolazione per Eneriga Reti e Ambiente), an independent authority that has overseen the gas, electricity and water sectors – and from 2018, the waste sector as well. Acea's 2019-2022 Strategic Plan envisages around 77% of total capex to be spent on regulated business, with the RAB expected to reach EUR 4.8Bn in 2022 from EUR 3.8Bn in 2018 (+26%).

Acea: EBITDA breakdown (2018)



Source: Company data

Acea 2019-2022 BP: RAB evolution (EUR M)



Note: A=actual; T= target. Source: Intesa Sanpaolo Research elaboration on Company data

Water services – second regulatory period, MTI-2 (2016-2019)

In December 2015, the Italian authority (formerly the AEEGSI) issued the final document for the calculation of the integrated water services tariffs for the second regulatory period (MTI-2). While extending the regulatory period to four years (2016-2019), the regulator confirmed the principles applied in previous framework, envisaging the full recovery of operating and capital costs. The allowed rate of return was fixed at 5.4%. An additional component of revenue was introduced by the regulator: a positive revenue item relating to the quality of service. The regulator confirmed the application of a tariff multiplier and introduced a six-scheme tariff matrix (four-scheme in 2014-2015) to calculate the cap for the annual tariff increase (with 6-9% the allowed range). For 2018-2019, the allowed rate of return was fixed at 5.3%. By the end of 2019, ARERA should release its determination for the next regulatory period, which should be overall consistent with the current one, in our view.
Water services contributed around 46% of Acea's 2018 EBITDA.

Water: main regulatory points

REGULATORY PERIOD: FOUR YEARS 2016-2019

- The **duration of the regulatory period** has been set at **four years**, with **biennial revision**
  - **2016-2017 WACC 5.4%**
  - **2018-2019 WACC 5.3%**

Main key points:

- Allowed revenues are based on **full cost recovery** subject to efficiency and capped in terms of tariff growth.
- **A cap on annual tariff increases (tariff multiplier)** ranging from 5.5% to 9%, depending on the regulatory framework approved by local authorities.
- Introduction of a **system of rewards and penalties linked to the contractually required quality standards**. The reward component is excluded from any tariff caps.
- Introduction of rewards/penalties linked to the **technical quality** of the integrated water service. Rewards and penalties will be quantified in 2020 based on performances in 2018 (base year 2016) and 2019 (base year 2018). The reward component is excluded from any tariff caps. Provisions must be made in 2020 for any penalties imposed.
- The mechanism for recognising a portion of **late payment costs** has been defined, taking into account the varying impact of this problem throughout the country (the maximum recognised cost, calculated on the basis of annual turnover, has been set at **2.1% in the North, 3.8% in Central Italy and 7.1% in the South** and providing incentives for the adoption of efficient credit management solutions.
- The **"ψ"** parameter, on which determination of the component intended to pre-finance the cost of new investment (FNI), may be selected within a range of **0.4-0.8**.
- The **1% time-lag for the cost of debt** has been confirmed, offsetting the cost resulting from the time lag between the year in which capex takes place and the year in which the related tariff increase is granted.

Source: Company presentation (April 2019)

Fifth regulatory period for electricity activities (2016-2023)

ARERA identifies the criteria with which to determine the "allowed returns" and their revision during a regulatory period as well as the methodology to calculate tariffs. This methodology is designed to cover capital and operational costs directly related to business activities, and envisages the calculation of annual allowed revenues as the sum of: i) remuneration on net invested capital, which is determined by multiplying the RAB, determined according to re-evaluated historical cost methodology, by the allowed rate of return, ie, WACC (set at 5.9% for 2019-2021 for electricity distribution vs 5.6% in 2016-2018); ii) depreciation allowance, which is calculated on the basis of the economical/technical lives set by ARERA for the different asset types; and iii) allowed operating costs. In December 2015, ARERA released the final framework for the fifth regulatory period for electricity activities, with among the main point: i) a new definition of regulatory period, lasting eight years, divided into two sub-periods of four years; ii) a shortened regulatory lag, with the previous criteria based on the increase of the rate of return granted to new investments (+1%) replaced by the recognition in the capital base (RAB) also of the investments made in the year t-1; and iii) an extension of the useful life of assets. At the same time, ARERA confirmed the no exposure for electricity distribution to changes in distributed energy volumes.
Electricity distribution contributed around 35% to Acea's 2018 EBITDA.

Income Statement, Balance Sheet and Key Indicators

Consolidated Income Statement - Main items (EUR M)	2018	LTM19	Chg %	1H18	1H19	Chg %	2Q18	2Q19	Chg %
Sales	3,028	3,127	3.3	1,454	1,553	6.8	709	730	3.0
EBITDA	933	986	5.6	450	503	11.7	221	255	15.4
Adjusted EBITDA	NA	NA	NA	NA	NA	NA	NA	NA	NA
EBIT	479	488	2.0	251	260	3.8	123	127	3.3
Adjusted EBIT	NA	NA	NA	NA	NA	NA	NA	NA	NA
Net interest expense	-83	-83	0.4	-42	-43	0.9	-22	-23	1.8
Income (loss) on equity investments	13	7	-43.8	9	4	-62.1	1	1	-30.5
Profit before tax	409	412	0.8	218	221	1.5	102	105	3.3
Net profit (loss)	285	289	1.4	151	155	2.7	70	73	4.4
Net profit (loss) attributable to the Group	271	271	0.1	143	143	0.2	65	67	3.3

Note: NA = not available, NM = not meaningful. Source: Intesa Sanpaolo Research elaborations on Company data

Consolidated Cash Flow Statement - Main items (EUR M)	2018	LTM19	Chg %	1H18	1H19	Chg %	2Q18	2Q19	Chg %
FFO	660	747	13.1	370	456	23.4	178	240	34.7
Net change in working capital	-14	NA	NA	-149	NA	NA	-13	115	NM
CFO	646	662	2.5	221	237	7.4	165	136	-17.6
Capex	-617	-672	8.9	-287	-342	19.1	-153	-191	24.7
FCF	29	-10	-134.2	-66	-105	58.3	12	-55	NM
Dividends	-137	-137	-0.4	-74	-74	-0.7	-75	-74	-1.1
Discretionary FCF	-109	-147	35.0	-140	-179	27.1	-63	-129	105.3
RCF	2	47	NM	-359	-314	-12.6	-276	-250	-9.5
Change in equity	0	0	NM	0	0	NM	0	0	NM
Change in debt	386	-267	-169.2	879	227	-74.2	-16	320	NM
CFF	386	-267	-169.2	879	227	-74.2	-16	320	NM
RCF + CFF	387	-220	-156.7	520	-87	-116.8	-292	70	-124.1
Change in liquidity	387	-220	-156.7	520	-87	-116.8	-292	70	-124.1

Note: NA = not available, NM = not meaningful. Source: Intesa Sanpaolo Research elaborations on Company data

Consolidated Balance Sheet - Main items (EUR M)	30.09.18	31.12.18	Chg %	31.03.19	Chg %	30.06.19	Chg %
Intangible assets	2,176	2,422	11.3	2,470	2.0	2,556	3.5
Property, plant & equipment	2,319	2,365	2.0	2,445	3.4	2,448	0.2
Financial and equity investments	332	338	1.5	348	3.1	341	-2.0
Total non-current assets	5,374	5,736	6.7	5,913	3.1	5,966	0.9
Inventory	54	49	-8.9	53	7.8	53	1.2
Trade receivables	827	928	12.3	1,036	11.7	1,047	1.0
Cash and current financial assets	1,251	1,182	-5.5	1,037	-12.3	1,230	18.6
Total current assets	2,342	2,421	3.4	2,335	-3.6	2,529	8.3
Total assets	7,716	8,157	5.7	8,248	1.1	8,495	3.0
Long-term debt	3,395	3,374	-0.6	3,011	-10.8	3,462	15.0
Provisions for risks and charges	218	137	-37.4	169	23.4	194	15.2
Total non-current liabilities	4,016	3,963	-1.3	3,633	-8.3	4,107	13.1
Short-term debt	522	409	-21.7	733	79.3	662	-9.7
Trade payables	1,102	1,525	38.3	1,542	1.1	1,462	-5.2
Total current liabilities	1,944	2,291	17.9	2,636	15.1	2,492	-5.5
Minorities	93	174	87.3	184	6.0	186	1.2
Shareholders' equity	1,664	1,730	4.0	1,795	3.8	1,710	-4.8
Total equity	1,757	1,903	8.4	1,979	4.0	1,896	-4.2
Total liabilities and equity	7,716	8,157	5.7	8,248	1.1	8,495	3.0
Net debt	2,631	2,568	-2.4	2,676	4.2	2,843	6.2
Adjusted net debt	NA	NA	NA	NA	NA	NA	NA

Note: NA = not available, NM = not meaningful. Source: Intesa Sanpaolo Research elaborations on Company data

Key Consolidated Economic Data - Financial indicators						
Profitability and coverage ratio (%)	2018	LTM19	1H18	1H19	2Q18	2Q19
EBITDA margin	30.8	31.5	30.9	32.4	31.1	34.9
Adjusted EBITDA margin	-	-	-	-	-	-
EBIT margin	15.8	15.6	17.2	16.8	17.4	17.5
Adjusted EBIT margin	-	-	-	-	-	-
EBITDA/net interest expense (x)	11.3	11.8	10.6	11.8	9.9	11.2
EBIT/net interest expense (x)	5.8	5.9	5.9	6.1	5.5	5.6
Leverage ratio (x)			30.09.18	31.12.18	31.03.19	30.06.19
Net debt/EBITDA			2.9	2.8	2.8	2.9
Adjusted Net Debt/Adjusted EBITDA (x)			-	-	-	-
Net debt/FFO			4.7	3.9	3.9	3.8
Net debt/equity			1.5	1.3	1.4	1.5

Note: NA = not available, NM = not meaningful. Source: Intesa Sanpaolo Research elaborations on company data

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Corporate credit view key

Credit rating key

Credit view	Definition
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NEUTRAL	We expect substantially stable fundamentals over the next six months
NEGATIVE	We expect a deterioration in fundamentals or visibility on fundamentals over the next six months
SUSPENDED	The credit view and investment recommendation for this company have been suspended as there is not a sufficient fundamental basis for determining an investment view. The previous credit view, if any, is no longer in effect for this company
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Historical Credit Views Changes

ACEA - Historical Credit Views (-1Y)

Date	Credit View

Historical Investment Recommendation Changes

ACEA - Historical Investment Recommendation (-1Y)

Date	Investment Grade Senior Unsecured
01/08/2019	Hold
17/05/2019	Buy

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Intesa Sanpaolo Research Credit View distribution at August 2019

Number of Companies subject to credit views: 28**	Positive	Neutral	Negative
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Company specific disclosures

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In particular, the description of the measures taken to manage interest and conflicts of interest – related to Articles 5 and 6 of the Commission Delegated Regulation (EU) 2016/958 of 9 March 2016 supplementing Regulation (EU) No. 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the technical arrangements for objective presentation of investment recommendations or other information recommending or suggesting an investment strategy and for disclosure of particular interests or indications of conflicts of interest as subsequently amended and supplemented, the FINRA Rule 2241, as well as the FCA Conduct of Business Sourcebook rules COBS 12.4 - between the Intesa Sanpaolo Banking Group and issuers of financial instruments, and their group companies, and referred to in research products produced by analysts at Intesa Sanpaolo S.p.A. is available in the "Rules for Research " and in the extract of the "Corporate model on the management of inside information and conflicts of interest" published on the website of Intesa Sanpaolo S.p.A..

At the Intesa Sanpaolo website, webpage http://www.group.intesasanpaolo.com/scriptIsir0/si09/studi/eng_archivio_conflitti_mad.jsp you can find the archive of disclosure of interests or conflicts of interest of the Intesa Sanpaolo Banking Group in compliance with the applicable laws and regulations.

Furthermore, we disclose the following information on the Intesa Sanpaolo Banking Group's conflicts of interest:

1. One or more of the companies of the Intesa Sanpaolo Banking Group plan to solicit investment banking business or intends to seek compensation from ACEA SPA in the next three months
2. One or more of the companies of the Intesa Sanpaolo Banking Group have granted significant financing to ACEA S.P.A. and its parent and group companies
3. One or more of the companies of the Intesa Sanpaolo Banking Group have been lead manager or co-lead manager over the previous 12 months of any publicly disclosed offer of financial instruments of ACEA S.P.A.

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