UNIVERSITÀ POLITECNICA DELLE MARCHE
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Corso di laurea magistrale in International Economics and Commerce

# Investor Relations Dynamics:

# A Journey through the Elica Case

## Le dinamiche delle Relazioni con gli Investitori:

## Un viaggio attraverso il caso Elica

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# ABSTRACT

La comunicazione finanziaria, fin dagli albori della civiltà umana, ha sempre rivestito un ruolo considerevole. È possibile riscontrare tracce che risalgono ai più antichi codici legali documentati, come il Codice di Hammurabi, a testimonianza della sua importanza duratura. Questo testo storico rivela l'entità attribuita alla comunicazione di concetti come il salario minimo, i tassi di interesse e gli obblighi contrattuali.

L' evoluzione della comunicazione finanziaria ha seguito da vicino lo sviluppo del mondo finanziario stesso, ma è stato l'avvento delle relazioni con gli investitori a segnare un cambiamento profondo nel panorama aziendale. Le relazioni con gli investitori, intimamente legate alla separazione tra proprietà e gestione, hanno iniziato a svilupparsi quando le imprese hanno cercato fonti di finanziamento esterne oltre ai loro proprietari.

Oggi, mentre ci troviamo sulla soglia di uno scenario macroeconomico complesso e interconnesso, l'importanza delle relazioni con gli investitori è sempre più evidente. Queste ultime fungono da ponte tra l'azienda e i suoi investitori, agevolando la trasparenza, la fiducia e la crescita sostenibile. Attraverso la cura delle relazioni, la divulgazione di informazioni finanziarie accurate e tempestive e l'adesione ai principi di buona governance, le organizzazioni possono sbloccare nuove opportunità e navigare nelle complessità dell'attuale contesto aziendale. Mentre ci prepariamo a intraprendere questa esaustiva esplorazione delle relazioni con gli investitori, è fondamentale riconoscere il loro potere trasformativo.

Nelle pagine successive, attraverseremo il terreno delle metriche finanziarie, della governance aziendale, delle pratiche sostenibili e di un panorama in costante

cambiamento, approfondendo le sfumature di EBITDA, l'analisi del flusso di cassa, la sostenibilità aziendale e il potere di una governance aziendale efficace.

In definitiva, l'obiettivo di questa tesi è portare alla luce il ruolo fondamentale delle relazioni con gli investitori nell'ambiente aziendale contemporaneo, esplorando le loro manifestazioni attuali e analizzando il loro impatto sulle prestazioni aziendali.

Nel capitolo 1, approfondiremo il ruolo intrinseco assunto dall'Investor Relator (IR), una figura imprescindibile all'interno delle società quotate. In un rapporto dinamico con i principali stakeholder, l'IR facilita abilmente lo scambio di informazioni e narrazioni complesse, promuovendo un ecosistema di trasparenza e responsabilità.

Nel capitolo 2, ci concentreremo sulla straordinaria storia di Elica S.p.A., un'azienda all'avanguardia che ha ridefinito profondamente il settore delle soluzioni di ventilazione e degli elettrodomestici. In questa esposizione emerge la traiettoria storica di Elica, arricchita dalla diversità delle sue unità aziendali, dall'ascesa dei marchi proprietari e da un portafoglio che si estende oltre i confini nazionali. Elica S.p.A., il punto focale dello studio, incarna la natura dinamica delle operazioni aziendali contemporanee. Grazie a un portafoglio diversificato, Elica ha navigato con successo attraverso diverse sfide, tra cui l'imperativo dell'innovazione continua, la sostenibilità e la gestione di un vasto sistema di distribuzione. Il successo di Elica non risiede solo nella sua capacità di adattarsi alle dinamiche di mercato mutevoli, ma anche nel suo impegno nell'espansione geografica e nella costruzione di solide relazioni con gli stakeholder.

Nel terzo capitolo di questo studio, entreremo nel cuore della trattazione, attraverso l'introduzione del "Kit Tecnico per le Relazioni con gli Investitori." Quest’ ultimo offre un insieme di strumenti finanziari avanzati e analitici, tra cui EBITDA, EBIT, Free Cash Flow e Discounted Cash Flow (DCF). L'utilizzo mirato di questi strumenti consente di tradurre dati finanziari in narrazioni, offrendo agli investitori una prospettiva chiara sulle prestazioni finanziarie dell'azienda e sulle sue prospettive future. Nel cuore della gestione delle relazioni con gli investitori, questo kit è una risorsa inestimabile, e con la padronanza di queste leve finanziarie, l'Investor Relator può contribuire in modo significativo a stabilire un rapporto di fiducia con gli investitori e garantire un'efficace comunicazione finanziaria.

Nel quarto capitolo, esamineremo il concetto di governance aziendale, un pilastro cruciale per la stabilità e la fiducia nelle organizzazioni moderne. La governance aziendale riguarda l'insieme di regole, processi e comportamenti attraverso i quali un'azienda è diretta e controllata. La sua corretta applicazione è essenziale per la tutela degli interessi degli azionisti e per garantire che l'azienda sia gestita in modo etico e conforme alle normative. Il capitolo si conclude con l'invito a un costante monitoraggio e miglioramento delle pratiche di governance aziendale, riconoscendo che il futuro delle imprese dipende dalla loro capacità di apprendere e adattarsi alle tendenze emergenti, prediligendo approcci innovativi per favorire una cultura di buona governance.

Il capitolo 5 si concentrerà sul mondo della Sostenibilità Aziendale, una variabile che influisce notevolmente sui piani strategici e industriali. Verrà offerta una panoramica completa delle considerazioni ambientali, sociali e di governance (ESG), fornendo una roadmap per la loro integrazione strategica. Esplorando i concetti di sostenibilità, investimenti ESG, dichiarazione finanziaria e il reporting sulle emissioni di carbonio, questa sezione fornirà la conoscenza e la comprensione necessarie per comunicare efficacemente l'impegno verso la sostenibilità alla vasta platea di stakeholder.

Il viaggio attraverso le sfumature delle relazioni con gli investitori svela una trama di complessità e opportunità che le società devono affrontare nel contesto dell'odierno panorama aziendale. Questa tesi fornisce un'analisi completa e critica, offrendo una profonda comprensione e suscitando intuizioni stimolanti per ulteriori esplorazioni.

Tuttavia, il cambiamento di paradigma nel panorama degli investimenti, caratterizzato da una crescente enfasi sui fattori ambientali, sociali e di governance (ESG) e dall'ascesa degli investimenti sostenibili, presenta nuove sfide e richieste per gli Investor Relator. Questi ultimi devono adattare in modo proattivo le loro strategie, coinvolgere i diversi stakeholder e soddisfare le crescenti aspettative degli investitori, dei regolatori e della società nel suo complesso.

# TABLE OF CONTENTS

# INTRODUCTION

Over the course of human history, financial communication has played a pivotal role in society. From ancient civilizations to the modern global economy, the need to disseminate and exchange financial information has been paramount. In the annals of financial communication, one can find traces dating back to the earliest documented legal codes, such as the renowned Babylonian Code of Hammurabi[1], which dates back to approximately 1745 BCE. This historic text reveals the importance placed on conveying concepts like minimum wage, interest rates, contractual obligations, and inheritance rules—a testament to the enduring significance of financial communication.

While financial communication has evolved alongside the progress of finance itself, it was the emergence of investor relations that marked a profound shift in the business landscape. Investor relations, intricately entwined with the separation of ownership and management, developed as enterprises sought external sources of financing beyond the proprietors themselves. In the bygone era of individual craftsmen and blacksmiths, where self-financing was the norm, the need for communicating financial information or fostering relationships with external investors was nonexistent. The craftsmen acted as investors, managers, and employees—a seamless fusion of roles that rendered investor relations unnecessary.

[1] Alexander V. Laskin, *Investor Relations and Financial Communication: Creating Value Through Trust and Understanding*, Wiley-Blackwell; 1st edition (November 19, 2021)

However, as industries advanced and enterprises expanded, the arrival of family businesses signaled a pivotal moment in the trajectory of investor relations. Families, with their collective investment and managerial responsibilities, supplanted individual craftsmen, giving rise to a new paradigm. Yet, even in these family enterprises, the dynamics revolved around familial ties rather than formal investor relations. It was not until the demands of human enterprises outgrew the capacities of a single individual or family that a fundamental shift occurred—a shift that necessitated pooling resources from diverse individuals. And thus, the concept of a shareholding company was born, marking a pivotal juncture in the evolution of investor relations.

Today, as we stand at the precipice of a complex and interconnected global business environment, the significance of investor relations has never been more pronounced. The dynamic interplay between shareholders, management, and stakeholders demands effective communication, transparent reporting, and the cultivation of lasting relationships. It is within this realm of investor relations that companies navigate the intricacies of financial disclosures, shareholder engagement, and strategic decision-making.

As we embark on this journey into the realm of investor relations, we delve into the multifaceted dimensions of financial communication. Through meticulous analysis and thought-provoking insights, we unravel the intricacies of investor relations, unveiling the strategies, tools, and principles that underpin its success.

In the chapters that follow, we will traverse the terrain of financial metrics, corporate governance, sustainable practices, and the evolving landscape of investor relations. By delving into the nuances of EBITDA, cash flow analysis, corporate sustainability, and the transformative power of effective corporate governance, we aim to equip ourselves with a comprehensive understanding of this ever-evolving discipline.

Ultimately, the objective of this thesis is to shed light on the pivotal role of investor relations in today's business environment. By unraveling its historical underpinnings, exploring its contemporary manifestations, and analyzing its impact on corporate performance and stakeholder relations, we aspire to empower organizations and professionals with the knowledge and insights necessary to thrive in an era defined by transparency, accountability, and investor engagement.

The investor relations function plays a crucial role in today's dynamic and competitive business landscape. As companies strive to attract and retain investors, it becomes essential to effectively communicate their strategic vision, financial performance, and growth prospects.

In Chapter 1, a profound exploration ensues into the intricate role assumed by Investor Relations (IR) professionals, an indispensable nexus between corporate entities and discerning investors. Within this dynamic interplay, IR practitioners deftly facilitate the exchange of intricate information and narratives, fostering an ecosystem of transparency and accountability. Their adept orchestration of relationships with a diverse spectrum of investors, analysts, and financial institutions imbues the company with an aura of credibility, elevating its reputation, market capitalization, and access to strategic capital reservoirs.

The subsequent chapter, Chapter 2, unfolds a compelling narrative that centers on the commanding presence of Elica S.p.A., an avant-garde force that has fundamentally redefined the landscape of kitchen ventilation solutions and household appliances. Within this exposition, the historical trajectory of Elica emerges, adorned with the diversity of its business units, the ascendancy of proprietary brands, and a portfolio that transcends conventional boundaries. This tapestry is enriched by the global footprints, strategic distribution networks, engagements with international currencies, and an unwavering allegiance to innovation and sustainability.

With the dawn of Chapter 3, the discourse subtly shifts toward the Investor Relations Technical Kit—a comprehensive arsenal intended to effectively articulate a company's financial narrative. It unveils an array of quantitative instruments that include EBITDA, EBIT, Cash Flow, Free Cash Flow, the intricate nuances of Discounted Cash Flow (DCF) analysis, the symphony of Price-to-Earnings (PE) and Price/Earnings to Growth (PEG) ratios, as well as the matrices of operational prowess—Return on Investment (ROI), Return on Assets (ROA), and Return on Equity (ROE). This profound array empowers Investor Relations professionals with the capacity to succinctly convey intricate financial tapestries.

Chapter 4, an exploration into Corporate Governance, unveils a lattice of governance intricacies that decisively shape modern organizational paradigms. A contemplative dissection exposes the fundamental objectives of transparency, safeguarding of shareholder interests, enhancement of organizational performance, and the veneration of legal and ethical mandates. The chapter further navigates the nuanced landscape of board composition, the cardinal precepts underpinning stalwart governance frameworks, the multiverse of global models, and the solemn elucidation of governance's fallibilities.

Within Chapter 5, the narrative shifts yet again, casting a luminous spotlight on the realm of Corporate Sustainability—an imperative that has veritably infiltrated the strategic imperatives of modern corporations. This chapter bequeaths a panoramic overview of the tripartite realm of environmental, social, and governance (ESG) considerations. The pivotal role of Investor Relations in shepherding the ESG narrative is contemplated, alongside the emergent landscape of ESG investing. The tapestry unfurls to encompass the triumvirate of corporate sustainability pillars, their manifold dividends, a roadmap to their strategic integration, and the irreplaceable role of comprehensive sustainability reporting.

By exploring the concepts of corporate sustainability, ESG investing, the sustainability report, and carbon reporting, this chapter equips IR professionals with the knowledge and understanding necessary to effectively communicate a company's commitment to sustainability and its ESG performance to the investment community.

Join me on this intellectual voyage, where we explore the synergies between financial communication, corporate governance, sustainability, and the pursuit of long-term value creation. Together, we will navigate the ever-changing landscape of investor relations, unlocking the potential for prosperous partnerships, informed decision-making, and enduring success.

As we embark on this comprehensive exploration of investor relations, it is crucial to recognize the transformative power it holds. Investor relations serve as the bridge between companies and their investors, facilitating transparency, trust, and sustainable growth. By nurturing relationships, disclosing accurate and timely financial information, and embracing principles of good governance, organizations can unlock new opportunities and navigate the complexities of today's dynamic business environment.

# 1. INVESTOR RELATIONS

Many people place their future in the hands of the effectiveness of the investing system and rely on the stock markets. To ensure that all market participants, from professional investors managing billions of dollars to retail investors with a few hundred dollars invested, have equal access to the information they need to make informed investment decisions, corporations must disclose significant information about their operations and finances.

## 1.1. The investor relations (IR) role

An investor relations (IR) professional is responsible for managing communication between a publicly traded company and its investors, shareholders, and financial analysts. They provide timely and accurate information about the company's performance, financial and non-financial results, strategy, and other relevant topics to help investors make informed decisions. Dissemination of information about intangible values, such as the business's corporate governance or corporate social responsibility policies are indeed included. The IR role is important because it helps to build trust and confidence in the company among the investment community, which can ultimately affect the company's stock price and overall valuation. Effective IR can also help to attract new investors and improve access to capital markets. The objective of investor relations shifts from information disclosure to investor education and expectation management concerning the true or fair value of the corporations.

The following definition is provided by the NIRI:

*A strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair valuation*[1].

All investor relations efforts should focus on fair valuation. Investor relations experts should therefore be comfortable sharing both positive and unfavorable information with the public since both might affect the value of a company's stock[2]. IROs risk causing overvaluation if they simply pay attention to good events while minimizing the influence of unfavorable ones. Overcorrection is a risk associated with overvaluation because, if and when all the information is revealed, market participants can overreact to the bad news. Also, these episodes tend to damage the firm's reputation, that of its management, and that of its investor relations division, jeopardizing any upcoming disclosures and endangering the ties between the company and its financial stakeholders.

The efficient market theory[3], which describes an efficient market as "a market in which prices always 'completely reflect' available information," is the foundation for the idea of fair market value. However, for the efficient market hypothesis to hold, the conditions must be satisfied. These conditions include that all pertinent information about the company and its performance is publicly available, that everyone who participates in the market has timely and equal access to this information, and that all investors are intelligent and capable of analyzing the

[1] https://www.niri.org/

[2] Fisher, Philip A. Common stocks and uncommon profits and other writings. Vol. 40. John Wiley & Sons, 2003, Pages 75-78

[3] Robert J. Shiller, *From Efficient Markets Theory to Behavioral Finance*, Journal of Economic Perspectives—Volume 17, Number 1—Winter 2003—Pages 83–104

information at their disposal. Investor relations are thus at the core of effective markets and become a crucial activity for the modern economy as a whole, not just for a specific company.

Investor relations officers (IROs) must advise shareholders, business journalists, and investors on the true implications of the information disclosed for the company's future. Modern firms are complicated organizations that profit from cutting-edge technological advancements, intangible reputational assets, and one-of-a-kind processes that they establish over many years. Even if these data have been communicated to those outside the organization, stakeholders might not fully grasp them. For them to understand, explanation and direction are necessary. Without some assistance from Investor Relators doing their job of educating the investment community, no one can determine the fair value of a firm.

Two-way communication is mentioned in the NIRI definition of investor relations. When an organization posts a press release online, it engages in one-way communication with the outside world. While it has its advantages, it is not always the best communication method. For instance, despite releasing a ton of information about new business innovations, the corporation cannot tell if shareholders fully comprehend how these new business concepts will affect the business model without shareholder feedback. The communication process enters a return loop as a result of this feedback, resulting in two-way communication. To put it another way, with two-way communications, both sides have an opportunity to speak and be heard, and information is transmitted both ways—from the company to the stakeholders and vice versa. The IROs now have additional responsibilities, including listening as well as disclosing information.

If the purpose of investor relations is to inform investors and other members of the financial community about the value of the company, then two-way communication is a crucial component of that process. The management of the company should know what the public thinks of its performance and should be able to provide feedback to the public. It is the duty of IROs to gather this data and deliver it to the business management. The creation of two-way channels of communication is therefore a priority for investor relations departments to enable interaction between businesses and the financial sector.

The definition of investor relations mentions several abilities that IROs must have to succeed in their positions. Indeed, IR professionals work closely with other corporate departments, such as legal, finance, and marketing, to ensure that all communication to investors is consistent and compliant with regulations. Although IR is a different division from media relations (IR focuses on the investment community rather than the general public), the two divisions may collaborate on news releases.

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*For example, when Peloton announced in February 2022 that co-founder John Foley would step down as CEO, a position he has held since the company was formed, the company's IR team was the first point of contact listed in the company's press release, and the release was posted in the IR section of the Peloton website*[4].

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They must also monitor and analyze the financial performance of the company and its industry peers to help management make informed decisions about strategic initiatives. It's fundamental for investor relations professionals to understand

[4] https://www.thebalancemoney.com/what-is-investor-relations- 5270282

accounting and financial concepts. One of the most important responsibilities of the IR function is to help the company manage its reputation and credibility with the investment community. By providing accurate and timely information, IR professionals can help to dispel rumors, counteract negative sentiment, and correct misconceptions about the company’s business and financial performance. Since two-way communication is a fundamental component of the job, as was already established, IR should be a skilled communicator.

Another key aspect of IR is the ability to build and maintain relationships with institutional investors, such as mutual funds, pension funds, and hedge funds. These investors are major stakeholders in the company and have significant influence over the company’s stock price and valuation. IR professionals must work to understand the needs and interests of these investors and provide them with the information they need to make informed decisions about investing in the company. Investor relations professionals may also organize meetings and presentations for investors, as well as participate in conferences and other events to promote the company to potential investors.

To be successful in the role of an investor relations professional, one must have strong communication skills, as well as a deep understanding of financial markets and the regulatory environment. In addition to traditional financial metrics, such as earnings per share and revenue growth, investor relations professionals are also expected to have knowledge of emerging trends and technologies that may affect the company’s future prospects.

The corporation should receive advice from IR departments on how to adhere to securities commission and stock exchange rules and on what can and cannot be done from a PR standpoint as well as information about changing regulatory restrictions. Additionally, there are numerous regulations governing what information must be conveyed, when it must be communicated, and through what channels. As a result, all these exchanges take place in a highly controlled environment. Both selective disclosure and dealing of privileged information are prohibited by law. All these requirements turn IROs into agents for the enforcement of securities market laws and regulations and call for IROs to be informed about these laws and regulations.

Marketing is also part of investor relations. Professionals in investor relations are required to interact with and develop relationships with the financial community, identify investors who would be a good target for the company's stock, boost the company's coverage by financial analysts, and even promote stock to retail shareholders.

Finally, the importance of the IR function has grown in recent years as the global economy has become more interconnected and competitive. With the rise of social media and other digital channels, companies must be more transparent and responsive than ever before. IR professionals play a critical role in helping companies adapt to this new environment and manage their reputation and credibility in the digital age. Because new regulations have strengthened corporate governance openness and huge, activist investors have sought the same, IR departments have become more significant over the past 20 years.

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*Corporate scandals that occurred over the past two decades, including the collapse of Enron, Corp. in the early 2000s, led lawmakers to institute more stringent oversight and financial reporting requirements via the Public Company*

*Accounting Reform and Investor Protection Act of 2002. The legislation strengthened the independence and financial literacy of corporate boards while also holding the CEO and CFO responsible for the accuracy of the information conveyed and communicated to investors via the IR team*[5].

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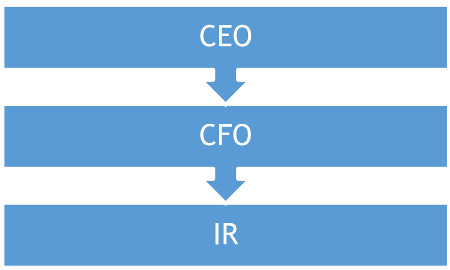
The entire model was put to the test by the spectacular business failures of the early twenty-first century, such as the dot-com bust and accounting scandals at the biggest corporations. The failure of Enron served as a wake-up call for the field of investor relations, which now faces greater obligations than ever. Unprecedented stock market expansion abruptly gave way to a recession. The struggle for capital became more competitive. CEOs realized that investor relations are not one of the supplementary roles but a function that can give a company a competitive advantage, making it one of the critical activities.

Today, many larger publicly traded companies have dedicated investor relations (IR) officers who are in charge of the majority of shareholder meetings, press conferences, private investor meetings, investor relations sections of company websites, and company annual reports. In smaller companies, the IR function is frequently outsourced to independent investor relations firms. For **Elica S.p.A.**, the investor relator is directly responsible to the CFO (Chief Financial Officer).




[5] https://www.thebalancemoney.com/what-is-investor-relations- 5270282

# 2. ELICA S.p.A.

Elica, a prominent manufacturer of hoods, aspiration hobs, and other high-end cooking appliances, was established in Fabriano, Italy, in 1970. The company has since expanded its operations and gained a dominant position in the production and distribution of motors and components for home appliances, ventilation systems, and heating systems. Elica strategically targets specific markets and geographic areas through a combination of its proprietary brands in the cooking segment and partnerships with leading kitchen and home appliance manufacturers such as Whirlpool, Bosch, and Ikea. The company also operates in the Motors business under the EMC Fime brand, with a primary focus on ventilation and a growing emphasis on developing innovative components for energy-efficient devices, including heat pumps, hydrogen, and biomass appliances.


*Figure 1 Elica (ELC) trend compared with the FTSE Italia STAR Index*

## 2.1. Overview

Elica has a highly effective distribution network that caters to small furniture and appliance stores, kitchen studios, and contractors across more than 100 countries. This network is supported by kitchen manufacturers, certified retail chains, and distributors. In line with its "local-for-local" philosophy, Elica operates seven production facilities worldwide, including four in Italy (which primarily focus on high-end products), one in Poland to meet the remaining demand for European production, one in Mexico, and one in China to serve Asia and Russia. The company's core strategy is centered around securing favorable prices for raw materials and semi-finished/finished products in advance, and proactively passing on price increases to customers in a timely manner through renegotiation of price lists with OEMs, kitchen manufacturers, and distributors. Elica's business model is heavily dependent on effective supply chain management, which plays a critical role in ensuring the company's success in the highly competitive kitchen and home appliance industry. Elica's focus on research and development is evident in its use of cutting-edge technologies developed in its laboratory to meet the evolving needs of consumers. The company specializes in cooker hoods and aspiration hobs, which represent a small percentage of the vast and diverse home appliance market.

As a global leader in the cooker hoods market and the top player in Europe, Elica has significantly increased its market share, rising from 5.9% in 2014 to 12% in 2022, thanks to the growing popularity of its proprietary brands. The company also holds a strong position in the European aspiration hobs niche, where its market share has grown to 14% in 2022 (up from 0.2% in 2016 when it first entered the market), thanks to its dominance in key markets such as Italy and France.

Furthermore, Elica holds the largest market share in the production of specific parts for domestic heating, hoods and aspiration hobs, and home appliances. The recent acquisition of EMC has enabled the Motors BU to expand its product line and strengthen its position in the European market. Elica's long-term strategy includes the development of hydrogen appliances for domestic heating, which could boost the reference market within the BU. Other energy efficiency trends within the BU include the expansion of heat pumps, the replacement of older gas appliances with newer, more efficient models, and the increasing deployment of heat pumps. To further expand its presence in the European and North American markets, the company's strategy combines organic expansion in the Cooking and Motors BUs, as well as M&A activities primarily in the Cooking BU.

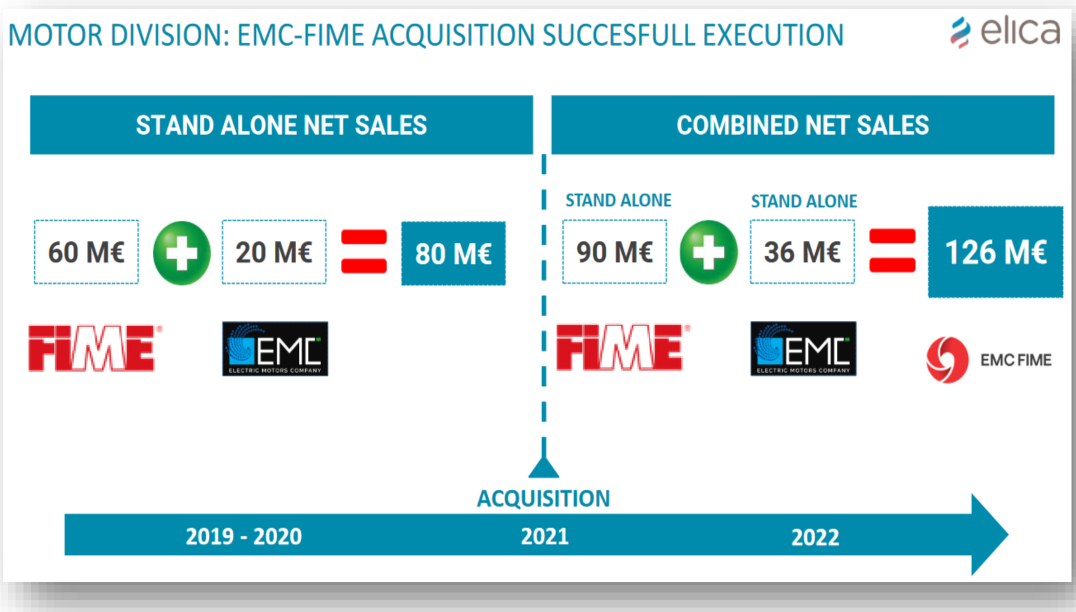



*Figure 2 EMC - FIME Acquisition*

## SWOT ANALYSIS

### Strengths

- An extensive product selection and strong placement in the aspiration hobs and cooker hoods sectors
- R&D expenditures and an innovation-based strategy helped the business earn more than 600 patents (more than 100 on NikolaTesla)
- Integrated presence within the Motors BU and complete supply chain control
- Worldwide coverage is made possible through a global footprint and capillary distribution network.
- A wide and diverse array of own brands to serve every market segment.
- A financial structure that is generally asset-light and supports competitive ROCE[1].

### Weaknesses

- exposure to the established kitchen appliance industry, which is subject to economic cycle volatility.
- partial susceptibility to raw materials shortages and price changes
- Rising cost pass-through must be discussed with OEMs, who may have greater negotiating power due to their larger size.
- Market penetration in North America is relatively low.

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[1]Amir, Eli, and Itay Kama. "The Market Reaction to ROCE and ROCE Components." *Available at SSRN 623161* (2005).

## Opportunities

- Even in North America, there is an increasing use of own brands to boost profitability.
- Expanding the product line beyond cooker hoods to include other kitchen appliances.
- European energy efficiency trends assist Motors' expansion in the home heating market.
- Further expansion of the business's market share in the quickly expanding aspiration hobs sector
- Improvements in profitability supported by the completion of the reorganization of the industrial footprint.
- There is room for value-adding M&A strategy.

## Threats

- Risks associated with internalizing the manufacturing of hoods and hobs by large OEMs.
- Delivery of efficiency gains from the restructuring of the European presence has been slower than anticipated.
- Rising competition risks, particularly in the most exclusive market areas
- FX's negative progression
- Raw material, energy, and freight cost normalization is taking longer than anticipated.
- Polish macroeconomic conditions, where the business has production facilities for both the Cooking and Motors BUs, are deteriorating.

### 2.1.2. Business Units

Below is a brief explanation of each Business Unit:

Elica creates, produces, and markets household kitchen hoods, aspiration hobs, and other cooking appliances under the Cooking Business Unit. The weight of aspiring hobs in the Cooking BU increased from 3% in 2017 to 16% in 2022. The company is one of the top players in the cooking industry and operates in two distinct ways:

**Own Brands**: (which accounted for 58% of BU revenues in FY22), including the flagship brand Elica and other brands for local markets like Turboair, Ariafina, Arietta, Airforce, Jetair, and Puti.

**OEM**: (who accounted for 42% of BU revenues in FY22). The top kitchen and home appliance producers in the world, including Whirlpool, Haier, Ikea, Bosch, and Samsung, are among the OEMs in the customer portfolio.

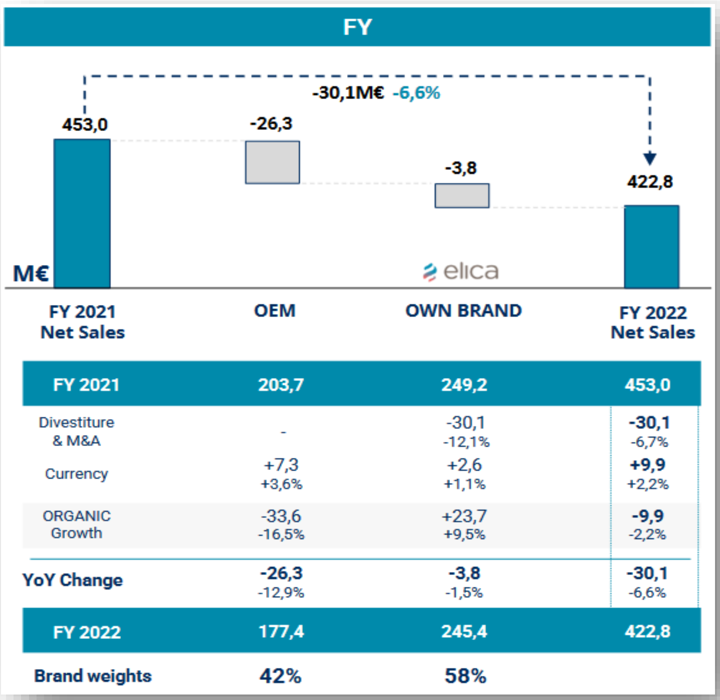


*Figure 3 Cooking Sales by Brand*

Elica is a manufacturer and distributor of electric motors for domestic heating (40% of the Motors BU's FY22 revenues), household and ventilation appliances (60% of the BU's FY22 revenues), and other applications. With the brands EMC and Fime, the company serves the Cooking BU as well as major international clients like Vaillant, Bosch, Viessmann, BDR Thermea, Riello, Ariston Group, Immergas, BSH, Miele, Whirlpool, and Electrolux. The company is also positioned among the market leaders in Europe for the Motors sector. By purchasing CPS and Electric Motors Company (EMC), Elica recently extended this line of operations. The company is now concentrating on the creation of revolutionary heat pumps, biomass, and hydrogen heating appliance products. The business unit (BU) makes use of internal R&D to create cutting-edge technology and vertical manufacturing methods used across Europe to provide effective supply chain management.

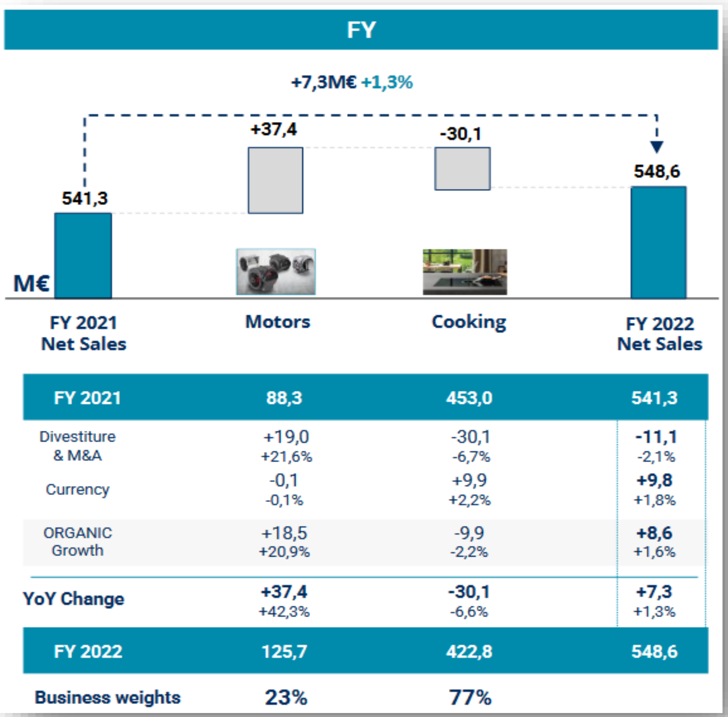


*Figure 4 Cooking Sales by Business*

Elica operates through both its own brands and as a supplier to OEMs, as was already indicated. Each brand has a certain market group in mind when marketing its products or determining its geographic reach.

### 2.1.3. Own Brands

An extensive description of the company's top brands is provided below:

**Elica**: was established in 1970. The Elica brand has a wide range of products (such as high-standing hoods, aspiration hobs, air quality balancers, and fragrances), and it is distinguished by an ever-evolving selection of goods that are regularly added to the portfolio of already existing goods. Elica also offers LHOV, a three-in-one appliance that combines an oven, a hood, and a hob. Price ranges for hoods offered under the Elica brands generally fall between €250 and €3,500, while those for aspiration hobs fall between €2,000 and € 4,000.

**Turboair**: provides a wide selection of mid-range items that stand out in the reference market for the caliber of materials used. Products produced under the Turboair name typically cost between €100 and € 500.

**Airforce**: targets the Central and Northern European market with mid- to high-end products that are distinguished by dependability, design, and innovation. These items are highly customizable and made in Italy. Elica markets hoods, aspirational hobs, induction hobs, and equipment for outdoor cooking under this brand.

**Ariafina**: creates hoods for the top end of the Japanese market in a joint venture agreement with Fuji Industrial, and it enjoys a strong competitive position in this market. The associated products combine traditional Italian design with Japanese technology.

**Arietta**: serves the North American market. The linked product line consists of fiercely competitive goods that stand out for their dependability, usefulness, beauty, and quality. Arietta's goods are sold by Home Depot.

**Jetair**: the brand is used to target the Russian market.

**Puti**: operates in the Chinese market and makes sterilizers for kitchen utensils as well as hobs.

**EMC Fime**: dedicated to the development, manufacture, and marketing of electrical motors for home appliances, heating, and ventilation. Products are frequently created with client input. The company's ventilation systems are capable of meeting the key industry standards for sustainability and energy efficiency. The business also sells fans from the PREMIX range that have been internationally approved for using hydrogen.


*Figure 5 Elica Own Brands*

### 2.1.4. Products

Elica offers a wide variety of goods to meet all customers' needs. These products are essentially divided into two subcategories: cooking (which includes hoods and aspiration hobs) and motors. The primary types of cooking-related products are described below:

**Wall-mounted hoods**: the most popular kind of hoods are wall-mounted models, which are generally mounted in kitchens. Wall-mounted hoods from Elica are available with the Dim Light feature (which controls light intensity) and the Tune White function (which controls light color).

*Figure 6 Open Suite*

**Built-in hoods**: A cutting-edge design of hood that is often mounted inside a wall cabinet. Because of the distribution of the aspiration surface around the perimeter, Elica's built-in hoods offer quick and easy installation, low maintenance requirements, and extremely effective aspiration. Dim Light and Tune White options are available for Elica's built-in hoods as well.

*Figure 7 Box in No Dry*

**Island hoods**: since they are not installed against a wall, these hoods are open to the air on all sides. Kitchen islands need more filters and cubic feet per minute (CFM) to operate at their peak efficiency because of this and the increased air motions they undergo. Due to their availability in a variety of forms and sizes, they provide design options intended to decorate any kitchen.

*Figure 8 Interstellar*

**Corner hoods**: they are made especially for hobs that are located in the corner of a room. Due to the way the body and flue are shaped, this sort of hood is available in many different styles. Elica's hoods make use of Control Ball technology to ensure simple and intuitive lighting and hood speed adjustment.

*Figure 9 Synthesis*

**Ceiling hoods**: These appliances are made to be mounted in ceilings, maintaining the feeling of spaciousness in any kitchen design. Elica's ceiling hoods offer Dim Light and Tune White options, offer the fastest aspiration speed while maintaining a pleasant noise level.

*Figure 10 Lullaby*

**Downdraft hoods**: These appliances are typically installed in a peninsular or island-shaped unit behind the range, and when turned on, they raise electronically from the counter. They provide the best way to satisfy certain space needs while ensuring high performance, style, and elegance.

*Figure 11 Pandora*

**Aspiration hobs**: Elica, with the NikolaTesla product family, sells a cutting-edge appliance that combines a hob and a hood into a single unit with the aspirating core housed inside the hob itself. These items, which have been available since 2016, may be integrated into any kitchen design while providing a superior cooking experience, simple cleaning, minimal noise, and substantial power. Both gas stoves and induction hobs are compatible with this line of devices. They brought in €70 million in income in FY22, making up 16% of the Cooking BU.

*Figure 12 Nikola Tesla Unplugged*

**LHOV**: Elica has announced the creation of a brand-new, cutting-edge product that will go by the name "LHOV." Fabrizio Crisà, Elica's Chief Design Officer, is the creator of the LHOV, a three-in-one appliance that combines a hob, a hood, and an oven to create a whole new class of built-in kitchen appliances. The product represents an important development in the company's strategy, which calls for increasing the premium product selection supplied to clients and the share of sales from own brands in the cooking category. The NikolaTesla family range's success will be gauged by the launch and continuing promotion of this new product, which will make use of the same European sales and distribution network.

*Figure 13 Lhov*

The three primary application areas for the Motors division are:

- **heating** (including condensing technologies, heat pumps, biomass, and hydrogen heating systems),
- **ventilation** (including hoods and aspiration hobs),
- **home appliances** (including ovens and no-frost solutions).

The following product categories are part of the product line, which is geared at effectiveness, minimal noise, durability, and compliance with regulations:

- Electric motors, such as brushless motors, capacitors, and motors with shaded poles.
- Blowers and fans, such as axial fans and centrifugal blowers rotating fans.
- Special applications, including premix blowers, blowers for hot air and exhaust gases, shaded poles fans for ovens and no-frost fans.

*Figure 14 Hydrogen Motor*

### 2.1.5. A long journey

Below is a quick summary of Elica’s past:

Ermanno Casoli, the current Executive Chairman Francesco Casoli’s father, founded Elica in 1970. In 1972, Mr. Casoli presented the first air extractor in Paris and signed the first contract with Philips. In 1978, the company’s management transferred responsibility to Francesco Casoli, who later became Elica’s CEO. In 1994 and 1998 respectively Elica opened the plants in Serra San Quirico and Mergo while in 2001, the company entered the Motors market with the acquisition of Fime. In 2002, Elica started its global development with the establishment of Ariafina in Japan as a result of a joint venture with Fuji, a pioneering manufacturer of hoods in Japan. Fime Poland was established in 2005, and an Ariafina showroom was established in Osaka. Elica’s IPO took place in 2006. Elicamex, a Mexican firm, was established that year, and its Queretaro, Mexico, facility was inaugurated.

The foundation of PB India Private Ltd. in 2010 gave Elica’s global reach an additional boost. Elica successfully acquired the majority of Zhejiang Putian Electric Co. Ltd., a leading manufacturer of home appliances in China and the owner of the "Puti" brand, in the same year. The Chinese business manufactures and sells hoods, gas ranges, and kitchenware sterilizers; Elica opened Elica Trade LLC in 2011, which allowed them to join the Russian market. Elica strengthened its European presence between 2014 and 2017 by expanding in Paris, Munich, and Barcelona and acquiring the remaining stake in Zhejiang Putian.

In 2021, Giulio Cocci, a former CFO, was named group CEO. The same year, Fime expanded its motor portfolio by paying €31 million to acquire EMC, a European market leader in the design and production of electric motors, domestic cooker hood fan systems, and pellet stove fans.

### 2.1.6. Geography

The current level of global coverage is the consequence of the ongoing geographic expansion that began in 2002 with the penetration of the Japanese market, as explained in the section on the company's history. A local-for-local strategy guides ELC's production footprint, which consists of seven facilities, four of which are in Italy (mostly devoted to high-end products), one in Poland to meet the remaining portion of European production needs, one in Mexico, and one more in China that serves Asia and Russia.

**EMEA (78% of revenues for FY22):** The company is active in Italy, where it has historical headquarters, a production facility, and key R&D laboratories in Fabriano (Marche), as well as other units in Mergo, Cerreto d'Esi, and Castelfidardo in the country's center. The Cerreto d'Esi factory is being phased down progressively by the firm. Elica Group Polska, located in the Jelcz Laskowice industrial zone of Wroclaw, conducts a large portion of the world's production. The company is presently working on a reshoring strategy that envisions higher production volumes in Poland, mostly through automated and standardized procedures for lower-value products and the production of high-end goods in Italy, such as the NikolaTesla aspirating hob. Both Poland and Italy are used in the manufacturing of the Motors BU's products. Elica is also present in Germany, serving the market directly through Elica GmbH, in Spain through a separate organization in Barcelona, and in France through Elica France, which is based in the heart of Paris. Elica Trading LLC, which has offices in Moscow and St.

Petersburg, was established by the corporation in 2011–12. The company has also been serving ISC countries with its own brands since 1995. Elica, Jetair, and Turboair are just a few of the brands the corporation uses to market in different nations. The company also has access to on-site storage facilities and a significant distribution network. Elica has built a network of directly managed technical assistance to better serve clients.

**Americas (c.15% of FY22 revenues):** Elica has a direct presence in Mexico through Elicamex, where it has a production facility and a business location in Queretaro. The business provides customer service to both South American and North American markets (also covered through a dedicated entity in Chicago). Elica aims to improve OEM operators' penetration in this region and develop new own brands.

**Asia & RoW (c.7% of FY22 revenues**): In 2002, Elica entered the Asian market with a joint venture with Japanese company Fuji Industrial, a major producer of hoods on the domestic market. The aforementioned joint partnership produced Ariafina, the reference brand for the premium Japanese kitchen hoods market. In 2005, the business also set up shop in Osaka. To penetrate the Indian market, Elica signed a joint venture in 2010. As a result, Elica PB India Ltd. was created, which manufactures and sells hobs and ovens for the local market under both its own brand and other brands. Elica sold Whirlpool its majority stake in the Indian business in 2021, and Whirlpool continues to market and sell Elica's goods while paying a portion of the sales to the Elica Group. In 2010, Elica expanded its business into China by purchasing Zhejiang Putian Electric, the proprietor of the Puti brand. The company provides a wide range of products in China, including hoods, gas hobs, and kitchen utensil sterilizers, by utilizing the Puti and Elica brands. Elica has a factory in Shengzhou that is used to produce goods for the Chinese market. Elica signed a joint venture with Fuji in China for the Japanese market by selling its around 3.0% stake in Zhejiang Putian in 2012.

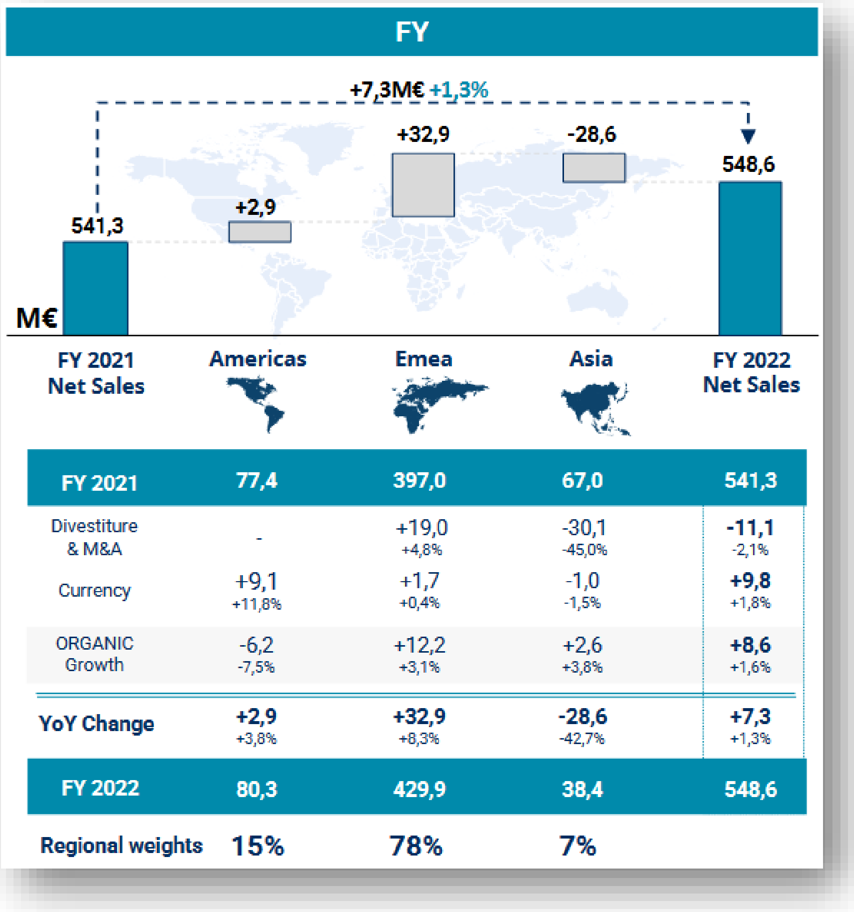


*Figure 15 Sales by Geography*

### 2.1.7. Distribution System

Products from Elica are available in more than 100 nations in Asia, the Americas, and EMEA. Together with its global reach and 11 legal companies, the company depends on a capillary and diversified distribution network, primarily made up of kitchen manufacturers, certified retail chains, and distributors, to achieve such broad geographic coverage. Elica furthermore produces goods for OEMs. Large kitchen manufacturers that directly provide end customers turnkey kitchens with Elica's goods installed include Lube, Nobilia, and Veneta Cucine. Kitchen manufacturers are the primary distribution channel for Elica's products in Germany and Italy. Beyond the design, manufacturers decide which product to include in their kitchen depending on how profitable they can be and when the product will be delivered (to grant customers an optimal service). The distribution route for Elica that is most profitable is the one that involves kitchen makers.

For Elica, qualified retail chains are more crucial than kitchen manufacturers in France, the USA, and the UK due to the market's structural peculiarities. Large companies like Leroy Merlin in Europe and Ferguson in the US are examples of qualified retail chains. However, they produce the lowest profitability for Elica.

Finally, distributors are smaller business owners who operate their distribution networks. They provide services to builders, kitchen studios, furniture and appliance stores, and other businesses that Elica is unable to directly contact owing to their small size. Also, Manufacturers like Whirlpool, Haier, Ikea, Bosch, and Samsung receive direct marketing from Elica for their products. Elica is able to forge profitable and long-lasting relationships with OEMs as a result of the high quality and competitiveness of its products.

### 2.1.8. Exposure to foreign currencies

Elica has varied exposure to a mix of American and Asian currencies due to its global structure, which is founded on a local-for-local strategy, and around 70% of revenues are denominated in euros. As a result, the corporation has implemented a strict policy to protect itself against the dangers associated with currency fluctuations.

The primary currencies to which the group is exposed, other than euros, are:

**US Dollar**, which is thought to make up about 11% of the group's revenue. In its normal operations, Elica frequently displays more revenues in USD than operating costs, however, this discrepancy is generally made up by the purchase of copper (which is denominated in USD). Elica typically uses derivatives negotiated in financial markets to hedge the volatility of the amount of USD not naturally hedged. However, given the increase in copper's price, the revenue-cost mismatch may close in 2023.

**Chinese Yuan** and the **Japanese Yen** are thought to make up about 5% of the group's total revenue. Elica projects to produce greater costs than CNY sales due to the costs of the production facility in China.

**Russian Rubles** are expected to make for around 1% of the group's revenue in 2022. Sales agreements with Russian distributors are tied to changes in the ruble's value relative to the euro. A non-negligible portion of the company's production is implemented in the Polish and Mexican plants, resulting in a net short position on these two currencies, while no production costs and only modest G&A expenses are borne in the Russian currency. Among other currencies, the company shows an overall limited top-line exposure to **Polish Zloty** and **Mexican Pesos**.

### 2.1.9. Innovation and Sustainability

WCM and innovation are key drivers of industrial processes and future expansion. In an effort to influence market trends, the company bases its leadership on an innovation-based strategy that combines insight and foresight of client demands. In order to provide clients with innovative solutions in terms of technology and raw material use, management has built inside the company a culture of innovation that also leverages partnerships with universities and national and international research centers. Due to this innovation-based strategy, during the past six years, the company has invested an average of 2% of yearly revenues on R&D. Elica's products are evaluated in the Elica Propulsion Laboratory, the only hood-focused laboratory in the world and one of the few in Europe that can test specialized acoustic properties to ensure the lowest possible noise level in its products. The Propulsion Laboratory received the Ilac-Accredia[2] accreditation back in 2013, which recognizes the technical, formal, and substantive expertise in carrying out particular certification and inspection activities, along with functional testing and calibration for the issuance of certificates to international standards. Elica Propulsion Laboratory also manages each and every test for the Chinese and Mexico labs.

Elica also joined the World Class Manufacturing Association [3]in 2009; this non-profit group of businesses from many industries is dedicated to the introduction and development of a single, coordinated change process. More specifically, this procedure encourages the evaluation and elimination of all waste while ensuring the greatest product quality.

The governance framework has a heavy focus on ESG goals. Elica has stepped up its efforts to include sustainability in its business model in recent years. In order to achieve this goal, the corporation built a governance model that involved cooperation between various organizations responsible for managing and overseeing ESG issues. For instance, the recently established Sustainability Board will work to promote projects that will benefit all of the Group's numerous

2 https://www.accredia.it/
3 https://www.elica.com/IT-it/casoli-presidente-wcm-association

stakeholders. The three key pillars on which the corporation builds its ESG approach are:

**Economic sustainability**: Elica strives to provide cutting-edge goods and design solutions that generate long-term value for stakeholders, draw in additional capital through environmentally friendly investments, and regularly engage stakeholders in sustainability-related discussions. Elica's dedication to innovation led to the acquisition of more than 600 patents (including more than 100 for NikolaTesla) and the creation of ground-breaking technologies like:

i) Airmatic, which calls for the installation of sensors to automatically manage the air quality.

ii) Elica Connect, which enables remote control of the product even through a voice assistant.

iii) No Drip system, which improves condensation management.

iv) Empowered Cooking on NikolaTesla

**Environmental sustainability**: The business is concerned with the effective use of energy carriers, the reduction of CO2 emissions during production processes, the increased use of renewable energy sources, the evaluation of suppliers based on social and environmental sustainability criteria, and the creation of energy-efficient and environmentally friendly products. This led to a significant reduction in the generation of hazardous waste, an increase in waste recovery, and a reduction in CO2 emissions in 2022.

**Social sustainability**: Elica is trying to implement the ISO 45001:2018 [4]management system at all manufacturing facilities, provide fair treatment by praising merit, and promote collaborative innovation through the arts to foster inclusivity and creativity. The corporation has approximately 88% of permanent employees, more than 40% of women on the board of directors, almost 50% of women in upper management, an average of 18 hours of training per person, and a wide spectrum of cultural and social projects.

Energy efficiency and EMC integration are driving growth in the motor industry. After completing the acquisition in 2021, Elica expanded its Motors BU with the goal of establishing a European center of excellence in the ventilation and heating industry and reaching a critical mass that would allow for improved customer responsiveness. The business is able to realize significant synergies such as

i) cross-selling, introducing Fime's products to EMC's customers, utilizing the expertise in biomass blowers, and leveraging a more solid positioning.
ii) improving the efficiency of the procurement of raw materials and components
iii) optimizing the production processes and footprint
iv) rationalizing R&D, product development, and commercial initiatives

With the use of the new EMC Fime, the company will be able to govern the entire supply chain and thus grow its market share.

[4]https://corporate.elica.com/sites/default/files/2023-04/DICHIARAZIONE%20NON%20FINANZIARIA%202022%20%28REPORT%20DI%20SOSTENIBILITA%27%29_RELAZIONE%20KPMG_v1.pdf

The strategy of EMC Fime is built upon three primary pillars, namely:

1. The company wants to improve its product line's efficiency, noise levels, and connection to comply with the EU energy label directive and the needs of new consumers connected to household comfort and the development of the IOT.
2. Switch from motors to systems - by improving internal electronics competencies, the company would be able to sell its clients more complete systems that included electronics, fans, and blowers in addition to motors. As a result, EMC Fime will be able to sell solutions with a greater level of value and satisfy the rising demand for brushless products.
3. Development of heating components aimed at energy efficiency trends - this entails the production and marketing of unique and ground-breaking products to capitalize on energy efficiency trends, such as the anticipated widespread use of heat pumps and the development of appliances utilizing hydrogen and biomass, supported by the recently unveiled REPowerEU [5]plan. To accomplish this goal, agreements with top OEMs and the development of cutting-edge technology may be used.

[5] https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/repowereu-affordable-secure-and-sustainable-energy-europe_it

# 3. INVESTOR RELATOR TECHNICAL KIT

As we delve into the heart of this manual, we approach a vital segment, titled "Investor Relations Technical Kit". This section aims to underscore the importance of thorough knowledge of financial, economic, and equity indicators, as well as a solid understanding of the annual financial statement.

Why, one might wonder, is this degree of expertise crucial for an Investor Relations professional? To answer this, we need to take a step back and consider the primary role of an Investor Relations Officer (IRO). Tasked with maintaining a healthy and mutually beneficial relationship between a corporation and its investors, an IRO serves as the conduit of vital financial information. Their job is to articulate this information in an understandable and reliable manner, painting an accurate picture of the company's financial health and future prospects. In essence, they bridge the gap between the organization and the investment community.

Financial, economic, and equity indicators are the backbone of this communication. These key performance indicators (KPIs) offer a snapshot of the company’s financial condition, operating results, and overall market position. For instance, financial indicators such as profitability ratios, liquidity ratios, and debt ratios offer insight into the company's ability to generate income, meet short-term obligations, and service its long-term debts, respectively. Economic indicators, on the other hand, give a macroeconomic perspective, enabling investors to understand the company's performance within a broader economic context. Equity indicators, such as the price to earnings ratio (P/E ratio), provide an understanding of the company's value in the eyes of the stock market.

Without the ability to interpret these indicators accurately, an Investor Relations professional would struggle to convey a cogent narrative about the organization's financial trajectory. Moreover, they would be unable to guide investors in making informed decisions, thus potentially eroding the trust that forms the bedrock of investor-company relationships.

A thorough understanding of the annual financial statement is just as pivotal. This document is a comprehensive record of a company's financial activities over a particular period. It comprises the balance sheet, income statement, statement of retained earnings, and cash flow statement, each offering different insights into the company's financial health. The balance sheet, for instance, presents a picture of the company's assets, liabilities, and shareholder's equity at a particular point in time, while the income statement provides a summary of the company's revenues, costs, and expenses over a period.

An IRO must not only understand these elements in isolation but also the intricate interplay between them. The ability to read, interpret, and communicate the information encapsulated in these financial documents is pivotal. It aids in painting a more comprehensive picture of the company's health and prospects, ensuring investors are well-informed and the company is adequately valued.

Therefore, the technical kit equips Investor Relations professionals with the tools necessary to carry out this mission critical role, building an essential bridge of understanding and trust between the organization and its investors. In the subsequent sections, we will delve deeper into each aspect of this technical kit, ensuring a robust comprehension of these key financial, economic, and equity indicators, as well as the subtleties of understanding the annual financial statement.

## 3.1. EBITDA

Earnings before interest, taxes, depreciation, and amortization, or EBITDA[1], is a measurement used to assess a company's operational performance. It might be viewed as a hazy representation of the total cash flow generated by the business's operations. Conceptually, it stands as an iteration of operating income (EBIT) that deliberately excludes all non-cash expenditures. These deductions aim to eliminate variables that business owners have control over, such as debt financing, capital structure, depreciation, and taxes (to some extent). It can be used to display a company's financial performance independent of its capital structure. Generally Accepted Accounting Principles do not recognize EBITDA as a measurement. A few publicly traded corporations include adjusted EBITDA figures in their quarterly reports along with the EBITDA figures themselves, which normally do not include any additional expenses like stock-based pay.

EBITDA has come under fire for allegedly overstating profitability as a result of increased reliance on it by businesses and investors. Indeed, its usage can be abused to inflate a company's true earnings. For instance, if a business has a lot of depreciable assets (and hence, a lot of depreciation expense), the cost of upkeep

[1] Paolucci, Guido. *Analisi di bilancio. Logica, finalità e modalità applicative. (Quarta edizione, aggiornata con le novità sul bilancio 2016)*. Franco Angeli, 2016, Pages 140-147

and maintenance of these capital assets is not taken into account. The SEC prohibits publicly traded corporations from reporting EBITDA on a per-share basis and mandates that they explain how EBITDA figures were calculated from net income.

The computational process is facilitated by perusal of financial statements. Depreciation and amortization data are often found on the cash flow statement or in the notes to operating profit, while earnings (net income), taxes, and interest are shown on the income statement. Operating profit, also known as earnings before interest and taxes (EBIT), is the standard starting point for computing EBITDA. Depreciation and amortization are then typically added back. There are two different EBITDA calculations, one that considers operating income and the other that considers net income.

The various EBITDA formulas are as follows:

***EBITDA = Net Income + Taxes + Interest Expense + Depreciation & Amortization***

and

***EBITDA = Operating Income + Depreciation & Amortization***

Regardless of the depreciation assumptions or financing strategies utilized, EBITDA can be used to monitor and analyze a company's underlying profitability. By dividing it by a valuation multiple derived from equity research reports, publicly listed peers, and industry transactions, or M&A, it can provide an analyst with a rapid estimate of the company's value as well as a valuation range.

### 3.1.2. History

The genesis of EBITDA traces back to the ingenuity of John Malone. As a visionary luminary within the cable industry, Malone conceived this metric during the 1970s with a dual motive: to secure the allegiance of lenders and investors towards his ambitious leveraged expansion blueprint. This blueprint, characterized by a strategic interplay of debt utilization and profit reinvestment, aimed not only to foster growth but also to curtail tax obligations. EBITDA was discovered to be helpful by lenders and investors in leveraged buyouts (LBOs[2]) throughout the 1980s in determining if the targeted company had the profitability to pay off the debt that was going to be incurred in the acquisition. It was appropriate to exclude the interest and tax expenses from earnings because a buyout would probably result in a change to the capital structure and tax obligations.

Depreciation and amortization expenditures are non-cash expenses; thus, they won't have an immediate impact on the company's capacity to pay down that debt. EBITDA was primarily utilized as a gauge of whether a corporation could afford to pay back the interest associated with restructuring because it was usual for investors to financially reorganize failing enterprises. The LBO buyers tended to focus on businesses with low or modest near-term capital spending plans, while their own need to secure financing for the acquisitions forced them to pay attention to the EBITDA-to-interest coverage ratio, which compares core operating profitability as measured by EBITDA against debt service costs.

[2] Kaplan, Steven N., and Per Stromberg. 2009. "Leveraged Buyouts and Private Equity." Journal of Economic Perspectives, 23 (1): 121-46.

EBITDA became well-known when several businesses inflated their financial performance during the dot-com bubble.

### 3.1.3. Applications

Nowadays, EBITDA can be used in many ways. It is frequently used by banks to calculate a company's debt payment coverage ratio (DSCR)[3]. This particular debt-to-income ratio is used to assess the borrowing capacity and cash flow for business loans.

EBITDA is a metric used by investors and business owners to compare firms in the same sector. With the technique, firm performance may also be normalized versus sector averages. Supporters of the EBITDA claim that it gives a more accurate picture of how well a company is doing and about its long-term potential. When dealing with investors, IT entrepreneurs, for instance, would prefer to omit the upfront business expense of developing sophisticated software by using EBITDA.

Investors can use the Enterprise Value/EBITDA[4] ratio to compare two companies and determine if one is overvalued (high ratio) or undervalued (low ratio). Comparing businesses that are comparable in nature (share the same industry, operations, clientele, margins, pace of growth, etc.) is crucial because typical ratios across different industries might range significantly (high ratios for high-growth industries, low ratios for low-growth industries). The ratio, which is calculated by

[3] https://corporatefinanceinstitute.com/resources/commercial-lending/debt-service-coverage-ratio/

[4] Mauboussin, Michael J. "*What does an EV/EBITDA multiple mean.*" Bluemont Investment Research (2018).

dividing a company's enterprise value by EBITDA, is frequently used in corporate valuation.

Financial modeling commonly uses EBITDA as a starting point to determine unlevered free cash flow. Even though a discounted cash flow (DCF) model solely evaluates the business based on its free cash flow, it is a frequently used metric in finance that it's advantageous to use.

Also, investors can use EBITDA to assess a company while it is not generating a net profit. Since it works so well for comparing businesses in the same sector, many private equity firms employ this indicator. It is used by business owners to assess how they stack up versus rivals. The amount of debt, interest rates, and management choices for debt vs. equity financing all affect interest costs. A focus on the cash earnings produced by the company's operations is maintained by excluding all of these items.

EBITDA is very popularly utilized in the study of asset-intensive industries with a lot of property, plant, and equipment and consequently large non-cash depreciation expenses. Amortization is frequently used to deduct the cost of creating software or other intellectual property. That’s why EBITDA is one of the metrics used by early-stage technology and research companies to present their performance.

### 3.1.4. Drawbacks

In some industries, the expenses that EBITDA does not include may mask changes in underlying profitability, as is the case, for instance, with energy pipelines[5].

[5] Bellelli, Gabriele, Andrew Lawford, and Maurizio Mazziero. *Manuale dell'investitore consapevole: incrementa e proteggi i tuoi risparmi investendo a basso rischio*. HOEPLI EDITORE, 2016, Page 133

*"References to EBITDA make us shudder," Berkshire Hathaway Inc. CEO Warren Buffett states. "Depreciation is a real expense that cannot be avoided; therefore, EBITDA is not a relevant measure of performance," in Buffett's opinion.*

For instance, a manufacturing company that is expanding quickly can show rising sales and EBITDA year over year. It bought numerous fixed assets throughout time to grow quickly, and each one was financed with debt. Investors should consider other measures, such as capital expenditures, cash flow, and net income, in addition to top-line growth, even though it may appear that the company has excellent top-line growth. Even yet, a high EBITDA doesn't guarantee great profitability for a company. Secondly, it's critical to be aware of any potential exclusions from the balance sheet when comparing a company utilizing the adjusted EBITDA. To get a precise analysis, it's important to compare like with like and to understand all the primary matters before drawing any inferences from the data.

The biggest criticism of EBITDA is that it doesn't take changes in working capital into account. A positive EBITDA value is not always indicative of a healthy company because taxes and interest are genuine expenses that the corporation must account for, even if a negative value typically indicates a problem with profitability. In contrast, a business may have little liquidity if its assets are hard to cash in while still operating profitably.

EBITDA may be altered. The amount of money a corporation has available to pay interest can potentially be skewed by EBITDA. Depreciation and amortization adjustments can make a company's earnings appear higher than they actually are. A company's profit estimates can be inflated by altering the depreciation schedule, which also affects EBITDA. Being a non-GAAP metric[6], each company may have a different method for calculating it. Companies frequently place more emphasis on EBITDA than net income since the former gives them a better appearance. It portrays the business as if it has never paid taxes or interest, and it depicts assets as never having lost their intrinsic value over time (no depreciation deducted).

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*EBITDA is sometimes misunderstood to be a cash earnings indicator. EBITDA, however, disregards the cost of assets, in contrast to free cash flow. EBITDA is sometimes criticized for assuming that profitability is solely a result of sales and operations, almost as if the company's assets and debt financing were a gift.*

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***To quote Buffett again,***

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*"Does management think the tooth fairy pays for capital expenditures?" Take wireless communication provider Sprint Nextel as a historical example. The stock was trading at 7.3 times the expected EBITDA on April 1, 2006. Although it may appear to be a cheap multiple, the company is not a good deal. Sprint Nextel traded at a substantially higher 20 times the estimated operating profit multiple. The company was valued at 48 times its projected net income at the time of trading.*

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*"There's been some real sloppiness in accounting, and this move toward using adjusted EBITDA and adjusted earnings has produced some companies that I think are trading on valuations that are not supported by the real numbers,"* ***hedge fund manager Daniel Loeb said in 2015***.

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6 https://www2.deloitte.com/us/en/pages/audit/articles/a-roadmap-to-non-gaap-financial-measures.html

Since then, not much has changed in that regard. Investors that base their decision on a company's valuation or performance entirely on EBITDA run the risk of making a mistake.

## 3.2. EBIT

EBIT[7], which stands for Earnings Before Interest and Taxes, is one of the subtotals that appear before net income on the income statement. Because it is obtained by subtracting all operational costs (including production and non-production costs) from sales revenue, EBIT is also occasionally referred to as operating income. EBIT is the same as operational profit since it assesses the profit a business makes from its activities. EBIT disregards taxes and interest expenses, instead concentrating solely on a company's ability to generate earnings through its operational activities. By excluding factors like capital structure and tax burdens, EBIT aims to distill the fundamental essence of an organization's earnings potential. This makes it a valuable tool for assessing a company's capability to generate sufficient earnings for profitability, debt repayment, and sustained operations. The practicality of EBIT underscores its significance as an essential indicator in evaluating a company's financial soundness and operational sustainability. The operating margin, represented as a percentage (for example, 15% operating margin), is obtained by dividing EBIT by sales revenue. The margin can be compared to the company's previous operating margins, its present net profit margin and gross margin, or to the margins of other, comparable firms that operate in the same industry.

[7] https://www.investopedia.com/terms/e/ebit.asp

There are two methods for calculating earnings before taxes and interest. In the first case, depreciation and amortization are first subtracted from EBITDA. Conversely, if a business does not employ the EBITDA metric, operating income can be calculated by deducting SG&A from gross profit (including depreciation but excluding interest).

***EBIT = Net Income + Interest + Taxes***

***EBIT = EBITDA – Depreciation and Amortization***

The easiest approach to begin is with net income and add back interest and taxes because these items will always be included in the income statement.

One-time or exceptional expenses that have no bearing on the business's main activities can be excluded, such as the money made from the sale of an asset or the cost of a lawsuit. Moreover, non-operating income from investments or other sources may be reported even though it's not required. EBIT is different from operating income in this situation because operating income, as its name suggests, excludes non-operating income.

Most businesses include interest revenue in EBIT, however depending on its source, others may not. This interest income is a component of operating income and is always included by a firm if it lends credit to its clients as a fundamental aspect of its business. On the other hand, interest income may be disregarded if it comes from investments in bonds or from charging late payment penalties to customers. This modification is at the investor's discretion and should be used consistently across all companies being compared, just like the other ones stated.

### 3.2.2. Applications

In some industries, EBIT can be used as a stand-in for free cash flow; this method is effective as long as it is employed with mature, stable businesses that make reasonably regular capital investments. Free cash flow and the EBIT indicator are interconnected.

$$FCF = EBIT\ (1 - T) + D\&A + \Delta\ NWC - CapEx$$

Where:

FCF = Free Cash Flow

T = Average Tax Rate

Δ NWC = Change in Non-Cash Working Capital

CapEx = Capital Expenditures

Investors who are comparing numerous companies with various tax conditions might also benefit from using EBIT. For instance, if an investor is considering purchasing stock in a company, EBIT can be used to determine the operating profit of the business without taking taxes into account. The company's net income or profit would rise if it recently obtained a tax break or if corporate taxes were reduced. EBIT, however, excludes the tax cut advantages from the study. Investors can compare two businesses in the same industry but with various tax rates using EBIT.

EBIT is useful for examining businesses in capital-intensive sectors, which have a high proportion of fixed assets on their balance sheets. Physical property, plants, and equipment are considered fixed assets and are frequently financed by debt. Since oil companies must finance their drilling machinery and oil rigs, their businesses require a lot of capital. As a result of having a substantial amount of debt on their balance sheets, capital-intensive sectors have high interest costs. Yet, debt is essential for the long-term expansion of businesses in the sector if it is effectively handled. When compared to other businesses, those in capital-intensive industries may have more or less debt. As a result, when compared to one another, the companies' interest expenses would differ. By eliminating debt and the ensuing interest expenditure, EBIT enables investors to assess the operating performance and earnings potential of businesses.

When valuing a company using comparable companies, the EV/EBIT[8] multiple is frequently utilized. We can calculate how much investors are ready to pay for each unit of EBIT by taking the company's Enterprise Value (EV) and dividing it by the annual operating income of the business. EBIT is a financial ratio that is utilized in numerous fundamental analysis financial ratios in addition to providing a sense of operational profitability. For instance, the EV/EBIT multiple compares a company's earnings to its enterprise value, while the interest coverage ratio divides EBIT by interest expense.

Earnings before interest, taxes, depreciation, and amortization (EBITDA) and EBIT, which are indicators of a company's fundamental earning potential, are used by a professional investor to determine the best use of debt versus equity when considering changing a company's capital structure for example, through a

[8] Chan, Ronald W., and Brian C. Lui. "EV/EBIT ratio: The best of both worlds." *Better Investing* 60 (2011): 27-28.

leveraged buyout (equity value). Investors, analysts, and creditors frequently use it to evaluate the financial stability and future growth of a company. Financial analysis and forecasting are other areas where EBIT is used. Investors and analysts can spot trends in an organization's operating profitability and estimate its future financial success by tracking the EBIT of a company over time.

### 3.2.3. Limitations

Depreciation is a factor in the EBIT calculation, as was previously mentioned, and can produce different results when comparing businesses in other industries[9]. Depreciation costs would be detrimental to the company with fixed assets if an investor were to compare it to a company with fewer fixed assets because the expense lowers net income or profit. Also, businesses with a lot of debt will probably incur a lot of interest expense. EBIT reduces interest costs and boosts a company's potential for profits, especially if it has a high debt load. If the company raises its debt level as a result of a lack of cash flow or subpar sales performance, failing to include debt in the study may prove troublesome. While examining a company's financials, it is crucial to keep in mind that in a rising rate environment, interest expenses will increase for businesses with debt on their balance sheets.

### 3.2.4. EBITDA vs EBIT

Although EBIT and EBITDA are closely related indicators, they ultimately give a glimpse of a company's financial situation. EBITDA is a term that is often used to refer to earnings before interest, taxes, depreciation, and amortization. The main distinction is the exclusion of depreciation and amortization from EBIT for fixed

[9] Nissim, Doron. "EBITDA, EBITA, or EBIT?." *Columbia Business School Research Paper* 17-71 (2019).

assets like buildings and equipment. In particular, for businesses with a high proportion of fixed assets, EBITDA might provide a more realistic picture of an organization's operational profit than EBIT. EBITDA can, however, misrepresent how businesses with significant fixed assets are actually operating because it does not take earnings after depreciation into account. The EBITDA increases in proportion to the depreciation expense. The EBIT formula enables you to evaluate the effectiveness of the core business model. It is entirely focused on business operations. In contrast, EBITDA assesses the company's cash flow. Depreciation and amortization in EBITDA are accurate depictions of the value that is lost over time as assets like property and equipment deteriorate. Even if the company didn't spend any money on these losses, they are nonetheless counted as losses. Businesses that own a large number of fixed assets can amortize the cost of those purchases over the course of those assets' useful lives. In other words, depreciation enables a business to spread the expense of an item over a long period or the asset's lifespan. The cost of an asset is not recorded in the year it was purchased thanks to depreciation. Profitability is consequently decreased by depreciation costs. Depreciation costs have the potential to negatively affect net income or the bottom line for businesses with sizable, fixed assets. By excluding depreciation, EBITDA calculates a company's earnings. EBITDA hence aids in gaining a deeper understanding of how profitable a company's operational performance is.

Each EBIT and EBITDA metric has advantages and purposes in financial research. A company's ability to perform will be revealed by an EBIT analysis, whereas an EBITDA analysis predicts its ability to spend cash. In businesses with significant capital expenditures, EBITDA is helpful. While being distinct, EBIT and EBITDA are equally important for estimating key analysis tools. They are frequently used by accountants to assess a company's overall financial health. The industry or the goal of the analysis will determine which computation is the most logical. EBITDA is more appropriate for capital-intensive, leveraged businesses. These businesses frequently generate low profits since they frequently have large, fixed assets and huge debt loads. Negative earnings might make it difficult to ascertain the company's financial status, hence analysts also utilize EBITDA to value such businesses. While EBITDA and EBIT are both valuable financial metrics, they do have some drawbacks that need to be taken into consideration. If a company has substantial capital expenditures, its EBITDA may be deceptive because it may not reflect its underlying cash flow. If a corporation has significant interest or tax costs, EBIT may be deceptive since it may not reflect the underlying operating profitability of the business. As a result, it's crucial to take into account both measurements together with other financial indicators like net income and cash flow when assessing a company's overall financial health.

## Elica Case no. 1

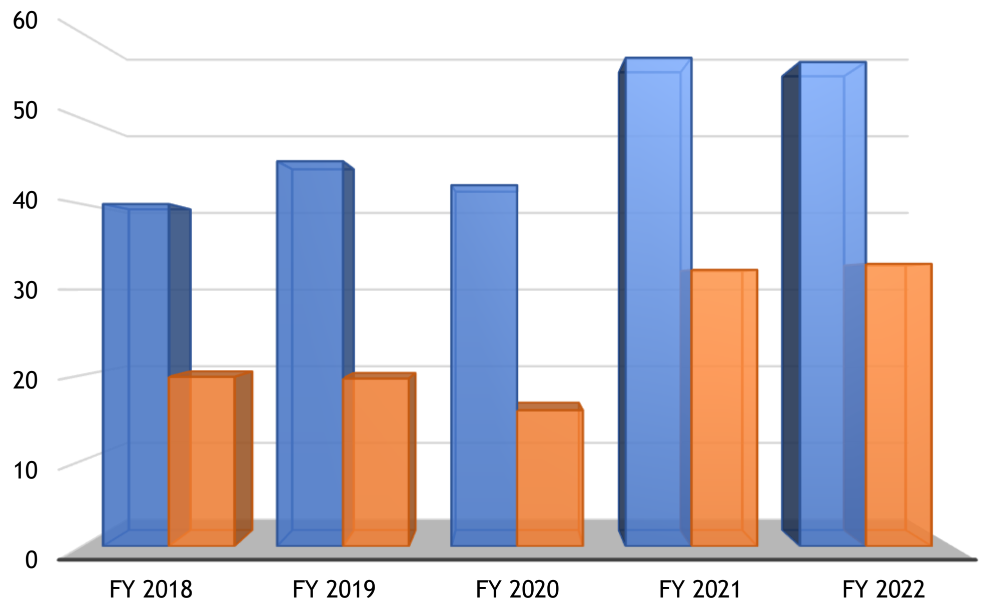
The company's financial performance from FY 2018 to FY 2022, as reflected in its EBITDA and EBIT, demonstrates a positive trajectory with a notable increase in operational profitability.

**Adjusted EBITDA**: the company's adjusted EBITDA increased from 40 million in FY 2018 to 56.6 million in FY 2022. This increase in operational profitability is a result of improved operational efficiency, favorable market conditions, and an effective pricing strategy. The slight dip in FY 2020 was due to the impact of the COVID-19 pandemic.

**Adjusted EBIT**: similarly, the company's adjusted EBIT also increased from 19.8 million in FY 2018 to 33 million in FY 2022. The increase in net operational profitability, despite the dip in FY 2020, is a testament to the company's resilience and ability to adapt to changing market conditions.

The company's improved operational efficiency over the period has led to cost reductions and increased sales. Favorable market conditions have resulted in an increased demand for the company's products or services, contributing to the increase in profitability. The company's pricing strategy, which has involved raising prices and improving the product mix, has also played a significant role in enhancing profitability.

The dip in FY 2020 was a direct result of the COVID-19 pandemic, which caused supply chain disruptions, temporary closures, and changes in consumer demand. Despite these challenges, the company was able to recover and continue its upward trajectory in profitability in the subsequent years.




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| EBITDA Adj | 40 | 45 | 42.2 | 57.1 | 56.6 |
| EBIT Adj | 19.8 | 19.6 | 15.9 | 32.3 | 33 |

*Figure 16 EBITDA & EBIT Adj*

**Gross Margin %**: this ratio measures the percentage of total sales revenue that the company retains after incurring the direct costs associated with producing the goods and services sold. The company's gross margin has shown a slight decrease from 47.57% in 2018 to 44.52% in 2022. This could be due to an increase in the cost of goods sold or a decrease in sales prices. The company's ability to maintain a relatively high gross margin over the period suggests that it has been able to control its direct costs effectively.

**Operating Margin %:** this ratio measures the percentage of total sales revenue that the company retains after paying for variable costs of production such as wages, raw materials, etc., and fixed costs like rent and depreciation. The company's operating margin has shown a positive trajectory, increasing from

4.26% in 2018 to 6.22% in 2022. This suggests that the company has been increasingly successful in converting its sales into operating profit.

**Net Margin %:** this ratio measures the percentage of total sales revenue that the company retains after all expenses and taxes. The company's net margin has shown a positive trajectory, increasing from -0.2% in 2018 to 3.03% in 2022. This suggests that the company has been increasingly successful in converting its sales into net profit.

**EBITDA Margin %**: this ratio measures the company's earnings before interest, taxes, depreciation, and amortization as a percentage of total sales revenue. The company's EBITDA margin has shown a positive trend, increasing from 5.72% in 2018 to 9.45% in 2022. This suggests that the company has been increasingly successful in generating EBITDA from its sales.

**Tax Rate %**: [10]This ratio measures the company's income tax expense as a percentage of its pre-tax income. The company's tax rate has shown some fluctuations over the period but decreased from 48.42% in 2018 to 29.7% in 2022. This is due to changes in tax laws, the company's tax planning strategies, and fluctuations in the company's pre-tax income.

In conclusion, the company has demonstrated strong financial performance over the period. Despite the slight decrease in the gross margin, the company has been able to improve its operating margin, net margin, and EBITDA margin, suggesting improved operational efficiency and profitability. The decrease in the tax rate also

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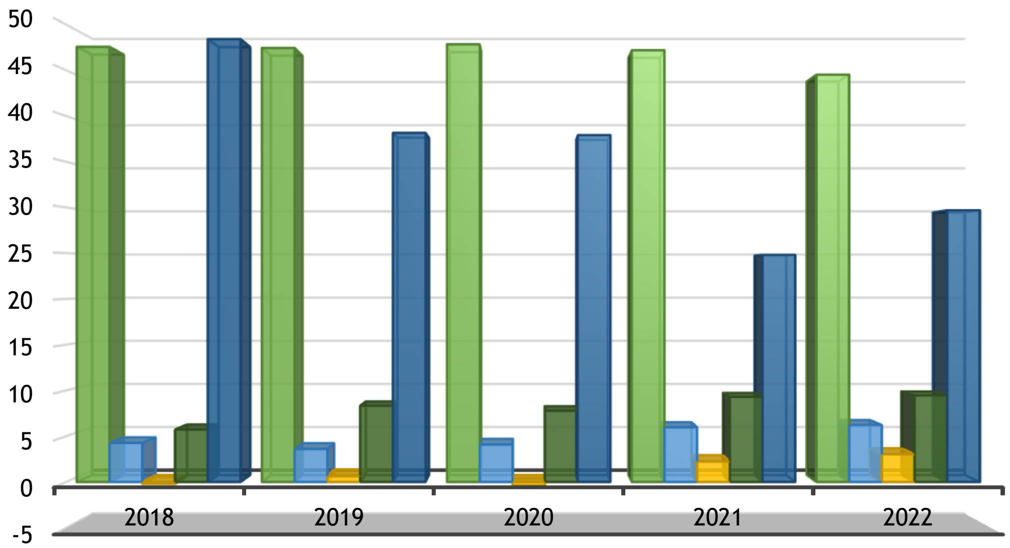
[10] Aswath Damodaran, *Investment Valuation Tools and Techniques for Determining the Value of any Asset, University Edition,* Pages 281 - 289

contributes to the increase in the net margin. These performance indicators suggest a strong foundation for future growth and profitability.




| | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|
| Gross Margin % | 47.57 | 47.45 | 47.85 | 47.2 | 44.52 |
| Operating Margin % | 4.26 | 3.6 | 4.08 | 5.97 | 6.22 |
| Net Margin % | -0.2 | 0.64 | -0.39 | 2.24 | 3.03 |
| EBITDA Margin % | 5.72 | 8.32 | 7.78 | 9.29 | 9.45 |
| Tax Rate % | 48.42 | 38.16 | 37.91 | 24.82 | 29.7 |

*Figure 17 Margins*

## 3.3. Cash Flow

Free cash flow[11] is the money that a business makes from regular business operations after deducting any money used for capital expenditures and before paying interest. Purchases of long-term fixed assets, such as property and equipment, are known as capital expenditures, or CAPEX. The cash generated by regular business operations or activities is known as operating cash flow. A company's operating cash flow reveals if it generates enough positive cash flow to

[11] Graham, Benjamin, and David Dodd. "Security Analysis: Foreword by Warren Buffett (Security Analysis Prior Editions).", Pages 391 - 399

maintain and expand its operations. When evaluating competitors in the same or similar businesses or assessing a firm that is being evaluated for investment, operating cash flow, free cash flow, and earnings are all crucial variables.

### 3.3.2. Operating Cash Flow

The financial metric denoted as operating cash flow, or OCF, represents the funds generated through a company's routine operational endeavors within a specific timeframe. The computation of OCF commences with the net income figure, located at the lowermost section of the income statement, and involves the reinstatement of any non-cash components while also accommodating adjustments for variations in net working capital. The consolidated statement of cash flows encompasses operating activities as its initial segment, succeeded by investment activities and financing activities. Furthermore, this statement provides a comprehensive overview, incorporating the initial cash balance, the aggregate alterations over the reporting period, and the closing balance, in addition to these three principal sections. How the operating section works:

1. The bottom line of the income statement (net income) is used as the starting point.
2. All non-cash items are "added back":
    a. Depreciation
    b. Stock-based compensation
    c. Unrealized gains or losses or accrued items
    d. Deferred taxes
3. Change in working capital:
    a. Inventory goes up (reduction in cash) or goes down (increase in cash)

b. Account receivables: if they increase, there's a reduction in cash since not all the revenues registered have been paid.
c. Account payables

The amount is listed as "Net cash provided by (used in) operating activities" at the bottom of the operating cash flow section. The line, which indicates the total for the time period, is the sum of all the items above it. Capital expenditures are not included in operating cash flow (the investment required to maintain capital assets).

### 3.3.3. EBIT vs OCF

Operating income, also known as EBIT (Earnings Before Interest and Taxes), stands as a separate entity from operational cash flow, denoted as OCF, which represents the cash inflow stemming from a company's routine business activities. The pivotal distinction lies in OCF's encompassment of interest and tax expenses, along with other operational outlays, as integral components of a company's standard operations. The operating cash flow ratio serves as an indicator of a business's capability to meet its financial obligations using its current cash inflows. The calculation involves dividing operating cash flow by current liabilities. A ratio exceeding 1.0 signifies that the business possesses a solid financial footing, enabling it to meet its obligations without accumulating additional debt.

### 3.3.4. OCF vs EPS

Operating cash flow is distinct from net income and earnings per share (EPS)[12], two of the most often used financial indicators. The main distinction can be boiled

[12] Almeida, Heitor. "Is it time to get rid of earnings-per-share (EPS)?." *Review of Corporate Finance Studies* 8.1 (2019): 174-206.

down to accounting principles like matching and accrual principles. All types of expenses are included in the net income, some of which may have been paid for in full and others of which may have simply arisen from accounting rules (such as depreciation). However, a considerable disparity between OCF and net income may be caused by a company's revenue recognition principle and matching of expenses to the timing of revenues. The straightforward assertion that one number consistently surpasses or falls short of the other is not accurate.

### 3.3.5. Free Cash Flow

The financial performance of an organization is quantified by free cash flow (FCF). It displays the available cash that a business can generate after deducting the cost of key investments like property investment, equipment, and other assets from its operating cash flow. FCF, or free cash flow, evaluates a company's capacity to generate the kind of cash that investors value most: cash that may be allocated at the discretion of management. For instance, while having $30 million in operating cash flow, a corporation must nevertheless spend $5 million a year on capital asset maintenance. For this reason, there is only $25 million of FCF available, unless managers and investors desire the company to downsize.

People may be referring to one of several metrics.

Referred to as 'Levered Free Cash Flow,' free cash flow to equity represents a financial metric derived by taking the operating cash flow and deducting capital expenditures, while incorporating net debt issued (or subtracting net debt repayment) in the calculation. FCFE only indicates the cash flow accessible to equity investors since it includes interest expense paid on debt and net debt issued or repaid (interest to debt holders has already been paid). The equity value of a company is calculated using FCFE (Levered Free Cash Flow) in financial modeling.

The computation of Free Cash Flow to the Firm, also recognized as Unlevered Free Cash Flow, involves multiple stages. This financial metric plays a pivotal role in Discounted Cash Flow analysis, aiding in the determination of Enterprise Value, which signifies the comprehensive value of the entire firm. FCFF is a projection that approximates the firm's financial standing under the hypothetical scenario of operating without any debt.

How to calculate it:

1. Use EBIT as starting point.
2. Estimate the company’s tax bill and subtract it from EBIT, to obtain the UNLEVERED NET INCOME
3. Add back depreciation and amortization.
4. Deduct any increase in non-cash working capital.
5. Deduct CAPEX

### 3.3.6. Free Cash Flow Applications

By comprehending the free cash flow of the company, the management can strategically determine future endeavors, which may encompass short-term investments or expansion initiatives, all designed to enhance shareholder value. Additionally, a robust free cash flow position serves as a reliable indicator of the company's capability to meet its financial commitments. Unlike earnings, free cash flow offers a more transparent assessment of the company's capacity to generate cash and profits. For prospective investors, companies exhibiting a strong free cash flow coupled with an attractive share price often attract attention. When evaluated alongside other key metrics, free cash flow emerges as a pivotal consideration for investors, given its substantial role in influencing stock valuation.

FCF can offer significant insights into a company's value and the strength of its fundamental trends because it takes changes in working capital into account. A drop in accounts payable may indicate that merchants want their money faster. A drop in accounts receivable could indicate that the company is being paid by its clients more swiftly. An increase in inventory could be a sign of a growing stockpile of goods that haven't been sold. The income statement lacks information that can be learned by including working capital in a measure of profitability. Assume, for illustration, that a business has earned $10,000,000 in net profits every year for the previous ten years. On the surface, that appears consistent, but what if FCF has been declining over the previous two years due to a rise in inventories, a beginning of payment delays by customers, and a rise in vendor demands for quicker payments from the company? In this case, FCF would disclose a significant financial vulnerability that wasn't noticeable by just looking at the income statement.

FCF can also be used as a starting point by long-term investors or lenders to determine whether the firm is likely to be able to pay expected dividends or interest. A lender would have a better notion of the quality of cash flows available for new borrowings if the company's debt payments were subtracted from free cash flow to the firm (FCFF). Similarly, shareholders can utilize FCF less interest expenses to assess the anticipated consistency of future dividend payments. To assess the impact of dilution, free cash flow is frequently examined on a per-share basis, much like how sales and earnings are.

Assume that a business has EBITDA of $1,000,000 per year. The working capital (current assets minus current liabilities) of this business hasn't changed, but towards the end of the year, they bought new equipment for $800,000. Depreciation will be used to stretch out the cost of the new equipment over time on the income statement, balancing the effect on earnings. Yet, because FCF takes into account the cash invested in new equipment during the current year, the business will report $200,000 FCF ($1,000,000 EBITDA - $800,000 equipment) on $1,000,000 of EBITDA for that year. EBITDA and FCF will be identical once more the next year, assuming nothing else changes and no new equipment is purchased. In this case, a potential investor must decide why FCF dropped so sharply one year before rising again and whether the trend is likely to persist. More insights can be gained by comprehending the depreciation mechanism being applied. For instance, depending on the amount of depreciation taken each year of the asset's useful life, net income and FCF will vary. If the asset is being depreciated over a useful life of 10 years using the book depreciation method, then net income will be $80,000 ($800,000 / 10 years) less than FCF for each year until the asset is entirely depreciated. On the other hand, if the asset is being depreciated according to the tax depreciation method, the asset will be fully depreciated in the year it was purchased, resulting in net income that equals FCF in later years.

What really makes for good free cash flow? Many companies have poor stock trends and very strong free cash flow. The analysis can be kept simpler by using the FCF trend. Rather than focusing on the absolute quantities of FCF, earnings, or revenue, technical analysts emphasize the fundamental performance pattern over time. A good FCF trend should, on average, be connected with positive stock price movements if stock prices are a result of the underlying fundamentals. Using the consistency of FCF trends as a risk indicator is a typical strategy. Bullish movements in the stock are less likely to be reversed in the future if the trajectory of FCF has been constant during the last five years. Falling FCF patterns, particularly those that deviate significantly from earnings and sales trends, however, suggest a greater likelihood of future poor price performance. This strategy ignores FCF's absolute value in favor of concentrating on its slope and how it relates to price performance.

### 3.3.7. Free Cash Flow Interpretation

Investors should be on guard if there is a significant divergence between the company's revenue and earnings statements and its cash flow, as this may indicate trouble for the business. Diverging trends like this may exist in a corporation because management is spending money on real estate, machinery, and equipment to expand the company. This scenario may be advantageous for the stock price if FCF + CapEx were still moving upward.

Poor cash flows may also be a symptom of ineffective inventory management. If too many resources are used to store unsold goods, even a company with robust sales and income may have reduced cash flows. These numbers could lead a cautious investor to draw the conclusion that the business may be experiencing weak demand or ineffective cash management.

Inventory changes or a change in accounts payable and receivable can both affect working capital. If a company's sales are having trouble, they can decide to offer their customers longer payment terms, which would ultimately result in a reduction in FCF. Alternatively, a company's suppliers may be no longer as eager to give credit and now want quicker payment. That will result in a decrease in accounts payable, which will affect FCF negatively. This specific type of credit issue plagued numerous solar enterprises in the late 2000s and early 2010s. Offering clients more favorable terms may increase sales and earnings. Since this problem was well-known within the sector, suppliers were less inclined to grant terms and preferred to receive payment from solar companies more quickly. Yet, a glance at the income statement alone did not instantly reveal the discrepancy between the fundamental patterns in this case.

### 3.3.8. Which metric should be used?

EBITDA is advantageous since it is simple to compute and widely reported. On the negative side, EBITDA can sometimes be distant from cash flow. The benefit of operating cash flow is that it is simple to extract from the cash flow statement and accurately depicts cash flow for the time. The drawback is that it is subject to "noise" from transient changes in working capital that can skew the data. FCFE is valuable since it is simple to compute and gives a genuine picture of cash flow after taking capital investments to support the firm into account. On the negative side, since most financial models are constructed using an enterprise value (unlevered) basis, more research is required. FCFF is useful because it closely correlates with the firm's economic value (on its own, without the effect of leverage). The drawback is that it necessitates study and suppositions regarding the size of the firm's unlevered tax bill. The majority of DCF models are valued using this indicator as the foundation.

## Elica Case no. 2

To comprehensively assess a company's financial health and performance, it is crucial to examine a range of financial indicators that provide insights into different aspects of the company's operations and financial management. The indicators chosen for this analysis serve this purpose by shedding light on the company's liquidity, leverage, cash flow growth, and investment in operations.

**Liquidity Ratios (Current Ratio and Quick Ratio)**: these ratios provide insights into the company's ability to meet its short-term obligations, which is a key aspect of financial stability. A company with strong liquidity is better equipped to navigate short-term financial challenges and seize business opportunities as they arise.

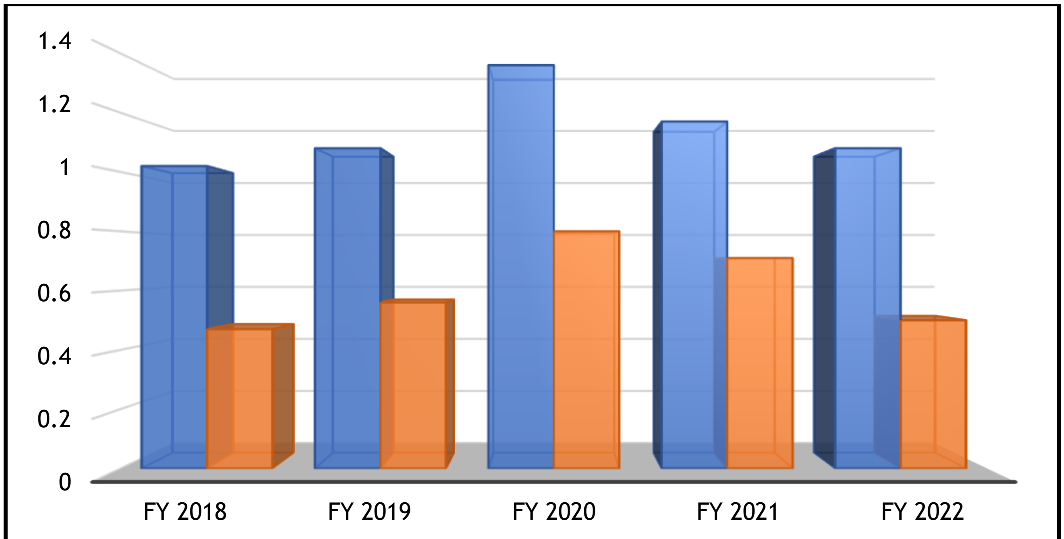
**Leverage Ratios (Financial Leverage and Debt/Equity)**: these ratios measure the extent to which the company is financed by debt versus equity. High leverage can increase a company's risk, as it implies a higher burden of debt repayments. However, it can also enhance returns for equity holders when the company is performing well. Understanding a company's leverage is therefore crucial for assessing its financial risk and return potential.

**Cash Flow Growth (Operating Cash Flow Growth % YOY and Free Cash Flow Growth % YOY)**: these indicators measure the growth in the company's cash flows, which are a vital sign of financial health. Unlike earnings, which can be influenced by various accounting decisions, cash flows provide a more direct measure of the money flowing in and out of the company.

**Capital Expenditure and Cash Flow Ratios (Cap Ex as a % of Sales, Free Cash Flow/Sales %, Free Cash Flow/Net Income, Free Cash Flow/Share)**: these ratios provide insights into the company's investment in its operations and its ability to generate cash after accounting for this investment. They are important for understanding the company's growth strategy and its efficiency in converting sales and earnings into cash.

By examining these financial indicators, we can gain a comprehensive understanding of the company's financial health and performance and make informed predictions about its future prospects.

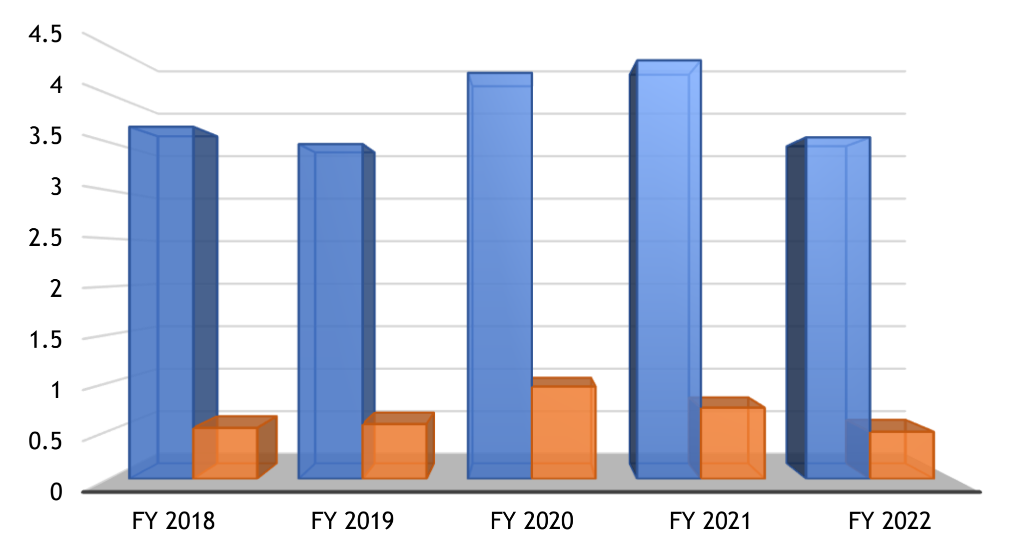
The Current Ratio, which compares all of a company's current assets to its current liabilities, has remained above 1 throughout the period, indicating that the company has more than enough short-term assets to cover its short-term liabilities. The Quick Ratio, which excludes inventory from current assets, has also remained above 0.5, suggesting that the company can cover its short-term liabilities even without selling its inventory. The increase in these ratios in 2020 indicates that the company effectively managed its working capital during the pandemic, by reducing its inventory or increasing its cash reserves.




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Current Ratio | 1.02 | 1.08 | 1.36 | 1.17 | 1.08 |
| Quick Ratio | 0.47 | 0.56 | 0.8 | 0.71 | 0.5 |

*Figure 18 Current & Quick Ratio*

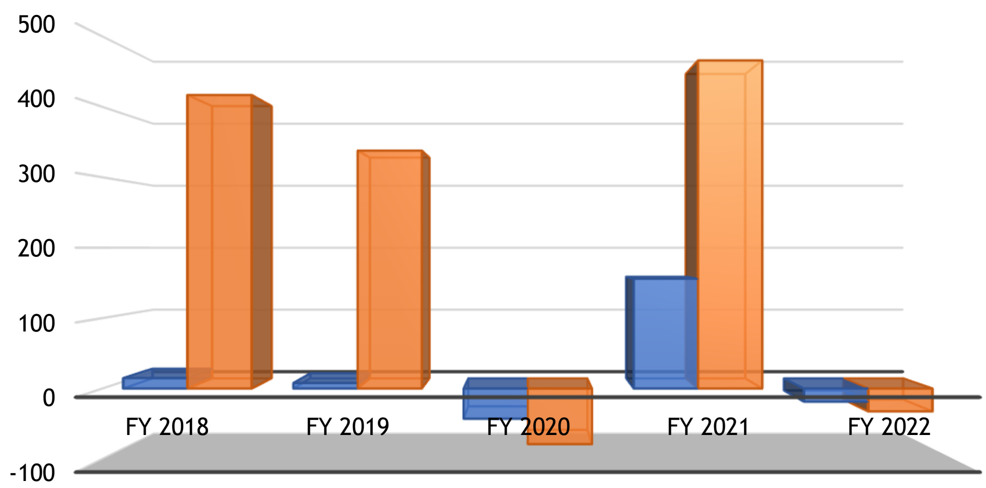
The Financial Leverage ratio, which compares the company's total assets to its equity, increased in 2020, suggesting that the company took on more debt during the pandemic. However, it decreased in 2022, indicating that the company has been reducing its debt and/or increasing its equity. The Debt/Equity ratio, which compares the company's total debt to its equity, shows a similar trend. The company's ability to reduce its leverage ratios in the post-pandemic period suggests effective debt management and improved financial stability.




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Financial Leverage | 3.66 | 3.48 | 4.22 | 4.35 | 3.55 |
| Debt/Equity | 0.53 | 0.57 | 0.96 | 0.74 | 0.49 |

*Figure 19 Financial Leverage & Debt/Equity*

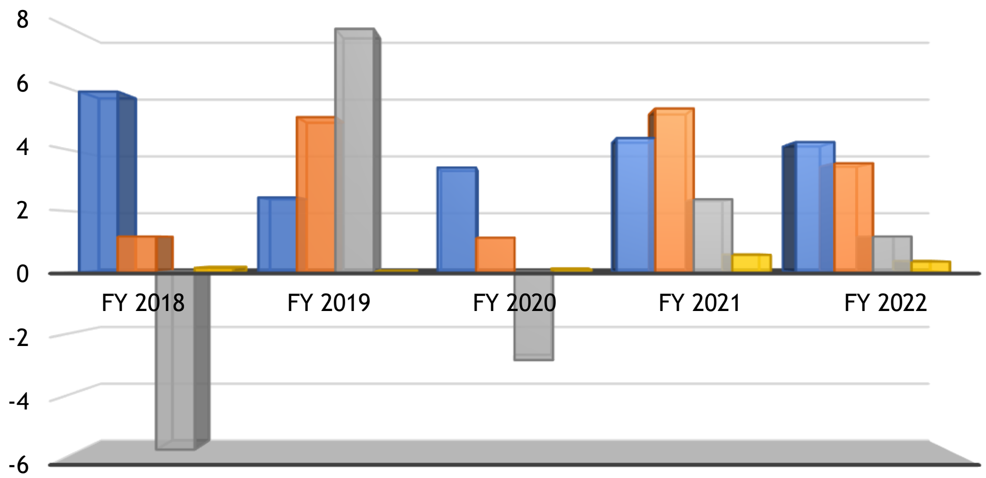
**Cash Flow Growth (Operating Cash Flow Growth % YOY and Free Cash Flow Growth % YOY)**: the negative growth in 2020 can be attributed to the impact of the pandemic, which may have reduced the company's cash inflows from operations or increased its cash outflows for expenses. However, the strong rebound in 2021 indicates that the company was able to recover its cash flows, by increasing its sales, reducing its costs, and managing its working capital more effectively. The decrease in 2022 suggests a return to more normal cash flow growth after the exceptional recovery in the previous year.




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Operating Cash Flow Growth % YOY | 14.89 | 7.84 | -42.88 | 155.69 | -18.59 |
| Free Cash Flow Growth % YOY | 416.79 | 337.8 | -78.98 | 465.88 | -32.45 |

*Figure 20 OCF & FCF Growth*

**Capital Expenditure and Cash Flow Ratios (Cap Ex as a % of Sales, Free Cash Flow/Sales %, Free Cash Flow/Net Income, Free Cash Flow/Share)**: these ratios measure the company's investment in its operations and its ability to generate cash after accounting for this investment. The relatively stable Cap Ex as a % of Sales suggests consistent investment in the company's operations. The Free Cash Flow/Sales % and Free Cash Flow/Net Income ratios have shown some volatility but have generally remained positive, indicating that the company has been able to generate cash after accounting for capital expenditures. The increase in Free Cash Flow per Share suggests an improvement in the return to the shareholders, which could be due to increased cash flows, reduced share count, or a combination of both.




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Cap Ex as a % of Sales | 5.88 | 2.44 | 3.41 | 4.37 | 4.24 |
| Free Cash Flow/Sales % | 1.17 | 5.05 | 1.13 | 5.33 | 3.55 |
| Free Cash Flow/Net Income | -5.76 | 7.92 | -2.85 | 2.38 | 1.17 |
| Free Cash Flow/Share | 0.15 | 0.02 | 0.09 | 0.57 | 0.35 |

*Figure 21 Capex & FCF Ratios*

In conclusion, the company has demonstrated strong financial management over the period. The company has been able to maintain its liquidity, manage its leverage, and generate positive cash flows. The company's financial performance is a testament to its operational efficiency, effective pricing strategy, and ability to adapt to changing market conditions.

## 3.4. DCF ANALYSIS

The term "discounted cash flow" (DCF)[13] refers to a financial technique for estimating future cash flows generated by an investment and discounting them back to their present value using a discount rate that takes into account both the risk and time value of money. It is an essential instrument for determining the worth of a business or investment opportunity. In corporate finance, investment banking, and other financial fields, it is widely employed. The DCF is a projection of a company's unlevered free cash flow discounted back to today's value, also known as the Net Present Value. The decision-making process for capital budgeting and operating expenses can both benefit from discounted cash flow analysis.

The opportunity should be considered if the calculated DCF value is higher than the investment's current cost. Before taking action, more investigation and analysis may be required if the computed value is less than the cost, signaling that the opportunity may not be a good one. The DCF technique, together with its presumptions, elements, and limits, will be covered in detail in this section.

### 3.4.2. DCF Functioning

The business's cash flow is discounted back to a certain date, usually the present. According to the theory of the time value of money, there are several factors that contribute to the discounted value of cash flow, but they can all be boiled down to opportunity cost and risk. According to the time value of money theory, a dollar that you have today is worth more than a dollar that you will get tomorrow since it

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[13] Jennergren, L. Peter. "A tutorial on the discounted cash flow model for valuation of companies." *SSE/EFI Working paper series in business administration* 1998.1 (2011): 1-55.

can be invested. Thus, a DCF analysis is helpful in any circumstance where a person is making a current payment with the hope of getting a future payment of more money. The needed rate of return expected by an investor is represented by a company's weighted average cost of capital.

The cost of equity and debt financing, weighted by their respective proportions in the company's capital structure, is calculated as the weighted average cost of capital, or WACC[14]. While using the DCF method, the cash flows are discounted using the WACC. Thus, it can also be considered as a company's opportunity cost, which means that if they can't find a higher rate of return elsewhere, they should buy back their own shares. A corporation is considered to be "creating value" to the extent that it produces rates of return that are higher than its hurdle rate, which is its cost of capital. They are said to be "burning value" if they are generating returns that are less than their cost of capital.

The expected rate of return for investors typically correlates with the investment's risk. As a result, the greater the required rate of return and the higher the cost of capital, the riskier the investment. The requirement for more discounting arises from the riskier and longer-term nature of the cash flow.

### 3.4.3. Key Concepts before starting with the DCF

**Cash flow** is the money that a company generates and can either distribute to investors or reinvest back into the company. Unlevered free cash flow, also known as free cash flow to the firm, is money that is available to both stock and debt investors. A company's economics may be compromised if it has a positive net

[14] Farber, André, Roland L. Gillet, and Ariane Szafarz. "A General Formula for the WACC." *International Journal of Business* 11.2 (2006).

income but a negative cash flow. Investors value cash, not accounting profit, in the truest sense.

**The Weighted Average Cost of Capital** (WACC) is a financial metric used to calculate the minimum return that a company must earn in order to satisfy all of its investors, both equity and debt holders. It is calculated by taking the weighted average of the cost of each type of financing that a company has, such as debt and equity.

The formula for calculating the WACC is as follows:

***WACC = ((E/V) x Re) + ((D/V) x Rd) x (1 - Tc)***

Where:

- E = Market value of the firm's equity
- D = Market value of the firm's debt
- V = Total value of the firm (E + D)
- Re = Cost of equity
- Rd = Cost of debt
- Tc = Corporate tax rate

The formula above can be broken down into several components. First, the market value of the firm's equity and debt are determined, which represents the total value of the firm. Next, the cost of equity and debt are calculated, which represent the minimum return that investors in each type of financing require.

The cost of equity is the rate of return that investors require on their investment in the company's stock. This rate of return is typically higher than the cost of debt, as equity investors assume more risk than debt holders. The cost of equity is often estimated using the Capital Asset Pricing Model (CAPM), which takes into account the risk-free rate of return, the market risk premium, and the beta of the company's stock.

The cost of debt is the rate of return that lenders require on their loans to the company. This rate of return is typically lower than the cost of equity, as lenders assume less risk than equity investors. The cost of debt can be estimated by taking the interest rate on the company's outstanding debt, adjusted for any tax benefits from deducting interest payments.

The final component of the WACC formula is the corporate tax rate, which reduces the overall cost of debt for the company. By deducting interest payments from taxable income, the company reduces its overall tax liability, which in turn reduces the cost of debt.

Let's take a look at an example to illustrate how the WACC is calculated.

Suppose a company has $50 million in equity and $50 million in debt, for a total value of $100 million. The cost of equity is estimated to be 12%, while the cost of debt is 6%. The corporate tax rate is 30%.

Using the WACC formula, we can calculate the company's WACC as follows:

WACC = ((50/100) x 0.12) + ((50/100) x 0.06) x (1 - 0.30) = 8.4%

Therefore, the company must earn a minimum return of 8.4% on its investments in order to satisfy all of its investors. The WACC is a critical financial metric that companies use to determine the minimum return they must earn.

**CAPM**[15] is a model used to determine the expected return on an asset, given its risk and the market risk premium. The model assumes that investors are rational and risk-averse and that they are concerned with the return and risk of their overall portfolio, rather than the return and risk of individual assets.

The formula for the CAPM is as follows:

r = rf + beta * (rm - rf)

where:

r = expected return on the asset

rf = risk-free rate

beta = asset's beta (systematic risk)

rm = expected return on the market

rm - rf = market risk premium

The **risk-free**[16] rate is the rate of return on a risk-free asset, such as government bonds, which is considered to have no risk. The market risk premium is the excess return that investors demand for holding a risky asset over and above the risk-free rate.

[15] Jagannathan, Ravi, and Ellen R. McGrattan. "The CAPM debate." *Federal Reserve Bank of Minneapolis Quarterly Review* 19.4 (1995): 2-17.
[16] https://www.wallstreetprep.com/knowledge/risk-free-rate/

**Beta**[17] is a measure of the systematic risk of an asset, which is the risk that cannot be diversified away by adding more assets to a portfolio. Beta is calculated as the covariance of the asset's return with the market return, divided by the variance of the market return.

The CAPM assumes that the market portfolio is efficient, which means that it is a portfolio of all assets in the market that provides the highest return for a given level of risk. According to the CAPM, the market portfolio is the only risky asset that investors should hold, since it provides the highest return for a given level of risk. Therefore, the expected return on any asset is determined by its beta, or systematic risk, relative to the market portfolio. If an asset has a beta of 1, its expected return is equal to the market return. If an asset has a beta greater than 1, its expected return is higher than the market return, and if an asset has a beta less than 1, its expected return is lower than the market return.

For example, suppose the risk-free rate is 3%, the expected return on the market is 8%, and the beta of an asset is 1.5. Using the CAPM formula, we can calculate the expected return on the asset as follows:

$r = 3\% + 1.5 * (8\% - 3\%)$ $r = 3\% + 1.5 * 5\%$ $r = 3\% + 7.5\%$ $r = 10.5\%$

Therefore, the expected return on the asset is 10.5%.

The CAPM has several assumptions and limitations, including the assumption of a single risk factor (the market portfolio), the assumption of linear relationships between returns, and the assumption of homogenous expectations among investors.

[17] https://www.bankrate.com/investing/use-beta-to-evaluate-stock-risk/

Additionally, the CAPM does not consider factors such as liquidity risk, credit risk, and inflation risk, which can affect asset prices and returns. Despite its limitations, the CAPM remains a widely used model in finance for estimating the expected return on an asset, and it provides a framework for understanding the relationship between risk and return in financial markets.

### 3.4.4. DCF Assumptions

Understanding the DCF method's basic assumptions is crucial before delving into its workings. First, the DCF technique presupposes that an investment's value is determined by its forecasted future cash flows. Second, it presumes that reasonable precision can be achieved in the estimation of future cash flows. Thirdly, it is predicated that the rate of discounting future cash flows accounts for the risk and opportunity cost of the investment opportunity. Finally, it considers that the investment will be kept for a set amount of time and that the cash flows produced during that time will be reinvested at the discount rate.

### 3.4.5. DCF Components

The terminal value, discount rate, and cash flow prediction are the three basic parts of the DCF approach.

Calculating the projected cash flows that the investment will provide is the first stage. This can be accomplished by estimating the cash flows for a given time frame, often 5 to 10 years. All sources of income, including revenue, interest, and dividends, as well as all expenses, including operational costs, capital expenses, and taxes, should be included in the cash flows. While estimating the cash flows, it's crucial to make realistic assumptions that take into consideration past performance, current market conditions, and anticipated future outcomes.

Understanding the business and the market where it competes in great depth is necessary for forecasting future cash flows. For the DCF value to be accurate, the cash flow prediction must be of high quality. Analysts forecast the anticipated cash flows using a variety of methodologies, including market research, management interviews, and historical financial data analysis.

The rate at which future cash flows are discounted to their present value is known as the discount rate. The discount rate considers both the risk associated with the investment opportunity and the time worth of money. The risk-free rate, which is the rate of return on a risk-free investment, such as a government bond, plus a risk premium, which is the additional return necessary to account for the risk associated with the investment opportunity, should serve as the foundation for the discount rate. Market risk, credit risk, and liquidity risk are a few examples of the particular risk variables that should be considered when determining the risk premium. The cost of capital for the investment, which includes the cost of debt and equity financing, is often the basis for the discount rate. The rate of return sought by investors to maintain ownership of a share of the company's stock is known as the cost of equity. It displays the return and risk expectations of equities investors. The interest rates a corporation pays on its debt constitutes the cost of debt. It exhibits the firm's credit risk.

Terminal value is the present value of all future cash flows beyond the projection period (usually 5-10 years). The projection period is determined by the analyst and depends on various factors such as industry capacity, competitive dynamics and operational cycle. The terminal value can be calculated using two main methods -

Perpetuity Growth and Exit Multiple[18]. In the perpetuity growth method, the terminal value is determined by estimating the cash flow for the final year of the projection period and then applying a growth rate in perpetuity. The growth rate can be based on various factors such as inflation, GDP growth and industry growth. On the other hand, the exit multiple method is commonly used for mature or declining businesses. The terminal value is calculated by taking the projected cash flows for the final year of the projection period and then multiplying it by a multiple factor. The multiple factors can be based on various factors such as industry benchmarks, comparable transactions, and earnings multiples.

### 3.4.6. Procedure

**Forecasting revenues**

There are various methods for creating a revenue prediction, and they can be divided into two groups: growth-based methods and driver-based methods. For steady, established firms where a straightforward year-over-year growth rate can be employed, a growth-based projection is easier to understand and makes sense. This is adequate for many DCF models. A forecast that is based on drivers is more intricate and difficult to create. It necessitates breaking down revenue into its many components, including price, volume, products, clients, market share, and outside variables. To ascertain the connection between underlying drivers and top-line revenue growth, regression analysis is frequently utilized as a component of a driver-based prediction.

[18] Janiszewski, Sławomir. "How to perform discounted cash flow valuation?." *Foundations of management* 3.1 (2011): 81-96.

**Forecasting expenses**

The process of creating a spending estimate might be highly intricate and granular, or it can be as straightforward as comparing one year to the next. The most thorough method is known as a Zero-Based Budget[19] and calls for creating the expenses from start without taking into account what was spent the previous year. Every expense that a department incurs is typically required. This strategy is frequently applied when financial controls are being implemented or when costs are being lowered. It can only be done effectively by corporate managers internally, not by outsiders like investment bankers or equities research analysts.

**Forecasting capital assets and changes in working capital**

It is time to forecast the capital assets once much of the income statement has been completed. PP&E is frequently the biggest line item on the balance sheet, hence capital expenditures (CapEx) and depreciation need to be represented separately. The most thorough method is to make a distinct DCF model plan for each of the significant capital assets, then combine those schedules into a single schedule. There will be multiple lines on each capital asset schedule, including opening balance, CapEx, depreciation, dispositions, and closing balance. Accounts receivable, accounts payable, and inventory all affect working capital, thus their impact on cash flow must be determined and added or subtracted from the total.

**Forecasting capital structure**

The most popular strategy is to maintain the company's current capital structure, assuming no significant changes outside of recognized factors like debt maturity.

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[19] https://www.deloitte.com/an/en/services/consulting/perspectives/gx-zero-based-budgeting.html

This step is not that crucial to the DCF model because it’s been utilizing unlevered free cash flow. Yet, if things are considered from the viewpoint of a stock investor or an equities research analyst, it is significant. Since it is more pertinent for M&A transactions, where the complete firm is bought or sold, investment bankers frequently concentrate on enterprise value.

**Terminal Value**

A DCF model's terminal value is a crucial component. It frequently accounts for more than 50% of the company's net present value, particularly if the projected term is five years or less. The perpetual growth rate technique and the exit multiple technique are the two methods used to determine the terminal value. According to the perpetual growth rate methodology, the cash flow created at the conclusion of the projected period will continue to increase at a constant rate indefinitely. According to the exit multiple strategy, the company will be sold for the price that a "fair bidder" would offer to buy it. Typically, this refers to an EV/EBITDA multiple that is at or very close to the current market values for comparable companies. The NPV of the terminal value is then calculated by discounting that value back to the present.

**Enterprise value or Equity Value**

The NPV is always the business's enterprise value (EV) when creating a DCF model using unlevered free cash flow. This is what is required to value the entire business or to compare it to other companies without taking their financial structures into consideration (i.e., same-level comparison). Enterprise value will be the main consideration in most investment banking deals. The NPV of the unlevered free cash flow should be calculated and adjusted for cash and equivalents, debt, and any minority interests if the equity valuation of the company is required. The equity value that results from this can then be divided by the total number of shares to obtain the share price. Institutional investors and stock research analysts are more likely to use this strategy because they are both considering purchasing or selling shares. When the DCF model is finished (the NPV of the firm has been calculated), a sensitivity analysis layer should be added to see what range of values the business might be worth when certain drivers or assumptions in the model change.

### 3.4.7. Limitations

The DCF technique is an effective tool for valuing assets that can shed light on the worth of a company or an investment opportunity. It does, however, include several restrictions and presumptions. For instance, the DCF technique bases its calculations on the assumptions that the cash flows are predictable, the discount rate stays the same during the forecast period, and the cash flows continue to increase at a steady rate after the forecast period. These presumptions could not be accurate. The DCF approach is used in practice due to its flexibility and intuitiveness despite its drawbacks. In addition to real estate, equities, and bonds, it may be used to appraise a wide range of investment alternatives.

### 3.4.8. Advantages

Investors and businesses can determine the value of a proposed investment using discounted cash flow analysis. The approach is applicable to many investments and capital projects where it is possible to anticipate future cash flows with reasonable accuracy. Its projections can be changed to provide varied outcomes for different what-if scenarios. Users can utilize this to take into account various projections that could be made.

### 3.4.9. Disadvantages

Discounted cash flow analysis is inherently limited by the fact that it relies on estimates rather than concrete figures, representing one of its primary drawbacks. Consequently, the DCF outcome also represents a well-informed estimation rather than an exact certainty. So, for DCF to be effective, both institutions and individual investors must accurately predict cash flows and a discount rate. The market demand, the state of the economy, technology, competition, and unforeseen dangers or opportunities are just a few of the variables that affect future cash flows. They cannot be precisely measured. Investors' decision-making depends on their awareness of this inherent disadvantage. Even if reliable projections can be obtained, DCF shouldn't necessarily be the only method used. While assessing an investment opportunity, investors should also take other, well-known factors into consideration. The use of comparable company analysis and precedent transactions are two more popular valuation techniques.

### 3.4.10. Warren Buffet Consideration[20]

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*"The first investment primer that I know of, and it was pretty good advice, was delivered in about 600 B.C. by Aesop. And Aesop, you'll remember, said 'A bird in the hand is worth two in the bush,'"* ***Warren Buffett said at the 2000 Berkshire Hathaway [21]Annual Meeting****. "Now, Aesop was onto something, but he didn't finish it, because there's a couple of other questions that go along with that. But it is an investment equation, a bird in the hand is worth two in the bush. He forgot to*

[20] https://mazorsedge.com/lessons-from-warren-buffett-what-aesop-got-right-about-investing/
[21] https://www.berkshirehathaway.com/

*say exactly when you were going to get the two in the — from the bush — and he forgot to say what interest rates were that you had to measure this against. But if he'd given those two factors, he would have defined investment for the next 2,600 years. Because a bird in the hand is, you know, you will trade a bird in the hand, which is investing. You lay out cash today. And then the question is, as an investment decision, you have to evaluate how many birds are in the bush. You may think there are two birds in the bush, or three birds in the bush, and you have to decide when they're going to come out, and when you're going to acquire them.*

*Now, if interest rates are five percent, and you're going to get two birds from the bush in five years, we'll say, versus one now, two birds in the bush are much better than a bird in the hand now. So, you want to trade your bird in the hand and say 'I'll take two birds in the bush,' because if you're going to get them in five years, that's roughly 14 percent compounded annually and interest rates are only five percent. But if interest rates were 20 percent, you would decline to take two birds in the bush five years from now. You would say 'that's not good enough,' because at 20 percent, if I just keep this bird in my hand and compound it, I'll have more birds than two birds in the bush in five years.*

*Now, what's all that got to do with growth? Well, usually growth, people associate with a lot more birds in the bush, but you still have to decide when you're going to get them. And you have to measure that against interest rates, and you have to measure it against other bushes, and other, you know, other equations.*

*And that's all investing is. It's a value decision based on, you know, what it is worth, how many birds are in that bush, when you're going to get them, and what interest rates are."*

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## 3.5. PE & PEG

The price-to-earnings (P/E) [22]ratio is a commonly used metric to evaluate the valuation of a company's stock. It represents the current market price of a share divided by its earnings per share (EPS) over a given period, usually the past 12 months. However, the P/E ratio can be misleading as it can be affected by short-term fluctuations in earnings or by one-time events, such as mergers or acquisitions. To address this issue, investors use the concept of normalized P/E, which adjusts the earnings used in the calculation of the P/E ratio to account for these fluctuations. Normalized P/E is calculated by dividing the current market price of a share by the normalized EPS. Normalized EPS is the earnings per share that a company would have earned if its earnings had been stable and consistent over a longer period, usually five to ten years. Normalized P/E is a more accurate measure of a company's valuation as it removes the effect of short-term fluctuations and provides a more stable basis for comparison across different companies or industries. However, calculating normalized EPS requires some assumptions about the company's future earnings growth rate, which can be difficult to estimate.

There are several methods for calculating normalized EPS, including the cyclically adjusted P/E (CAPE) ratio[23], which considers the business cycle and adjusts earnings accordingly, and the adjusted EPS, which removes the effect of non-recurring items from earnings. Investors should carefully consider the method used

[22] Lynch, Peter, and John Rothchild. *One up on Wall Street: how to use what you already know to make money in the market*. Simon and Schuster, 2000.
[23] Siegel, Jeremy J. "The Shiller CAPE ratio: A new look." *Financial Analysts Journal* 72.3 (2016): 41-50.

to calculate normalized EPS and the underlying assumptions before making investment decisions.

In summary, normalized P/E is a useful metric for evaluating a company's valuation as it adjusts for short-term fluctuations in earnings. Investors should carefully consider the method used to calculate normalized EPS and the underlying assumptions before making investment decisions.

The price-to-earnings to growth (PEG) [24]ratio is another valuation metric that investors use to evaluate a company's stock. The PEG ratio considers the company's growth rate in addition to its P/E ratio. The PEG ratio is calculated by dividing the P/E ratio by the company's earnings growth rate. The PEG ratio is a more comprehensive valuation metric than the P/E ratio alone as it takes into account the company's growth potential. A company with a low PEG ratio, meaning a relatively low P/E ratio and high growth rate, may be considered undervalued compared to a company with a high PEG ratio, meaning a relatively high P/E ratio and low growth rate.

When calculating the PEG ratio, it is important to use a realistic estimate of the company's future earnings growth rate. The growth rate should be based on historical growth rates, industry trends, and future prospects. The PEG ratio is particularly useful for evaluating growth companies or companies in emerging industries where the earnings growth rate is expected to be high. However, the PEG ratio also has some limitations. It assumes that the company's earnings growth rate will remain constant over time, which may not be the case. In addition, the PEG

[24] Aswath Damodaran, *The Little Book of Valuation How to Value a Company, Pick a Stock and Profit,* Pages 54 - 62

ratio does not take into account other factors that may affect the company's valuation, such as its competitive position, management quality, and economic conditions.

In summary, the PEG ratio is a useful valuation metric that considers a company's growth potential in addition to its P/E ratio. However, it is important to use a realistic estimate of the company's future earnings growth rate and to consider other factors that may affect the company's valuation.

## 3.6. ROI, ROA & ROE

**ROE**[25], or Return on Equity, is a financial ratio that measures the amount of net income generated by a company in relation to the amount of equity invested in the company by shareholders. In other words, ROE is a measure of how efficiently a company is using shareholder funds to generate profits.

The formula for calculating ROE is:

***ROE = Net Income / Shareholders' Equity***

Net Income is the amount of profit a company generates after all expenses and taxes have been paid. Shareholders' Equity is the amount of money invested in the company by shareholders, which includes both common stock and retained earnings.

[25] https://www.businessinsider.com/personal-finance/return-on-equity?r=US&IR=T

ROE is expressed as a percentage and is often used by investors to evaluate the profitability of a company. A higher ROE indicates that a company is generating more profit for each dollar of shareholder equity, which is generally seen as a positive sign.

However, it's important to note that a high ROE can also indicate that a company is taking on a lot of debt to finance its operations, which can be risky. Additionally, some industries, such as utilities and telecom, tend to have lower ROEs due to their capital-intensive nature.

ROE can be broken down further into two components: net profit margin and asset turnover. Net profit margin is the percentage of revenue that a company retains as profit after all expenses have been paid. Asset turnover is the amount of revenue a company generates for each dollar of assets it owns.

The formula for calculating ROE using these components is:

***ROE = Net Profit Margin x Asset Turnover x Leverage***

Leverage refers to the amount of debt a company has relative to its equity. By including leverage in the formula, we can see how much of the company's return is coming from debt financing.

However, it's important to consider industry norms and the company's debt levels when interpreting ROE.

Return on Assets (**ROA**)[26] is a financial performance ratio that measures how efficiently a company uses its assets to generate profits. It is calculated by dividing net income by average total assets over a specific period. ROA is a critical metric for investors and analysts to evaluate a company's profitability and efficiency in managing its assets. ROA provides valuable insights into a company's financial health and performance by measuring the profitability of the assets used in its operations. The higher the ROA, the more efficiently a company is utilizing its assets to generate profits. Conversely, a lower ROA indicates that a company is not using its assets efficiently, and it may have operational or financial issues. ROA is particularly useful when comparing companies in the same industry, as it can help investors and analysts identify companies that are generating better returns on their assets. It can also be used to compare a company's performance over time and against industry averages.

To calculate ROA, the following formula is used:

***ROA = Net Income / Average Total Assets***

Where net income is the company's total revenue minus expenses, and average total assets are the average of the beginning and ending total asset values for the period being analyzed. It is essential to note that ROA should be analyzed in conjunction with other financial performance ratios, such as Return on Equity (ROE) and Return on Investment (ROI), to get a complete picture of a company's financial performance.

[26] Jewell, Jeffrey Jay, and Jeffrey A. Mankin. "What is your ROA? An investigation of the many formulas for calculating return on assets." *Academy of Educational Leadership Journal* 15 (2011): 79-91.

**ROI**[27] is a widely used financial metric that measures the profitability of an investment. It is calculated as the ratio of the investment's net profit to its cost, expressed as a percentage. The net profit is the total return minus the cost of the investment. ROI is an important metric for investors, business owners, and managers because it provides a way to evaluate the financial performance of an investment and compare it to other investments or to a company's overall performance. ROI can be used to evaluate investments of any size or type, including stocks, bonds, real estate, and business ventures. It is also a useful tool for measuring the success of marketing campaigns, product launches, and other business initiatives. The ROI formula is simple and easy to use, but it is important to understand the underlying assumptions and limitations of the metric.

To calculate ROI, you need to know the cost of the investment and the total return generated by the investment. The total return includes any gains or losses from the investment, such as dividends, interest, or capital gains. The ROI formula is as follows:

***ROI = (Total return - Cost of investment) / Cost of investment x 100%***

For example, if you invested $10,000 in a stock and sold it for $12,000, your total return would be $2,000. Your ROI would be:

ROI = ($2,000 - $10,000) / $10,000 x 100% = 20%

This means that for every dollar invested, you earned a return of 20 cents.

[27] Friedlob, George T., and Franklin J. Plewa Jr. *Understanding return on investment*. John Wiley & Sons, 1996.

ROI can be used to compare the profitability of different investments or to evaluate the performance of a single investment over time. However, it is important to consider the time horizon and the risk associated with each investment. A higher ROI does not necessarily mean that an investment is better than another one. It may have a higher risk or a shorter time horizon. ROI can also be used to evaluate the success of a business initiative or a marketing campaign. For example, if a company spends $50,000 on a marketing campaign and generates $100,000 in sales, the ROI would be:

***ROI = ($100,000 - $50,000) / $50,000 x 100% = 100%***

This means that for every dollar spent on the campaign, the company earned a return of one dollar.

ROI has some limitations that should be taken into account when using it as a performance metric. First, it does not consider the time value of money, meaning that it assumes that all cash flows occur at the same time. This is not the case, where cash flows may occur at different times and have different values. Second, ROI does not consider the risk associated with an investment. A high ROI may be achieved with a high-risk investment, which may not be suitable for all investors. Finally, ROI does not consider the opportunity cost of an investment. This is the cost of not investing in other opportunities that may have a higher return.

It is important to consider the underlying assumptions and limitations of the metric and to use it in conjunction with other performance measures. ROI should not be used as the sole measure of success or profitability, but as one tool in a broader toolkit of financial analysis.

**Elica Case no. 3**

To evaluate a company's profitability and the efficiency with which its capital is used, several key financial metrics are often examined. These include Return on Assets (ROA), Return on Equity (ROE), and Return on Invested Capital (ROIC).[28]

**Return on Assets (ROA)**: this ratio provides insight into how effectively a company is using its assets to generate profits. A higher ROA indicates that the company is using its assets more efficiently to generate earnings.

**Return on Equity (ROE)**: this ratio measures the financial return that a company is able to generate on the equity that has been invested into the business. A higher ROE indicates that the company is generating more profit per dollar of equity.

**Return on Invested Capital (ROIC)**: this ratio measures how effectively a company generates a return on all of the capital that it has invested in its business, including both debt and equity. A higher ROIC indicates that the company is using its total capital more efficiently to generate profits.

These ratios are crucial for investors and stakeholders as they provide a clear picture of a company's profitability and capital efficiency, which are key indicators of the company's financial health and its potential for future growth.

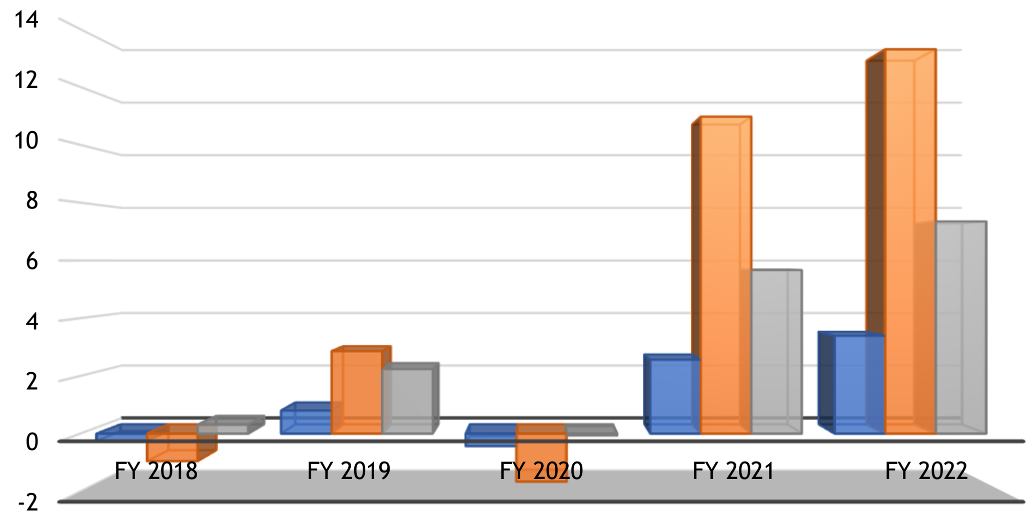
**Return on Assets (ROA):** the company's ROA has shown a positive trajectory from -0.25% in FY 2018 to 3.39% in FY 2022. This suggests that the company has been increasingly effective at using its assets to generate profit. The negative ROA

[28] Graham, Benjamin, and Bill McGowan. *The intelligent investor*. New York: Harper Collins, 2005, Pages 396 – 402

in FY 2020 can be attributed to the impact of the COVID-19 pandemic, which likely disrupted the company's operations and reduced its profitability. However, the strong recovery in FY 2021 and FY 2022 indicates that the company was able to overcome these challenges and improve its asset utilization.

**Return on Equity (ROE):** the company's ROE has also shown a positive trajectory, increasing from -0.95% in FY 2018 to 13.3% in FY 2022. This suggests that the company has been increasingly effective at generating a return on the equity invested in it. The negative ROE in FY 2020 can be attributed to the same factors as the negative ROA. However, the strong recovery in FY 2021 and FY 2022 indicates that the company was able to improve its profitability and provide a higher return to its equity investors.

**Return on Invested Capital (ROIC):** the company's ROIC has shown a positive trajectory, increasing from 0.31% in FY 2018 to 7.35% in FY 2022. This suggests that the company has been increasingly effective at generating a return on the total capital invested in it. The negative ROIC in FY 2020 can be attributed to the same factors as the negative ROA and ROE. However, the strong recovery in FY 2021 and FY 2022 indicates that the company was able to improve its profitability and provide a higher return to all its capital providers.




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Return on Asset % | -0.25 | 0.8 | -0.43 | 2.56 | 3.39 |
| Return on Equity % | -0.95 | 2.86 | -1.66 | 10.97 | 13.3 |
| Return on Invested Capital % | 0.31 | 2.24 | -0.06 | 5.67 | 7.35 |

*Figure 22 ROA & ROE & ROIC*

## 3.7. Net Debt

Net debt, a liquidity metric, is employed to gauge a company's capability to settle all its immediate debt obligations. This metric is calculated by subtracting liquid assets from the total debt on a company's balance sheet. It serves as an indicator of a company's potential to assume additional debt and meet its current debt obligations.

***Net Debt = Short-Term Debt + Long-Term Debt – Cash and Equivalents***

Where:

**STD** = Debt that is due in 12 months or less and can include bank loans, lease payments and accounts payables

**LTD** = Debt with a maturity date longer than one year and include bonds, lease payments, note payables

**CCE** = The total cash of a corporation must also be determined in order to calculate net debt. Cash and other highly liquid assets are included in the total cash. Stocks, some marketable securities, and the balances in checking and savings accounts all fall under the category of cash and cash equivalents. It's crucial to remember that many businesses could choose not to classify marketable securities as cash equivalents because this depends on the investment vehicle and if it can be converted within 90 days.

A company's net debt is calculated by deducting its most liquid assets from its total debt. It provides analysts and investors with information on the degree of under- or over-leverage in a company. Negative net debt companies are typically better able to weather recessions, variable interest rates, and severe economic shifts. Investors use it to decide whether to purchase or sell a company's shares since it can be a useful indicator of the company's financial health. The debt indicator should not, however, be the only one used to assess a company's financial standing. The current ratio and the debt-equity ratio should be utilized in combination with it for determining leverage and liquidity. Yet, since it's typical for businesses to have more debt than cash, investors must juxtapose a company's net debt with that of other businesses in the same sector.

Although the net debt figure provides a valuable starting point, a prudent investor should delve deeper into the company's debt profile. Examining the specific debt amounts, encompassing both short-term and long-term obligations, as well as assessing the proportion of total debt due for repayment in the forthcoming year, are critical aspects that demand careful scrutiny.

Effective debt management is of paramount importance for businesses because, when executed judiciously, it paves the way for future financial accessibility. For numerous enterprises, securing new debt financing serves as a means to retire or restructure existing, more costly debt, or to underpin expansion endeavors, thereby positioning debt management as a linchpin of their long-term growth strategy. While an excessive debt burden can signal financial distress for a company, it is equally critical to scrutinize the debt's duration. If the majority of a company's debt is categorized as short-term, it becomes imperative for the business to generate sufficient income and maintain a suitable level of liquid assets to meet impending debt maturity obligations.

Investors want to think about whether the company would be able to pay off its immediate debts if its sales drastically declined. On the other hand, if the company's current revenue stream is only able to cover its short-term debt payments and is unable to sufficiently pay off its long-term debt, it is only a matter of time before the company would experience difficulty or require a cash infusion or financing. It's best to compare a company's net debt to that of other businesses in the same industry and of comparable size because businesses handle debt differently and in a variety of ways.

### 3.7.2. Debt/Equity Ratio

The debt-to-equity (D/E) ratio, a financial indicator, compares a company's total debt with its total equity (the sum of the cash that shareholders have contributed in the business). A company's total debt is divided by its total equity to arrive at its D/E ratio.

For assessing a company's financial stability and risk profile, analysts and investors, frequently use the D/E ratio. When a company has a high debt-to-equity ratio, it means that it has more debt than equity, which could put it at greater risk of financial problems, especially in the event of an economic downturn or rising interest rates. With a low D/E ratio, a company is more likely to have equity than debt, which could mean that its operations are more stable, and its financial situation is stronger.

By sector and business size, the appropriate D/E ratio can change dramatically. When compared to a service-based business like software development, a capital-intensive industry like manufacturing may have a greater D/E ratio. In comparison to smaller organizations, larger companies may be able to bear more debt. Generally speaking, a D/E ratio of 1 or less is seen as healthy, however a ratio of 2 or greater may be cause for concern.

However as was already noted, this might differ by industry and size of the organization. When assessing a company's financial health, it's necessary to also take other aspects into account, such as cash flow, revenue expansion, and profitability. If a company has a healthy cash flow and is using its debt to support expansion prospects that may produce higher returns in the future, a high D/E ratio might be appropriate. The D/E ratio is a helpful measure for assessing a company's risk profile and financial health in general, but it should be used in conjunction with other quantitative and qualitative metrics.

### 3.7.3. Limitations of Net Debt

Even though it's generally believed that businesses with negative net debt are better equipped to withstand macroeconomic downturns and deteriorating conditions, having too little debt could be a red flag. Due to the absence of debt, a company may find it difficult to compete with rivals who are making investments in their long-term growth. Large fixed assets, such as property, plant, and equipment, must be purchased by capital-intensive businesses. Because of this, businesses in the sector frequently use substantial amounts of long-term debt to fund their equipment. An oil company's net debt should be positive, but investors must compare the company's net debt with that of other oil firms operating in the same sector. Comparing the net debt of an oil and gas corporation to the net debt of a consulting firm with little to no fixed assets is illogical. Hence, net debt is not a useful financial statistic when comparing businesses in different industries because the businesses may have quite diverse capital structures and borrowing requirements.

The total nominal value of all debts and other related liabilities that a corporation has on its balance sheet is known as gross debt. There may be a problem if there is a considerable disparity between net debt and gross debt because it means there is a lot of debt and a lot of cash on hand.

When determining enterprise value (EV), especially in the context of a business acquisition, the subtraction of cash and cash equivalents from the total debt, referred to as net debt, proves instrumental. Net debt provides a more precise evaluation of the acquisition's worth.

### 3.7.4. Financial Covenants and NFP/EBITDA

Financial covenants[29] are restrictions placed on borrowers by lenders to ensure that they meet certain financial performance targets. One of the most commonly used financial covenants is the NFP/EBITDA multiple. The NFP/EBITDA[30] multiple is a measure of a company's financial health that compares its net debt to earnings before interest, taxes, depreciation, and amortization (EBITDA). This multiple is commonly used by lenders to assess a company's ability to pay back its debt obligations. Financial covenants related to the NFP/EBITDA multiple typically require a borrower to maintain a certain level of NFP/EBITDA ratio.

For example, a covenant might require that the borrower maintain an NFP/EBITDA ratio of no more than 3:1. If the borrower's NFP/EBITDA ratio exceeds this level, they may be in breach of the covenant and subject to penalties or other consequences. It's important to note that financial covenants related to the NFP/EBITDA multiple can vary widely depending on the lender, the borrower, and the specific circumstances of the loan. Some covenants may be more lenient, while others may be stricter.

In summary, financial covenants related to the NFP/EBITDA multiple are an important tool used by lenders to ensure that borrowers maintain a healthy level of debt relative to their earnings.

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[29] Adler, Konrad. "Financial covenants, firm financing, and investment." *Firm Financing, and Investment (December 11, 2020)* (2020).

[30] Nicolas Schmidlin, *The Art of Company Valuation and Financial Statement Analysis A Value Investors Guide with Real-life Case Studies*, Pages 70-72.

## Elica Case no. 4

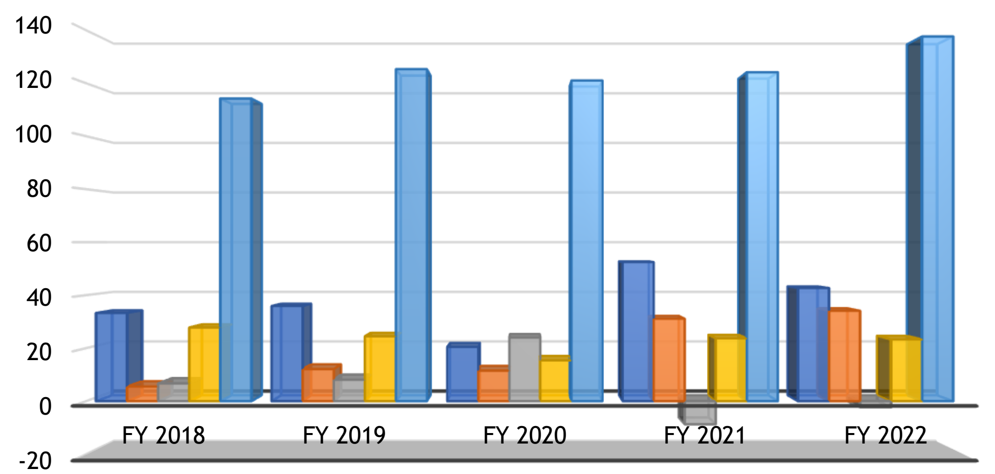
**Cash and Cash Equivalents**: the company's cash and cash equivalents have shown a significant increase from €35.6 million in FY 2018 to €67.7 million in FY 2022. This increase in liquidity provides the company with a larger safety net to cover unexpected expenses or investment opportunities. The significant increase in FY 2020 and FY 2021 can be attributed to the company's effective cash management during the COVID-19 pandemic, which may have involved cost-cutting measures, improved receivables collection, or increased operating cash flow.

**Operating Cash Flow**: the company's operating cash flow has shown a positive trajectory, increasing from €33.3 million in FY 2018 to €42.7 million in FY 2022. This suggests that the company's core business operations have become more profitable over time. The dip in FY 2020 can be attributed to the impact of the pandemic, which may have disrupted the company's operations or increased its operating expenses. However, the subsequent recovery indicates the company's resilience and its ability to adapt to changing market conditions.

**Free Cash Flow**: the company's free cash flow has shown a significant increase from €5.5 million in FY 2018 to €34.1 million in FY 2022. This suggests that the company has been increasingly successful in generating cash that can be used for dividends, share buybacks, debt repayment, or reinvestment in the business. The increase in free cash flow also indicates that the company has been able to manage its capital expenditures effectively, either by reducing these expenditures or by increasing its operating cash flow.

**Net Working Capital**: the company's net working capital has shown some fluctuations over the period. The negative net working capital in FY 2021 and FY 2022 suggests that the company has more current liabilities than current assets. However, this is not necessarily a problem if the company has a high cash conversion cycle, which means it can quickly convert its inventory and receivables into cash to meet its current liabilities.

**Capital Expenditure (Capex)**: the company's capital expenditure has remained relatively stable over the period, suggesting a consistent investment in its operations. This could involve the purchase of property, plant, and equipment, investment in research and development, or other activities that are expected to generate future benefits for the company.



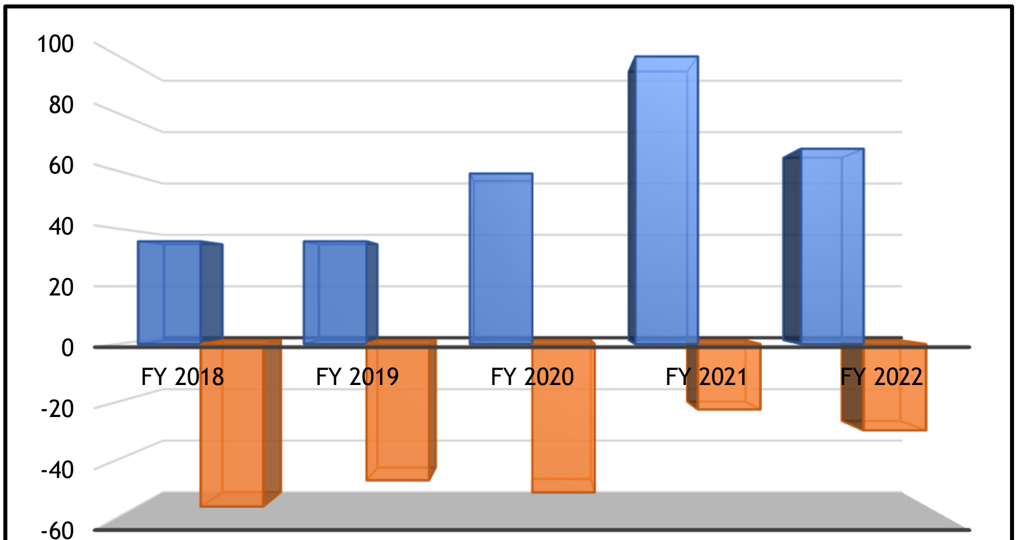

| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Cash Flow Operativo | 33.3 | 35.9 | 20.5 | 52.5 | 42.7 |
| Free Cash Flow | 5.5 | 12.1 | 11.5 | 31.1 | 34.1 |
| Net Working Capital | 6.7 | 8.1 | 24 | -8.7 | -2.3 |
| Capex | 27.8 | 24.5 | 15.4 | 23.7 | 23.3 |
| Patrimonio Netto | 114.2 | 125.3 | 121 | 124.1 | 137.6 |

*Figure 23 Liquidity Overview*

**Net Equity**: the company's net equity has shown a positive trajectory, increasing from €114.2 million in FY 2018 to €137.6 million in FY 2022. This suggests that the company has been successful in increasing the value of the shareholders' investment, either by retaining earnings or by issuing new equity.

**Normalized Net Financial Position**: during the specified timeframe, the company's NFP exhibited certain fluctuations but consistently remained at an acceptable level. The company's capacity to uphold a steady net financial position underscores effective financial management and diminishes the risk of encountering financial distress.

The company has been able to improve its liquidity, generate more cash from its operations, increase the value of the shareholders' investment, and maintain a stable net financial position. The company's financial indicators suggest a strong foundation for future growth and profitability.




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Disponibilità Liquide | 35.6 | 35.6 | 59.1 | 99.7 | 67.7 |
| PFN normalizzata | -56.3 | -47.2 | -51.4 | -22.7 | -29.9 |

*Figure 24 Net Financial Position*

## 3.8. DPO, DIO & DSO

**DPO**[31], or Days Payable Outstanding, is a financial metric that measures the average number of days it takes a company to pay its suppliers or vendors after they have provided goods or services. It is calculated by dividing the total accounts payable by the average daily cost of goods sold (COGS). DPO is an important indicator for several reasons. First, it can help a company manage its cash flow by giving it an idea of how quickly it needs to pay its suppliers. Second, it can help a company negotiate better payment terms with its suppliers, which can improve its financial position. Finally, it can help investors and analysts evaluate a company's financial health and its ability to manage its financial obligations.

The formula for calculating DPO is as follows:

***DPO = (Accounts Payable / Cost of Goods Sold) x Number of Days***

For example, let's say a company has $50,000 in accounts payable and $200,000 in annual COGS. The average daily COGS would be $200,000 / 365 days, or $548. The DPO would be calculated as:

DPO = ($50,000 / $200,000) x 365 days = 91.25 days

This means that, on average, it takes the company 91.25 days to pay its suppliers after they have provided goods or services.

One advantage of using DPO is that it provides insight into a company's cash flow management. A high DPO means that a company is taking longer to pay its suppliers, which can help it manage its cash flow and avoid financial difficulties.

[31] https://www.clear.in/s/dpo-days-payable-outstanding

Additionally, a high DPO can signal that a company is good at negotiating payment terms with its suppliers, which can be seen as a positive sign by investors and analysts. However, a high DPO can also have disadvantages. For example, it can strain relationships with suppliers if they feel they are being paid too slowly. Additionally, a high DPO can suggest that a company is not investing in its supply chain, which can lead to quality and delivery issues.

In conclusion, the DPO is an important financial metric that can provide valuable insights into a company's financial health and cash flow management. However, it is important to consider the potential disadvantages and to interpret the metric in the context of other financial and operational indicators.

**DIO**[32], or Days Inventory Outstanding, is a financial metric that measures the average number of days it takes for a company to sell its inventory. This metric is an important indicator of a company's efficiency in managing its inventory, as it provides insight into how long it takes for a company to convert its inventory into sales. To calculate DIO, you divide the average inventory balance by the cost of goods sold (COGS) per day. The resulting number is the number of days it takes for a company to sell its inventory.

For example, let's say a company has an average inventory balance of $100,000 and a COGS of $1,000 per day. The DIO for this company would be 100 days, as it would take an average of 100 days to sell its inventory.

[32] https://corporatefinanceinstitute.com/resources/accounting/days-inventory-outstanding-dio/

One advantage of using DIO as a financial indicator is that it provides insight into a company's inventory management practices. A high DIO may indicate that a company has excess inventory that is not being sold quickly enough, which can lead to increased storage costs and reduced cash flow. On the other hand, a low DIO may indicate that a company is effectively managing its inventory and is able to quickly convert its inventory into sales.

However, there are also some disadvantages to using DIO as a financial indicator. For example, DIO may not be comparable across different industries, as different industries may have different inventory turnover rates. Additionally, DIO may not provide a complete picture of a company's financial health, as it only focuses on inventory management and does not consider other important financial metrics such as revenue, profitability, and cash flow.

In conclusion, DIO is a useful financial indicator that provides insight into a company's inventory management practices. However, it should be used in conjunction with other financial metrics to provide a complete picture of a company's financial health.

**DSO**[33] is a key performance indicator (KPI) that measures the average number of days it takes for a company to collect payment from its customers after a sale has been made. This metric is commonly used to assess a company's accounts receivable management and its overall cash flow position. DSO can be calculated using the following formula:

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[33] Stephen H. Penman, *Financial Statement Analysis and Security Valuation,* Page 377

***DSO = (Accounts Receivable / Total Credit Sales) x Number of Days***

For example, if a company has \$1,000,000 in accounts receivable and \$10,000,000 in total credit sales, and the number of days in the period being measured is 30 days, the DSO would be:

DSO = (\$1,000,000 / \$10,000,000) x 30 = 3 days

This means that, on average, it takes the company 3 days to collect payment from its customers after a sale has been made.

One of the advantages of using DSO is that it provides insight into a company's cash flow position, as well as its ability to collect payment from its customers in a timely manner. If DSO is too high, it may indicate that a company is having difficulty collecting payment from its customers and may be facing cash flow issues. On the other hand, if DSO is too low, it may indicate that a company is too aggressive in its collections efforts and may be sacrificing customer relationships.

However, there are also some disadvantages to using DSO as a KPI. One potential issue is that it may not accurately reflect the underlying cash flow position of a company, as it only takes into account accounts receivable and does not factor in other cash flow items such as accounts payable or inventory. Additionally, DSO can be affected by seasonal fluctuations in sales or payment patterns, which may make it difficult to compare across different time periods.

While it can provide valuable insights into a company's accounts receivable management and cash flow position, it should be used in conjunction with other financial metrics to fully assess a company's overall financial health.

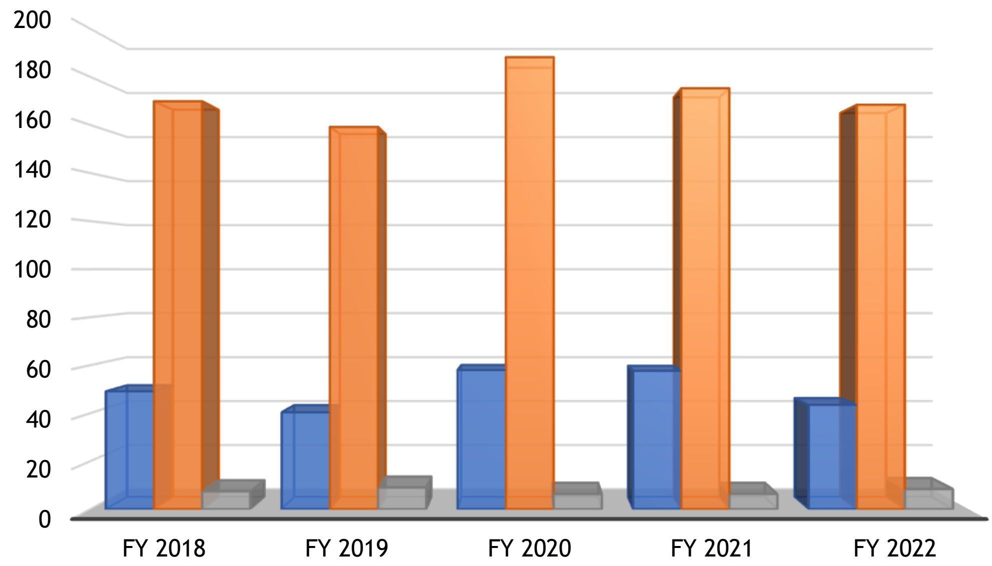
## Elica Case no. 5

**Interest Coverage**: this ratio measures how easily a company can pay interest expenses on outstanding debt[34]. The company's interest coverage ratio has significantly increased from 2.94 in 2018 to 11.52 in 2022. This suggests that the company has been generating sufficient earnings to comfortably cover its interest payments, reducing its risk of financial distress and enhancing its creditworthiness in the eyes of lenders.

**Days Sales Outstanding (DSO)**: the company's DSO has fluctuated over the years but has shown a decrease from 49.11 days in 2018 to 43.47 days in 2022. This improvement suggests that the company has been successful in implementing efficient credit and collection processes, which has helped to improve its cash flow and reduce the risk of uncollectible accounts.

**Days Inventory**: the company's days inventory has remained relatively stable over the period, suggesting that the company has been maintaining an effective balance between keeping enough inventory to meet demand and minimizing the costs associated with holding inventory.

[34] Greenwald, Daniel. "Firm debt covenants and the macroeconomy: The interest coverage channel." (2019).




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Days Sales Outstanding | 49.11 | 40.38 | 58 | 57.66 | 43.47 |
| Payables Period | 169.82 | 159.19 | 188.16 | 175.25 | 168.39 |
| Receivables Turnover | 7.43 | 9.04 | 6.29 | 6.33 | 8.4 |

*Figure 25 DSO & Payables Period & Receivables Turnover*

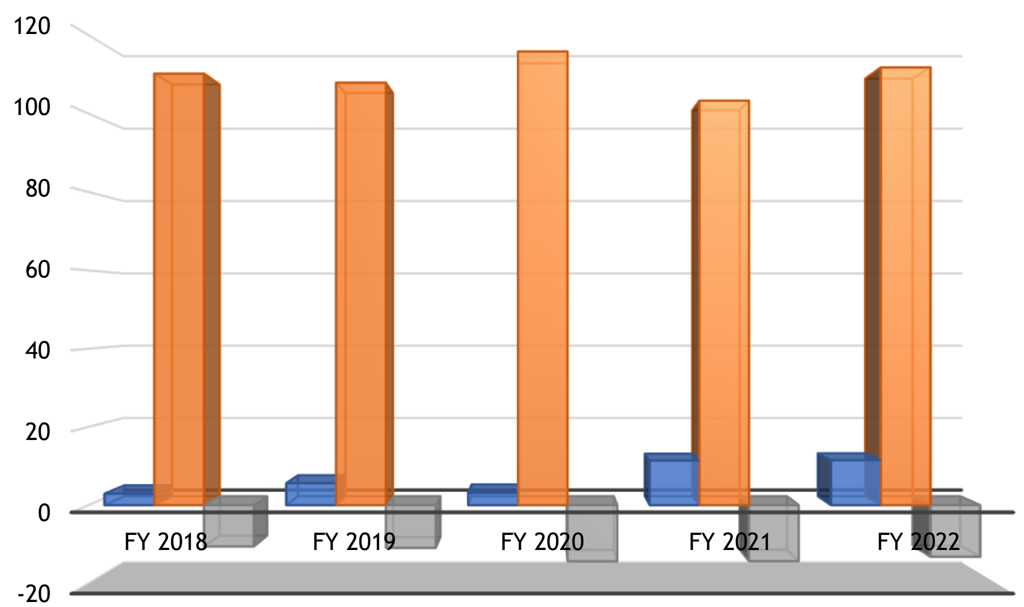
**Payables Period**: the company's payables period has remained relatively high over the period, suggesting that the company has been able to negotiate favorable payment terms with its suppliers. This allows the company to use its cash in other areas of the business before it has to pay its suppliers, improving its cash flow.

**Cash Conversion Cycle (CCC)**[35]: this metric measures the time it takes for a company to convert its investments in inventory and other resources into cash flows from sales. The company's negative CCC suggests that it is able to collect

[35] Nobanee, Haitham, and Maryam Al Hajjar. "An optimal cash conversion cycle." *International Research Journal of Finance and Economics. March (120)* (2014): 13-22.

cash from its customers before it has to pay its suppliers. This is beneficial for its cash flow and suggests effective management of its working capital.

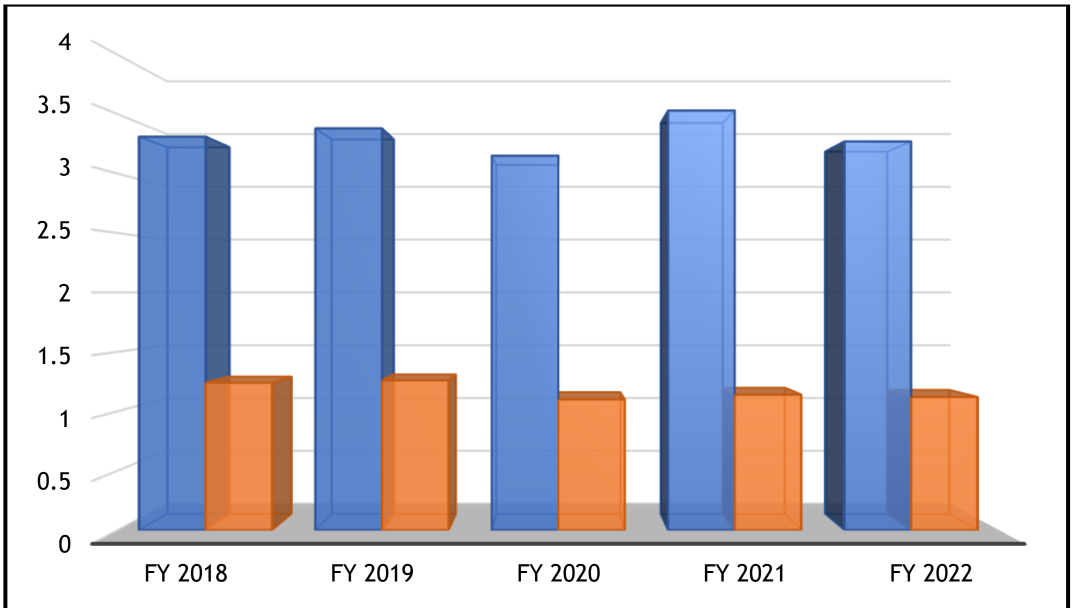
**Receivables Turnover and Inventory Turnover**: these ratios measure the efficiency with which a company manages its accounts receivable and inventory. The increase in receivables turnover and the relatively stable inventory turnover suggest that the company has been effective in collecting payments from customers and managing its inventory, contributing to its operational efficiency.




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Interest Coverage | 2.94 | 5.62 | 3.14 | 11.4 | 11.52 |
| Days Inventory | 110.16 | 107.87 | 115.8 | 103.27 | 111.73 |
| Cash Conversion Cycle | -10.56 | -10.94 | -14.36 | -14.32 | -13.19 |

*Figure 26 Interest Coverage & Days Inventory & Cash Conversion Cycle*

**Asset Turnover**: this ratio measures the efficiency with which a company uses its assets to generate sales. The company's asset turnover has remained relatively stable over the period, suggesting that it has been able to generate a consistent level of sales from its assets. This indicates effective asset management and contributes to the company's profitability.




| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Inventory Turnover | 3.31 | 3.38 | 3.15 | 3.53 | 3.27 |
| Asset Turnover | 1.24 | 1.26 | 1.1 | 1.14 | 1.12 |

*Figure 27 Inventory & Asset Turnover*

Elica has been effective in managing its interest payments, working capital, and assets, contributing to its operational efficiency and profitability. These performance indicators, along with the company's improved liquidity and profitability ratios, suggest future profitability.

# 4. CORPORATE GOVERNANCE

A crucial aspect of community and investor relations is communicating a company's corporate governance[1]. For instance, Elica's investor relations website describes its corporate leadership (its executive team and board of directors). It offers information on corporate governance, including committee charters and governance papers like bylaws, rules for stock ownership, and articles of incorporation. Corporate governance refers to the set of laws, customs, and procedures that regulate an organization and allow management and the board to conduct it more effectively and efficiently. Finding a balance between the interests of many stakeholders within an organization, including the board of directors, management, employees, shareholders, clients, and the government, among others, is the main goal of corporate governance.

## 4.1. What is Corporate Governance?

Corporate governance, which includes everything from action plans and internal controls to performance assessment and corporate disclosure, covers every aspect of management since it provides the foundation for achieving a company's goals. Corporate governance is distinct from the regular operational tasks carried out by an organization's management. The Board of Directors, as opposed to the

[1] Zattoni Alessandro, *Assetti proprietari e corporate governance* - (2006), pp. 1-414.

management team, oversees corporate governance. The four guiding principles of corporate governance are accountability, transparency, fairness, and responsibility. The decision-making process, accountability framework, and power structure of an organization are all defined by corporate governance. The majority of enterprises aim for excellent corporate governance. It is insufficient for a business to only be profitable. Additionally, it must exhibit excellent corporate citizenship by a commitment to the environment, moral conduct, and effective corporate governance. Poor governance can have a negative effect on a company's operations and profits.

### 4.1.2. Objectives

People, process, performance, and purpose are the four P's of corporate governance. The goals of corporate governance are as follows:

- Draw a distinction between ownership and administration by establishing various organizations like the board of directors, shareholders, and management.
- Maintaining and enhancing the company's bottom line.
- Verify that company procedures and processes comply with applicable laws and ethical standards for corporate governance (ESG).
- Guard against risks associated with poor management, such as fraud and money-related misuse, for the company's resources.

### 4.1.3. Benefits

- Share prices can increase as a result of sound corporate governance.
- It supports long-term financial viability, opportunities, and returns.
- It promotes trust among individuals and investors.

- Transparent rules and controls are established by good corporate governance, and the interests of shareholders, directors, management, and staff are all aligned.
- Corporate governance may give stakeholders and investors a clear understanding of a company's direction and business ethics.
- The likelihood of financial loss, waste, hazards, and corruption may be reduced.
- It might make capital raising easier.

### 4.1.4. Corporate Governance Dimensions

A range of significant dimensions must be steered by the corporate governance function in order for a firm to move forward. These parameters consist of:

- Enterprise risk management entails locating and minimizing operational, reputational, financial, and even strategic risks.
- Strategic planning is all about spotting and seizing opportunities to forge durable competitive advantages and future value.
- Accounting & Disclosure - The corporate governance unit must support financial recordkeeping and approve public stakeholder reporting (including financial statements and sustainability disclosures).
- Talent management - Leaders should be knowledgeable about luring, keeping, and enhancing the organization's human resources. It is commonly known as Human Capital Management[2].

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[2] Van Marrewijk, Marcel, and Joanna Timmers. "Human capital management: New possibilities in people management." *Journal of Business Ethics* 44 (2003): 171-184.

- Succession Planning — This is people management in essence, especially at the senior levels. As a result, the company is better able to secure the existence of a strong leadership "pipeline."

In a broader sense, the corporate governance function encompasses an organization's capacity to operate ethically (guided by moral values) and to demonstrate compliance with all legal and regulatory obligations.

### 4.1.5. Corporate Hierarchy

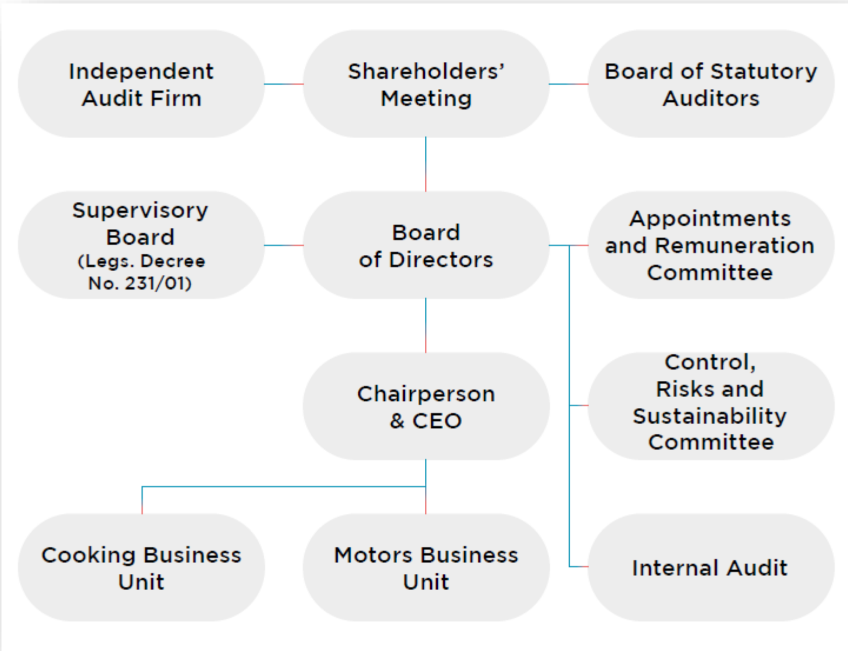


*Figure 28 Corporate Hierarchy*

The CEO is the most senior member of the C-suite, which is the group within the company that makes operational decisions. The Board of Directors is the CEO's supervisor. The corporate governance function is directed and carried out by the BOD, which is chaired by the executive chairman. Separating ownership and control is a key component of good governance. While the company's managers have operational authority over it, the company's stockholders own it. In a perfect environment, the directors would strive to match the interests of the shareholders with those of the managers and the company. All publicly traded businesses are required to have a board of directors, which convenes periodically throughout the year. A board's function in governance is crucial and intricate. The board must guarantee the organization is abiding by its principles and ethical standards and set the tone for the entire organization. Also, they must be capable of making difficult judgments and managing disagreements. A corporate governance committee performs a variety of tasks. They consist of:

- Appointing and discharging the CEO
- Controlling the process of financial reporting.
- Promoting openness and dialogue with shareholders, top management, and other stakeholders.
- Ensuring adherence to rules and legislation.
- Establishing and preserving a corporate culture that encourages the achievement of the organization's objectives.
- Endorsing the tactical plan.
- Reviewing the CEO's work.
- Supervising the organization's management.
- Deciding who will lead the executive team.
- Determining the organization's tolerance for risk.

In general, the BOD is in charge of establishing plans and objectives as well as prescribing policies for the firm, overseeing their implementation. Management is in charge of directing the day-to-day business activities of the organization in order to carry out these objectives. The BOD is also in charge of establishing the remuneration plan for the management team and monitoring their performance.

### 4.1.6. BoD Composition

Insiders, including significant shareholders, founders, executives, and independent members, make up boards. A director is deemed independent if they don't have any connections to the company directly or to any of its subsidiaries. This includes financial rewards or significant stock holdings. As a result, they are more objective than corporate managers. They are chosen due to their background in managing huge corporations. Independents are regarded as being beneficial to governance since they assist balance shareholder interests with insider interests and reduce the concentration of power. Within or outside directors are both eligible to serve as the chairperson. Inside directors are executives, such as the CEO.

The company's shareholders must approve any appointments to the Board by vote. This makes the BOD dependent on shareholders in numerous ways. The majority of BODs have traditionally worked along these lines. The idea of "shareholder primacy" refers to the tacit recognition that every choice taken within a company must take the best interests of its shareholders into consideration. Stakeholder primacy has, however, recently come under assault as a result of the rising acceptance of Environmental, Social, and Governance (ESG) as an analysis framework, which has compelled corporations (and their corporate governance activities) to give it more serious thought.

According to the shareholder primacy principle, it is the leadership's first duty to make decisions that are in line with the expectations of investors. Despite this, shareholder primacy often pushes leadership teams to think in the short term. Top management will be forced to take risks in order to hit quarterly goals out of fear that the stock price will drop if they don't. Arguments against this idea include the fact that bad business behavior is often the result of short-term thinking and profit-maximizing systems of governance, which can have unfavorable externalities like environmental damage and social inequity. Stakeholder primacy asserts that all strategic and operational decisions should take into account the interests and outcomes of all stakeholders, including those of employees, clients, partners in the supply chain, and residents of the communities in which an organization operates.

### 4.1.7. Principles

A number of rules regulate good company governance. Key guidelines consist of:

**Fairness** is a key corporate governance principle. This means that management choices should not favor one set of shareholders over another and that all shareholders should be treated equally. Organizations must also treat community members equally, including employees, vendors, and employees. By appointing independent directors, fairness is promoted.

**Transparency** A corporate must provide all relevant information to its board of directors, auditors, and shareholders. These details could relate to the company's financial standing, board meeting minutes and decisions, adjustments to regular operations, and resignations and replacements of senior executives and board members.

**Responsibility** entails that everyone in the organization is accountable for their deeds. Employees are accountable for adhering to corporate policies, shareholders are liable for electing directors, and directors are responsible for the financial stability of the organization.

**Accountability** guarantees that the board of directors is answerable to the shareholders and other external stakeholders. Accountability, one of the main tenets of effective governance, strives to prevent anyone in the organization, including the managers, from using the resources for personal gain or to their own benefit rather than for the benefit of the organization and its stakeholders.

**Risk Management** Systems and procedures for identifying and managing risks should be in place, as determined by the board and senior management. Also, they ought to have guidelines for how to avoid risks and deal with them.

### 4.1.8. Corporate Governance Models

When an alternative legislative option is not available, the **ordinary system**—a typical Italian model—is employed. A Board of Directors and a Control Body (Board of Statutory Auditors) are incorporated in this Corporate Governance framework. The latter may exert management control and accounting control only in cases where the bylaws specifically permit it, and only in cases where the auditors are listed on the Registry of the Auditors. The Board of Statutory Auditors will, however, only exercise the control of legality if the bylaws do not specifically assign this role to it or if the circumstances that permit the function to be exercised do not exist. In this situation, the accounting control will be under the supervision of an external auditor.

The management of the corporation is split between a Management Board and a Supervisory Board under the **dualistic system** (two-tiered). It can be used as an alternative to the other two corporate governance systems with a specific regulatory indication. The Supervisory Board will be given certain responsibilities under this structure that would normally fall under the sole purview of the

Assembly. The financial statements' approval is the most well-known example. The Management Board, who is in charge of managing the company, must also be appointed concurrently by the Supervisory Board. The accounting oversight will always be given to an outside entity (as it is in the ordinary system), such as an auditor or a firm tasked with this responsibility.

The **monistic model** (one-tiered) of corporate governance is an Anglo-Saxon-inspired structure in which the management of the company is entrusted to a single body (the Board of Directors), within which a specific Control Committee is established. Similar to the dualistic system, all organizations may choose to use this model as an alternative to the other two through a special regulatory provision. Once more, the audit will be required to be performed by an outside entity, such as an auditor or auditing company.

In general, it is believed that the ordinary corporate governance model is the one that is most suited to protecting civil liberties. This is because it creates a distinct division between control and administration, whose appointed entities are chosen independently by the shareholders' assembly. The dualistic system, in contrast, merely requires the shareholders to set the parameters of the company's financial program and to make the most crucial choices, such as capital and extraordinary transactions and the selection of the supervisory board. Due to these idiosyncrasies, this model is perfect for firms where shareholder influence is minimal. The monistic model, in comparison to the other two Corporate Governance systems, has a flexible and streamlined structure and tends to encourage the exchange of data and information between the control and administrative authorities. This qualifies this approach for use by companies looking for sizable time and money savings.

### 4.1.9. Bad Governance Examples

Ineffective corporate governance can raise questions about a company's trustworthiness, transparency, or duty to shareholders. All may have an impact on the company's financial stability.

- Poor executive compensation plans that don't give corporate managers the best possible incentive.
- Boards with poor organizational structures that make it too challenging for shareholders to remove unproductive members.
- Businesses that publish fictitious or noncompliant financial papers as a result of inadequate auditor cooperation or poor choice of auditors on a scale that is appropriate.

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*"Tolerance or support of illegal activities can create scandals like the one that rocked Volkswagen AG starting in September 2015. The details of "Dieselgate[3]" (as the affair came to be known) revealed that for years, the automaker had deliberately and systematically rigged engine emission equipment in its cars in order to manipulate pollution test results in America and Europe. Volkswagen saw its stock shed nearly half of its value in the days following the start of the scandal. Its global sales in the first full month following the news fell 4.5%. VW's board structure facilitated the emissions rigging and was a reason it wasn't caught earlier. In contrast to a one-tier board system that is common in most companies, VW has a two-tier board system, which consists of a management board and a supervisory board. The supervisory board was meant to monitor management and approve corporate decisions. However, it lacked the independence and authority to carry out these roles appropriately. The supervisory board included a large portion of shareholders. Ninety percent of shareholder voting rights were controlled by members of the board. There was no real*

[3] Di Rattalma, Marco Frigessi, ed. The dieselgate: a legal perspective. Springer, 2017.

*independent supervisor. As a result, shareholders were in control and negated the purpose of the supervisory board, which was to oversee management and employees, and how they operated. This allowed the rigged emissions to occur".*

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#### 4.1.9.1. Corporate Governance Trends

The corporate governance activities in firms of all sizes are under intense strain as a result of certain interesting, recent trends.

The "**Great Resignation**[4]," as it is known, has produced a setting where the whole nature of labor (as we once knew it) has transformed. When planning to hire, firms must take remote and hybrid working arrangements into account. While this has its drawbacks, it has also made it possible for employers to access a far wider talent pool since candidates are no longer restricted to those who commute to the nearest office.

As a result of physical climatic impacts, regulatory-driven "transition risks," and potential reputational harm, leadership at many firms is realizing that **climate change** poses existential threats to business operations in addition to environmental issues. It is essential to have BOD representatives with some ESG experience to navigate the ESG disclosure landscape and prevent the perception of greenwashing since numerous firms are making commitments to achieve "Net Zero" or even carbon neutral emissions targets.

Ethical business practices lead to financial viability, which is the result of good corporate governance. That might then lure in investors. The BOD and

[4] Sull, Donald, Charles Sull, and Ben Zweig. "Toxic culture is driving the great resignation." *MIT Sloan Management Review* 63.2 (2022): 1-9.

management must have their responsibilities clearly defined for corporate governance to operate well. It also calls for a positive working relationship between the CEO and the Board. Similar to this, having at least some independent Directors (defined as those who are not employees of the company) often helps with dispute resolution and objectivity when it comes to other strategic and executive matters that are important to a firm. A corporation that adheres to the principles of good corporate governance will act in a way that is honest and transparent and that benefits all of its stakeholders. Poor corporate governance causes a corporation to collapse, which frequently results in scandals and bankruptcy.

## 4.2. Shareholders’ meeting

There are various corporate events held by organizations, but the Shareholders' Meeting stands out. This meeting of the corporation's stockholders is where resolutions are presented to the shareholders for discussion of corporate issues and other subjects outlined in the bylaws of the business. It might be performed repeatedly (like annually or six-monthly or quarter or in exceptional circumstances). Despite this, stockholders do not run the business. Shareholders pick a few management professionals, known as the Board of Directors to oversee the business affairs of the organization. BOD acts as the corporation's management by making decisions and requesting shareholder approval. According to their ownership of capital stock, shareholders have rights and obligations at meetings; the more the ownership, the greater the obligations and rights.

### 4.2.2. Types of Meeting

The most significant assembly, which must be held annually, is the **ordinary general meeting**. There shouldn't be more than 15 months between the two AGMs. The company may ask the Minister for an extension of time if there are any issues conducting an AGM within the allotted time frame, but only for specific circumstances. The maximum length of such an extension is three months. It is necessary to give at least 21 days' notice before calling for an AGM. However, if the approval of all members who are qualified to attend and vote is secured, the notice period may be served with less formal notice.

An **extraordinary meeting** is one that is called due to special circumstances at the firm. Anytime they see fit, the Board of Directors may call an extraordinary general meeting. The main purpose of organizing an EGM is to debate any pressing issues (i.e., to conduct special business) or any crisis that needs the members' special attention. Thus, the management cannot wait till the AGM is summoned. Unlike an AGM, which must be held on days other than national holidays, an EGM can be held on any day, including holidays. Shareholders, members, or the tribunal may request the calling of an EGM.

A **shareholder class meeting** is intended for discussion of matters that only concern or have an impact on certain groups of shareholders. For instance, shareholders with smaller holdings or shares may convene to discuss bylaws that concern them. These assemblies are necessary if the business wants to pass a new resolution that only applies to certain shareholders.

### 4.2.3. Subjects Addressed

Deliberation and agreement on the following topics are among the items that will be covered during such a meeting:

- The appointment of external auditors
- Modifications to the corporation's bylaws
- Firm restructuring, mergers, spin-offs, acquisitions, or capital increases
- The dissolution of the corporation
- Any other matters imposed by law
- Distribution of dividends
- Approval of annual financial statements
- Determination of how profits or losses will be allocated
- Confirmation of corporate management
- Directors appointed to the board of directors

All shareholders, including those who cast no votes or did not attend the meeting, must abide by the resolutions passed.

### 4.2.4. Who attends the meetings

All shareholders have the right to attend the meetings, however in the case of corporations like limited liability companies, the bylaws may prescribe that attendance is contingent on possessing a minimum number of shares. A shareholder also has the option to name a representative to represent them at the general meeting and cast their votes on their behalf if they are unable to attend. Proxy must be assigned in writing or by notice that satisfies the legal criteria linked to the ability to exercise remote voting, and it must be done separately for each meeting. For limited liability companies, voting on proposals related to the agenda items at any type of General Meeting may be delegated to a proxy or exercised by the shareholder by mail or any other form of remote communication, provided that the shareholder's identity is established and in accordance with the bylaws of the company. For the purposes of the assembly, shareholders who voted by virtual means should be regarded as present.

Minority shareholders who are interested in attending the general meeting but do not possess the minimum number of shares required by the bylaws for attendance may find themselves in this scenario. In these situations, the legislation permits minority owners to combine their shares to reach the necessary minimum.

### 4.2.5. Final Remarks

The shareholders, as capital contributors, play a crucial part in decision-making since they must approve deals that will lead to long-term advantages and proper general management operations. Each form of meeting has its unique importance, so not all ordinary meetings may be special meetings, and vice versa. Internal laws and bylaws must be followed by every board; failure to do so could result in sanctions from the government.

## 4.3. Insider Trading

Insider trading[5] is the act of buying or selling securities of a publicly traded corporation while in possession of relevant information that has not yet become public knowledge. Any information that could have a significant impact on an

[5] Bainbridge, Stephen M. "Insider trading: an overview." *Available at SSRN 132529* (1998).

investor's choice to buy or sell a security is referred to as relevant data. Non-public information is information that only a small number of persons who are directly related to it possess and that is not legally in the public domain. An insider can be a company executive or a member of the government who has access to economic reports before they are made available to the public.

The U.S. Securities and Exchange Commission (SEC) defines illegal insider trading as:

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*"The buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, nonpublic information about the security"*[6].

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The effort to keep a fair marketplace gives rise to the legality debate. One who has access to insider information would have an unfair advantage over other investors who do not and might possibly generate higher, unfair profits. When you share any kind of significant nonpublic knowledge with others, you are engaging in illegal insider trading. Whether the individual is an employee of the corporation or not has no bearing on how the material nonpublic information was obtained. When company directors buy or sell shares, but legally declare their transactions, this is referred to as lawful insider trading. Rules have been developed by supervisory bodies to shield investments from the effects of insider trading.

[6] https://www.sec.gov/Archives/edgar/data/25743/000138713113000737/ex14_02.htm

### 4.3.2. Some Cases

***Amazon***

*"In September 2017, former Amazon.com Inc. (AMZN) financial analyst Brett Kennedy was charged with insider trading. Authorities said Kennedy gave fellow University of Washington alumni Maziar Rezakhani information on Amazon's 2015 first-quarter earnings before the release. Rezakhani paid Kennedy $10,000 for the information. In a related case, the SEC said Rezakhani made $115,997 trading Amazon shares based on the tip from Kennedy"*[7].

***AT&T***

*"The Securities and Exchange Commission today charged AT&T, Inc. with repeatedly violating Regulation FD, and three of its Investor Relations executives with aiding and abetting AT&T's violations, by selectively disclosing material nonpublic information to research analysts.*

*According to the SEC's complaint, AT&T learned in March 2016 that a steeper-than-expected decline in its first quarter smartphone sales would cause AT&T's revenue to fall short of analysts' estimates for the quarter. The complaint alleges that to avoid falling short of the consensus revenue estimate for the third consecutive quarter, AT&T Investor Relations executives Christopher Womack, Michael Black, and Kent Evans made private, one-on-one phone calls to analysts at approximately 20 separate firms. On these calls, the AT&T executives allegedly disclosed AT&T's internal smartphone sales data and the impact of that data on internal revenue metrics, despite the fact that internal documents specifically*

[7] https://www.justice.gov/usao-wdwa/pr/former-amazon-financial-analyst-sentenced-prison-insider-trading

*informed Investor Relations personnel that AT&T's revenue and sales of smartphones were types of information generally considered "material" to AT&T investors, and therefore prohibited from selective disclosure under Regulation FD. The complaint further alleges that as a result of what they were told on these calls, the analysts substantially reduced their revenue forecasts, leading to the overall consensus revenue estimate falling to just below the level that AT&T ultimately reported to the public on April 26, 2016.*

*"Regulation FD levels the playing field by requiring that issuers disclosing material information do so broadly to the investing public, not just to select analysts," said Richard R. Best, Director of the SEC's New York Regional Office. "AT&T's alleged selective disclosure of material information in private phone calls with analysts is precisely the type of conduct Regulation FD was designed to prevent."*

*"The SEC remains committed to assuring an even playing field by taking appropriate action, including litigation when necessary, against public companies and their executives who selectively disclose material nonpublic information," added Melissa R. Hodgman, Acting Director of the Division of Enforcement.*

*The SEC's complaint, filed in federal district court in Manhattan, alleges that AT&T violated Regulation FD and reporting provisions of the Securities Exchange Act of 1934, and that Womack, Evans, and Black aided and abetted those* *violations. The complaint seeks permanent injunctive relief and civil monetary penalties against each defendant"*[8].

**Michael Anthony Dupre Lucarelli**[9]

*"The Securities and Exchange Commission today charged a director of market intelligence at a Manhattan-based investor relations firm with insider trading ahead of impending news announcements by more than a dozen clients. The charges were filed against Michael Anthony Dupre Lucarelli, who garnered nearly $1 million in illicit profits.*

*An SEC investigation and ongoing forensic analysis of Lucarelli's work computers uncovered that he repeatedly accessed clients' draft press releases stored on his firm's computer network prior to public announcements. The SEC alleges that Lucarelli, who had no legitimate work-related reason to access the draft press releases, routinely purchased stock or call options in advance of favorable news and sold short or bought put options ahead of unfavorable news.*

*In a parallel action, the U.S. Attorney's Office for the Southern District of New York today announced criminal charges against Lucarelli.*

*"Employees of investor relations firms have access to sensitive information about their clients and exploiting that information for personal gain is not an option," said Andrew M. Calamari, director of the SEC's New York Regional Office.*

*According to the SEC's complaint filed in federal court in Manhattan, Lucarelli traded in securities belonging to companies that his firm was advising in advance*

[8] https://www.sec.gov/news/press-release/2021-43
[9] https://www.sec.gov/news/press-release/2014-175

*of announcing their earnings or other significant events such as a merger or clinical drug trial result. Lucarelli began taking a position in a client's securities in the days immediately preceding the announcement, although in a few instances he began making his purchases weeks in advance. Lucarelli started divesting himself of his position immediately after the announcement in order to reap instant profits.*

*The SEC further alleges that Lucarelli attempted to hide his illicit behavior by lying to brokerage firms where he set up his trading accounts. Lucarelli purposely omitted listing his investor relations firm employment on account-opening applications and instead falsely stated that he was self-employed or retired.*

*"Lucarelli knew full well that he was prohibited from trading on information contained in draft press releases that had not yet been made public, but he brazenly gave himself a head start on the rest of the investors by trading based on the nonpublic details and exiting his holdings after the news came out," said Sanjay Wadhwa, senior associate director of the SEC's New York Regional Office".*

### 4.3.3. Internal Dealing

Due to the notion that it is unfair to the typical investor, the word "insider trading" often carries a negative connotation. Weekly legal insider trading takes place on the stock market. The regulatory agencies demand that transactions be submitted electronically promptly and made public on the business' website. Whether insider trading complies with the regulations set forth by supervisory agencies will determine whether it is legal or illegal. Directors and significant stockholders are required to report their holdings, transactions, and ownership changes.

In the context of the procedures relating to the Market Abuse Regulations (Regulation (EU) No. 596/2014 of the European Parliament and of the Council of the European Union of April 16, 2014[10], on market abuse - Market Abuse Regulation), the procedure for the fulfillment of internal dealing obligations governs disclosure obligations relating to financial instrument transactions made by Relevant Persons, in order to ensure greater market transparency and protect investors.

According to the regulations, every transaction involving the Company's financial instruments that was deemed pertinent by the Consob regulations and the Procedure had to be immediately reported to the market and Consob by Relevant Persons, as defined by the Procedure itself.

Relevant Parties and Persons Closely Associated with Relevant Parties are considered to be Relevant Persons. Relevant Parties are those that fit the following description:

- The top executives who, as determined by the Board of Directors, have regular access to inside information and the authority to make management choices that may have an impact on the development and prospects of the firm in the future. This definition specifically covers the CEO and President.
- Relevant Shareholders of voting shares that comprise at least 10% of the company's share capital, as determined by Article 118 of the Issuers' Regulation, are considered Relevant Parties, together with any other person or entity that controls the business.

[10] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0596

**Elica Case no. 6**

Elica S.p.A.'s adherence to the Corporate Governance Code of Borsa Italiana is a clear indication of its commitment to uphold the highest standards of corporate governance. This adherence is not merely a formality, but a strategic decision that aligns with the company's core values and its commitment to its stakeholders. By aligning with national and international best practices, Elica S.p.A. ensures that it operates with transparency, integrity, and accountability, which are fundamental to maintaining stakeholder trust and achieving long-term success.

The company's governance structure is based on a traditional model of administration and control. The Board of Directors[11], which is responsible for the strategic supervision and direction of the company, is assisted by internal board committees. These committees[12] play a crucial role in the governance structure, providing specialized oversight and guidance in their respective areas.

The Nomination and Remuneration Committee is responsible for proposing candidates for director positions and setting remuneration policies. This committee ensures that the board is composed of competent and dedicated individuals and that remuneration policies are aligned with the company's strategic objectives and the interests of its shareholders.

The Control, Risks, and Sustainability Committee oversees the company's risk management and internal control systems, as well as its sustainability practices. This committee ensures that the company effectively identifies, measures,

[11] https://corporate.elica.com/it/governance/sistema-di-governance#cda
[12] https://corporate.elica.com/it/governance/sistema-di-governance#comitati

manages, and monitors its risks, and that it operates in a sustainable and socially responsible manner.

The supervisory functions are carried out by the Board of Statutory Auditors[13]. This body provides an additional layer of oversight, ensuring that the company complies with laws and regulations, operates according to the principles of correct administration, and maintains an adequate organizational, administrative, and accounting structure.

Elica's Internal Control and Risk Management System (ICRMS)[14] is a comprehensive framework designed to manage the risks that could hinder the company's ability to achieve its objectives. The ICRMS is structured on three levels of control, each of which plays a crucial role in the company's risk management strategy.

The first level of control involves the operational controls carried out by the Group's management. These controls are embedded in the company's day-to-day operations and are designed to prevent or detect errors or irregularities.

The second level of control involves the monitoring and management of various types of risks, including operational, financial, and compliance risks. This level of control is carried out by various individuals and departments within the company, who work in close coordination to ensure that risks are effectively managed.

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[13] https://corporate.elica.com/it/governance/sistema-di-governance#collegio
[14] https://corporate.elica.com/it/governance/sistema-di-controllo

The third level of control involves independent assurance provided by the Internal Audit function. This function provides an objective assessment of the effectiveness of the first and second levels of control and the overall risk management strategy.

In conclusion, Elica's corporate governance structure and practices demonstrate a comprehensive approach to management, risk mitigation, and compliance. The company's commitment to upholding the highest standards of corporate governance is a testament to its dedication to its stakeholders and its pursuit of sustainable success.

# 5. CORPORATE SUSTAINABILITY

Investors are becoming more concerned with how well their selected companies perform in the areas of environmental sustainability, social responsibility, and corporate governance (ESG). The expanding market of responsible investors is not the sole source of the scrutiny; traditional investors are also paying more attention to ESG and continuing to look beyond short-term investment horizons to the production of longer-term shareholder value. A few years ago, investors simply did not talk about issues like modern slavery, financial climate risk, energy transition, appropriate tax procedures, and impact investing, but today they do. Furthermore, a significant association exists between the cost of financing and how proactive a company is in meeting the ESG requirements of its investors. Analysts predict that this tendency will pick more speed as more powerful investment groups emerge among the socially conscious generations who have grown up in an era of climate change and exponential population expansion. Because of this, it's more important than ever for businesses to interact with investors about ESG and tailor their messages to satisfy their needs.

## 5.1 ESG & IR

Understanding investor expectations is a critical undertaking for management and the Board since it drives management decisions on strategy and internal processes connected to strategy. Making sure the business complies with investors' ESG requirements is essential. Investors may occasionally specify their needs or the reporting indices and guidelines companies should adhere to.

Investors, for instance, are increasingly demanding that corporations include climate change in their business strategies, including it in specific indices, such as the DJSI, and be in compliance with the UN Global Compact. The use of reporting standards guides sustainability reporting, just as financial reporting. The threshold at which ESG issues become sufficiently important to investors and other stakeholders that they should be reported is referred to as the principle of materiality in ESG.

Professionals in Investor Relations should primarily focus on these aspects, particularly in light of time and resource constraints. If the sustainability team has conducted a materiality review, Investor Relations should be well-versed in the material issues that are of greatest concern to investors. The outcome and impact of investors' "investments," such as the amount of $CO_2$ emissions the company has prevented, are what they are most interested in reading about.

A company's approach to ESG governance is frequently the key sign of how seriously it takes sustainability and ESG. Investors may want to know how business management and the board of directors are involved in and committed to environmental and social issues. GRI offers helpful advice on management indicators and good governance of non-financial matters. Leading companies have created an ESG management profile and are increasingly tying senior management pay to ESG success metrics.

## 5.2. ESG Investing

*"Our conviction is that companies perform better when they are deliberate about their role in society and act in the interests of their employees, customers, communities and their shareholders"* - ***Blackrock***

ESG investing[1], commonly referred to as "socially responsible investing," is the practice of prioritizing the best environmental, social, and governance (ESG) variables or outcomes when making investment decisions. ESG investing is frequently referred to as a method of investing "sustainably"—where investments are made while taking into account the economy, the environment, and human welfare. It is founded on the expanding premise that environmental and social concerns have an increasing impact on an organization's financial performance. ESG investing's guiding ideas are not novel.

Investment choices were affected by religious and moral convictions hundreds of years ago. Muslims created investments that abided by Sharia law, which forbade the use of weapons. Investor awareness of ethical market participation has grown as corporate social responsibility and social sustainability have gained more traction nowadays.

Following the publication of the Principles for Responsible Investments (PRI)[2] in 2006—a collection of United Nations principles for the adoption of sustainability issues into business policy and strategy—ESG investing may have formally entered the mainstream of investment debate. The PRI is frequently regarded as

[1] Hvidkjær, Søren. "ESG investing: a literature review." *Report prepared for Dansif* (2017).
[2] https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment

the official source of information for anything ESG investing. ESG investing has significantly increased over the past few years due to a growing awareness among companies and people of the connections between social, environmental, and economic challenges. This pattern was noticeably influenced by the COVID-19 epidemic. Many investors turned to ESG funds for greater resilience when the pandemic in 2020 created market disruption and anxiety. In fact, $45.6 billion USD flowed into these funds globally in the first three months of 2020. Globally, there are $30.7 trillion in sustainable investment funds, and in the next 20 years, it's expected that number will increase to over $50 trillion. More investors are trying to support businesses and goods that support and promote sustainability and adhere to new laws like those governing climate change.

Due to ESG funds' robustness to typical market upheavals, this demand has been met by both growing corporate world action on these issues and steadily rising returns on investment for these funds. Long-term performance of portfolios that incorporate ESG and sustainability is usually superior to those of portfolios that do not. For instance, the US financial services company Morningstar discovered that, over a ten-year period, 80% of blend equity funds that invest sustainably outperformed conventional funds. Additionally, they discovered that 77% of ESG funds from ten years ago have survived, compared to 46% of regular funds.

There are many reasons for the current ESG investing surge. There is a growing awareness of social, labor, and human rights challenges and risks for the business sector as supply chains become more complex. Investor decisions are also influenced by the growing awareness for environmental issues like climate change. The ESG investment boom is also believed to have been influenced by the increased involvement of demographic groups that were previously less engaged in traditional investing, particularly young people. If firms wish to compete in their industry and benefit society, they must embrace forward-looking ESG practices that reflect these changing societal ideals.

Industries that are sluggish to adapt to these changes are under growing pressure from stakeholders and investors. Legal requirements are going to become increasingly stricter for these industries. A Dutch court ordered Royal Dutch Shell to reduce greenhouse gas emissions by 45% by 2030 in May 2021[3]. ExxonMobil and Chevron were under pressure from their shareholders to lessen the firms' contributions to climate change during the same week. These occurrences are probably going to lead to more changes in these organizations.

### 5.2.1. ESG Topics

There are numerous subjects covered by ESG challenges, and they are relevant to all businesses and organizations. ESG investing involves a wider range of issues, such as:

| *Environmental* | *Social* | *Governance* |
| --- | --- | --- |
| Climate change | Working conditions | Business ethics |
| Greenhouse gas (GHG) emissions | Equal opportunities | Executive pay |
| Resource depletion | Human rights | Board diversity and structure |
| Waste and pollution | Employee diversity | Bribery and corruption |
| Water and energy efficiency | Health and safety | Political lobbying and donations |
| Deforestation | Child labor and slavery | Tax strategy |
| Biodiversity | Community engagement | Compliance |
| | Philanthropy | |

*Figure 29 https://www.adecesg.com/resources/faq/what-is-esg-investing/*

[3] https://www.theguardian.com/business/2021/may/26/court-orders-royal-dutch-shell-to-cut-carbon-emissions-by-45-by-2030

There are only a few company operations areas where ESG is not important. But when it comes to investment, not all ESG factors are treated equally. A company is unlikely to give equal weight to all ESG issues related to its business plan, just as every investor in the market has distinct reasons and objectives. The environmental, social, and economic conditions of the time, as well as what is thought to be more crucial and substantial to a company given its industry, geography, and particular circumstances, determine which are prioritized by investors and organizations. Leading ESG concerns that have an impact on investors include:

- Concerns about human rights in a company's supplier chain
- Equal opportunity and diversity in the workplace
- The actions taken by organizations to lessen the effects of climate change and other natural disasters, like the extinction of species

Stakeholders can make important decisions based on how a business performs in relation to ESG concerns, and there are numerous techniques available to gauge or report on ESG performance. The Global Reporting Initiative (GRI), the Task Force on Climate-related Financial Disclosures, and CDP are some of the most well-known. These organizations assist businesses in tracking performance in a variety of areas, such as governance, emissions, resource management, climate-related risks and opportunities, and procurement. The Dow Jones Sustainability Index (DJSI), Morgan Stanley Capital International, and other popular tools are used by investors to measure companies' ESG ratings (MSCI). These indexes, which offer concise indicators regarding a company's financial performance, tend to be more investor oriented.

Organizations must understand and accept the change in the investing landscape. Due to the growing introduction of more progressive and holistic ESG ideals into the investment world, the variety of variables investors take into account when making decisions has expanded significantly. In addition to highlighting the vulnerability of business-as-usual techniques, problems like COVID-19 have also shown how crucial organizational resilience is. To support future generations, stakeholders anticipate a shift toward corporate activity that is more environmentally, socially, and economically sustainable. By incorporating an ever-wider range of measurements into their daily operations and long-term objectives, organizations must strengthen their ability to change with the times. Organizations can position themselves for success by selecting ESG benchmarks that are important to them and setting realistic goals against these.

## 5.3. Corporate Sustainability

The future impact of any business practice or policy on people, ecosystems, and the whole economy is emphasized by sustainable policies. The idea is frequently associated with the conviction that the state of the planet will become irreparably damaged unless significant changes are made to how it is managed. As awareness of anthropogenic global warming, biodiversity loss, and pollution has grown, the world has begun to embrace sustainable practices and policies, primarily through the adoption of sustainable corporate practices and increased financial expenditures in green technologies. The old growth and profit-maximization strategy can be replaced with corporate sustainability. Corporate sustainability acknowledges the significance of business expansion and profitability, but it also calls on the corporation to work toward societal objectives, particularly those that support sustainable development, such as environmental preservation, social justice, and economic progress.

In reaction to public worries that a concentration on short-term profits might have long-term negative effects, corporate sustainability evolved as a component of business ethics. With the aim of pursuing inclusive and environmentally sound goals, this responsibility perspective urges enterprises to strike a balance between long-term benefits and current profits. This encompasses a wide range of potential practices. The following actions would be considered steps toward sustainability: reducing emissions, reducing energy use, purchasing goods from fair-trade businesses, and making sure their physical waste is disposed of appropriately and with a lesser carbon impact.

It is improbable that all businesses will adopt the ideals of corporate sustainability, at least not freely. Currently, not all businesses do. However, a sizable number of businesses have publicly pledged their support for economic growth, social fairness, and environmental preservation. Their number keeps increasing. If investors and other stakeholders encourage and reward businesses that operate in a sustainable manner, this trend will be strengthened. In recent years, many firms have adopted similar sustainability commitments. Walmart[4], for instance, promised to cut emissions by 2040. By 2050, Morgan Stanley promises to have zero "financed emissions."[5] By 2030, Google promises to run carbon-free. The quest for sustainability may also be seen in the production of energy, as new deposits have been sought after to keep up with the depletion of old ones. For

[4] https://corporate.walmart.com/esgreport/environmental/climate-change

[5] https://www.morganstanley.com/content/dam/msdotcom/en/assets/pdfs/Morgan_Stanley_2021_Sustainability_Report.pdf

instance, some electrical companies now make their targets for generating energy from renewable resources like solar, wind, and hydropower public.

Corporate sustainability draws inspiration from a variety of sources. In addition to outlining the performance areas that businesses should prioritize, sustainable development also contributes to the corporation's vision and social goals. Stakeholder theory[6] offers business justifications for why firms should work toward these objectives, while corporate social responsibility adds ethical justifications. The justification for firms reporting to the community on their performance in these areas is provided by corporate accountability.

### 5.3.1. Pillars

Economic, environmental, and social, also referred to as profits, planet, and people make up the concept of sustainability. The idea of "economic sustainability" puts a strong emphasis on protecting the natural resources that supply the physical inputs for economic activity, including both renewable and exhaustible resources. The idea of "environmental sustainability" places an even higher focus on the preservation of the life-sustaining ecosystems that are necessary for economic activity or human existence. Examples of these ecosystems include the soil and atmosphere. It involves initiatives to end hunger and poverty as well as fight inequality. Social sustainability focuses on the human implications of economic systems. The WCED[7] was founded by the United Nations in 1983 to investigate

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[6] Baumfield, Victoria Schnure. "Stakeholder theory from a management perspective: Bridging the shareholder/stakeholder divide." *Stakeholder Divide (September 1, 2016)* 31 (2016).

[7] https://sdgs.un.org/

the relationship between ecological health, economic development, and social fairness.

### 5.3.2. Sustainable Development

Sustainable development is a wide notion that strikes a balance between the need for social fairness, environmental conservation, and economic prosperity. The phrase was first used in the book "Our Common Future," written by the World Commission for Environment and Development, which was published in 1987. According to the WCED, sustainable development is defined as meeting present-generational demands without compromising the potential of future generations to do the same.

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*"A process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations."*

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Economics, equitable society, environmental science and management, corporate governance, politics, and law are all incorporated into sustainable development. The WCED recognized that accomplishing the objective of sustainable development could not be merely left to government regulators and policy makers. It acknowledged that companies had a big part in society. Even though enterprises have always been the driving forces behind economic growth, they need to take a more proactive approach to balancing this drive with social justice and environmental protection, in part because they are responsible for some of the unsustainable conditions and in part because they have access to the resources needed to address the issues. Sustainable development makes two contributions to corporate sustainability. First, it aids in defining the areas on which businesses should concentrate: economic, social, and environmental performance. Second, it promotes ecological, social, and economic sustainability as a common societal objective for companies, governments, and civil society to work toward. However, sustainable development does not by itself offer the compelling justifications for why enterprises should be concerned about these challenges. Those justifications are based on stakeholder theory and corporate social responsibility.

### 5.3.3. Corporate Social Responsibility

A dialectical principle, corporate social responsibility (CSR) examines the place of business in society. Its fundamental tenet is that corporate managers have an ethical duty to consider and solve societal issues in addition to acting in their own or the interests of shareholders. In many respects, corporate social responsibility (CSR) is a topic of contention. Usually, the issue is not whether business management must take into account societal requirements, but rather how much they should do so. Compared to sustainable development, CSR has been around for a lot longer. The origins of CSR can be found in ancient Greece, where governing authorities established standards of conduct for business people and merchants, according to a 1973 article by Nicholas Ebserstadt.

### 5.3.4. Corporate Accountability

Accountability is the moral or legal obligation to give a justification for the activities for which one is held accountable. In contrast to responsibility, which refers to the obligation to act in a particular way, accountability refers to the obligation to defend or account for one's conduct. Although there are many distinct accountability relationships in the business world, the one that matters is the one between corporate management and shareholders. In this relationship, corporate management serves as the "agent" and the shareholders serve as the "principal," according to the fiduciary model, which is based on agency theory and agency law. It is possible to think of this relationship as a contract where the principal entrusts the agent with money and the agent is obligated to use that money in the principal's best interests. The principle will hold the agent accountable for the use of that money as well as the investment's return.

Corporate accountability does not necessarily have to be limited to the traditional fiduciary model or to the interaction between management and shareholders. Contractual agreements that businesses enter with other stakeholder groups can operate as the framework for accountability relationships. For instance, businesses that obtain environmental permits and permissions from authorities to operate facilities are frequently held responsible by those authorities for ensuring that the conditions of the approval are being followed. According to proponents of the social contract idea, businesses should be held accountable to society for their actions since they are granted a "licence to operate" by society in exchange for good behaviour. Business accountability theory contributes to business sustainability by defining the type of interaction that exists between company management and the rest of society. Additionally, it outlines the justifications for why businesses should provide information on their economic, social, and environmental performance in addition to their financial performance. The term triple bottom line"[8] reporting was coined in 1997 by John Elkington to describe this method of accounting for environmental, social, and financial performance.

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[8] Elkington, John. "The triple bottom line." *Environmental management: Readings and cases* 2 (1997): 49-66.

### 5.3.5. Benefits

The transition to sustainability can be challenging. First, it can be challenging to fully comprehend the influence of any company. Finally, it is challenging to predict how economic agents will react to shifting incentives. The second challenge is ranking the environmental impact of various activities. According to polls on sustainable investing conducted over the last few years, 50% of investors believe that sustainability is "fundamental" to their investment strategy. Companies that successfully apply sustainability strategies might benefit financially in addition to the social benefits that come from enriching the environment and caring for human needs. Just as reducing waste and pollution can help a firm save money, using sustainable resources can enhance a company's long-term viability. For instance, installing more energy-efficient lighting and plumbing fixtures can reduce a company's power costs and boost its reputation. Government tax incentives may also be available to businesses that implement specific sustainability practices. A corporation may become more appealing to investors by practicing sustainability. According to a 2019 HEC Paris Research study, shareholders place such a high value on a company's ethical practices that they are willing to pay $.70 extra for a share of a company that donates $1 or more per share to charities. According to the study, companies whose social influence is thought to be bad suffer from a decline in valuation. While it may be alluring to support businesses that appear to be environmentally friendly, some are really less sustainable than they appear to be. "Greenwashing"[9] refers to the use of deceptive branding or advertising to convey a false sense of sustainability.

[9] de Freitas Netto, Sebastião Vieira, et al. "Concepts and forms of greenwashing: A systematic review." *Environmental Sciences Europe* 32.1 (2020): 1-12.

### 5.3.6. The Path to Sustainable Business Strategy

Many companies are attempting to incorporate sustainable business principles into their core business structures. Similar to how they create their other strategic plans, businesses can adopt sustainability strategies. The first step in incorporating sustainability measures is to pinpoint a particular flaw or weakness. An organization may decide, for instance, that it produces too much trash or that the local communities are being harmed by its hiring policies. The organization should then decide on its objectives and the measures it will employ to gauge its success. A company can establish a challenging objective for lowering its carbon footprint or a precise % target for diversity hiring. This will make it possible for the business to evaluate its aims objectively.

The strategy's implementation and evaluation are the last two steps. As a corporation expands, its aims may alter, necessitating ongoing examination. For firms that want to be sustainable, there are certain frequent problems. One of these is the knowledge-action gap, which refers to the fact that few executives really take action to achieve sustainability goals, even though many executives have sustainability as one of their key priorities.

The compliance-competitiveness gap is another. While increasing sustainability indicators might help a business become more competitive in the marketplace, these objectives should not be confused with the legal obligations that a business must follow. Sustainability is optimal, but compliance must be met.

By employing renewable energy or cutting back on waste, many environmentally friendly firms aim to lessen their impact on the environment. Companies can become more sustainable by encouraging equality and diversity in the workplace or by implementing community-oriented initiatives. Products that are not sustainable use resources that cannot be refilled or replaced as quickly as they are used up. The resources required to produce products that rely on fossil fuels cannot ever be replaced, hence they cannot be sustainable. If they are only used within limits that allow for the replenishment of current stocks, other resources, such as fisheries, wildlife, and forest timber, can also be replenished.

As consumers' awareness of environmental issues grows, more firms are looking for ways to lessen their negative effects on the environment and their local communities. With the help of sustainability initiatives, businesses can draw attention to their positive social impacts while retaining their clientele.

### 5.3.7. An Example

Unilever, the manufacturer of Dove soaps, Axe body spray, and many more well-known brands, is an intriguing example of a cutting-edge sustainability strategy. The business launched the Unilever Sustainable Living Plan in 2010[10], a ten-year strategy for lessening the environmental effect of its businesses while fostering a more equitable workplace. By the time the Unilever Sustainable Living Plan ended, the company was able to highlight significant advancements in both its environmental impact and financial performance. The business was able to save more than 1 billion euros between 2008 and 2018 by trying to conserve water and electricity. Additionally, by boosting opportunities for women, Unilever has elevated itself to the top position among graduate employers in the consumer products industry across 50 nations.

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10 https://assets.unilever.com/files/92ui5egz/production/9752ff2d82b8afabb507eb92c47b5dad795801d5.pdf/unilever-sustainable-living-plan.pdf

## 5.4. The Sustainability Report

The primary instrument available to an organization or business to voluntarily publicize its performance and impact in environmental, social, and governance (ESG) matters is the sustainability report. The material in the report must be meaningful to stakeholders. A sustainability report's primary objective is to be transparent about the company's contribution to sustainable development. It also serves as a way of accountability to stakeholders. (Investors, employees, market regulators, suppliers, civil society, customers, etc.). By gathering data and keeping it current on a regular basis, the report's author must create and communicate the connections between sustainability and the company.

One benefit of creating a sustainability report is that it can help the organization better manage itself by recognizing risks, spotting energy-saving opportunities, avoiding compliance problems, and enhancing internal communication and a sense of community. Many individuals in huge organizations are uninformed of company moves that they might agree with. The sustainability report also helps to improve the organization's reputation and image by highlighting its link to sustainable development through a variety of sustainable services as well as its social and environmental commitment. By sending a consistent message and eliminating statements that are off-topic, it strengthens financial relations. The report provides a consistent source of trustworthy information because it is generated based on internal consensus.


HIGHLIGHTS 2022

**ISPIRIAMO VALORE**
L'IMPRONTA SOSTENIBILE IN AMBITO ECONOMICO

Pensare in ottica sostenibile è l'ispirazione che ci permette di guardare avanti, consapevoli che la vera ricchezza è quella che coinvolge tutti: i dipendenti, i fornitori, la comunità, l'ambiente.

€ 548,6 mln
Ricavi totali del Gruppo
(€ 541,3 mln nel 2021)

€ 56,6 mln
EBITDA
(€ 57,1 mln nel 2021)

€ 528 mln
Valore economico distribuito
(€ 512,05 mln nel 2021)

€ 11,7 mln
Spese per investimenti in Ricerca e Sviluppo
(€ 10,7 mln nel 2021)

COOKING
280
Brevetti
(278 nel 2021)
367
Brevetti design
(250 nel 2021)

MOTORI
98
Brevetti
(71 nel 2021)
3
Brevetti design
(invariato nel 2021)

**CI ISPIRIAMO ALL'AMBIENTE**
L'IMPRONTA SOSTENIBILE IN AMBITO AMBIENTALE

Crediamo che solo attraverso il pieno rispetto per l'ambiente il valore possa essere creato e sostenuto nel lungo periodo.

-9.900 ton $CO_2$
Grazie all'utilizzo di energia 100% green cd. Market Based con Certificati di Garanzia di Origine
(-52% vs. emissioni totali del 2021)

-399 ton $CO_2$
Grazie all'utilizzo di energia prodotta dagli impianti Fotovoltaici in Italia
(invariato vs. 2021)

Premio "Ecopack" Conai
Grazie al design di imballaggi sostenibili

Motori 30% "Hydrogen Ready"
100% della gamma "Premix" certificata per utilizzo blend 30% metano/idrogeno

**ISPIRIAMO LE PERSONE**
L'IMPRONTA SOSTENIBILE IN AMBITO SOCIALE

Guardare alle nostre persone come la risorsa più importante sarà sempre la nostra più grande ispirazione.

2.578
Dipendenti nel mondo

XXXX
ore di formazione EHS o Safety

45% Donne
sul totale dei dipendenti
(39,7% nel 2021)

di cui 50%
tra i Dirigenti Strategici
(invariato vs. 2021)

20 Ore
di formazione medie pro capite (16,8 ore nel 2021)

Marshy
Il premio Ermanno Casoli promosso dalla Fondazione Ermanno Casoli (FEC) una dimostrazione di fare arte attraverso l'uso di materiali riciclati

*Figure 30 Elica Sustainability Report Highlights*

### 5.4.1. Materiality Analysis

What is significant for inclusion in the report is determined by the materiality analysis[11], which involves consulting all parties who contribute to or are impacted by the organization. The Global Reporting Initiative[12], sponsored by CERES and the UN Environment Programme, developed the most frequently used standard for creating sustainability reports. A sustainability report aims to take something abstract and make it concrete; it is more than just a collection of data. An organization's strategy can be better configured by creating a sustainability report, which also makes it simpler to set targets, evaluate performance, and eventually manage the transition to a sustainable business model.

### 5.4.2. The EU perspective

In areas where reporting requirements are still developing, such, for example, social, environmental, and risk reporting, organizations are encouraged to adopt disclosure or communication practices:

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*"Many enterprises provide information on a broader set of topics than financial performance and consider disclosure of such information a method by which they can demonstrate a commitment to socially acceptable practices.".*

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Large businesses and groups are required to publish a non-financial statement about environmental and social information personnel, respect for human rights, and fight against corruption for each financial year following the adoption of Directive 2014/95/EU of the European Parliament and of the Council on October

[11] https://aplanet.org/resources/how-is-a-materiality-analysis-prepared/
[12] https://www.globalreporting.org/

22, 2014, and its transposition through the Legislative Decree of December 30, 2016, No. 254[13]. Subjects outside the scope of application may voluntarily prepare and publish separate or combined non-financial statements in accordance with the aforementioned legislative decree, as well as, under certain circumstances, affix a declaration of compliance with the decree.

The Consob adopted the decree's implementing regulations with resolution 20267, which states:

- How to send the non-financial statement immediately
- All techniques for disseminating the non-financial declaration.
- The Consob control procedures and terminology.
- The standards of behaviour and methods for carrying out the work of having the auditors verify the accuracy of the information.
- The requirement to present a non-financial statement containing environmental and social information pertaining to personnel, respect for human rights and the fight against corruption for businesses and large organizations.

The profiles for which Consob oversees the disciplinary proceedings are specified in the decree. Consob may request the necessary integrations from the company in the event of incomplete or non-compliant declarations. Sanctions can be avoided if the company responds appropriately.

The European Commission unveiled a proposal for a Corporate Sustainability Reporting Directive on April 21st, 2021, as part of a package of measures to help increase the flow of funding towards sustainable activities throughout the

[13] https://eur-lex.europa.eu/legal-content/EN/NIM/?uri=CELEX%3A32014L0095

European Union. This proposal aims to enhance the consistency of sustainability reporting among businesses, fostering the availability of comparable and reliable sustainability information for financial institutions, investors, and the broader public.

### 5.4.3. GRI

Recent annual reports demonstrate the growth of ESG and sustainability reporting. In its annual reports, ASML, for instance, cites ESG 71 times and Philips over 95 times. To counteract the growing problem of greenwashing, it is imperative that all assertions are accurate and verifiable.

This is made possible by the Global Reporting Initiative (GRI), the most widely adopted sustainability reporting standard in the world. Transparency is the key to a sustainable future, according to GRI. Since 1997, it has been dedicated to the goal of achieving widespread sustainability reporting among all businesses. GRI has created the GRI Standards, a universal language for discussing sustainability, to aid businesses in their reporting.

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*"We are working with companies, investors, policymakers, society, labour organisations and other experts to develop the GRI Standards and promote their use by companies around the world. With thousands of participants in more than 100 countries, the standards advance the practice of sustainability reporting and empower companies and their stakeholders to take action and make better decisions that deliver economic, environmental and social benefits for all"* ***GRI.***

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The GRI Standards are an integrated modular collection of standards. They enable businesses to inform stakeholders and other interested parties transparently and systematically about the effects of their operations, preventing the practice of "greenwashing." Organizations can demonstrate their positive or negative contributions to sustainable development by using these Standards to determine which subjects are material (relevant) to report on.

The Standards also assist other information consumers and stakeholders in understanding what is expected of an organization in terms of reporting on and utilizing the data that is published by organizations in various ways. Investors, for instance, might review an organization's use of sustainable development in its strategy to identify financial risks and gauge its long-term success using the information provided. The information provided can also be of valuable assistance to various stakeholders, including analysts, policymakers, and academics, supporting their research endeavors, benchmarking activities, and policy formulation.

The **Universal Standards**, **Sector Standards**, and **Topic Standards** are the three series that make up the Global Reporting Initiative's Standards. Within each Standard, there are Disclosures outlining the framework for a company's structured sustainability reporting.

**Universal Standards**: these guidelines describe the methodology and process for creating a sustainability report and are applicable to any type of business.

**Sector Standards**: these standards apply to the majority of businesses in a specific industry. The 40 sectors covered by the Sector Standards are still being developed, and they will ultimately be released, starting with those that will have the most influence, such as oil and gas, agriculture, aquaculture, and fisheries. The GRI Sector Standards are designed to improve the accuracy, consistency, and comprehensiveness of organizational reporting. The Standards include a list of issues that are likely to be important to the majority of organizations in a particular industry, together with the appropriate disclosures that should be made. An organization must utilize an applicable Sector Standard when reporting with the GRI Standards if one is available.

**Topic Standards**: a collection of requirements for particular subjects, like waste, pollutants, corruption, and taxes. A business selects the pertinent Topic Standards. There are more standards and frameworks that are gaining ground in addition to the Global Reporting Initiative.

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*"The private sector can play an important role in accelerating progress on the SDGs. Working closely with the UN, national and regional governments and international organisations, we are actively working to implement smart policies that strengthen the private sector's contribution to the SDGs"* ***GRI***.

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Additionally, the Corporate Sustainability Reporting Directive, which will go into force in 2024, has been significantly influenced by the Global Reporting Initiative in the establishment of new sustainability standards:

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*"The sustainability reporting landscape is in a state of flux, with significant global developments that could raise the bar for corporate accountability ... With the new European sustainability reporting standards under development, to which GRI has been an expert contributor, we are at a crucial point. GRI is committed to playing its part and working with all stakeholders to promote transparency and corporate responsibility"* ***Eelco van der Enden, CEO of GRI.***

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The Standards are used by internal reporters to report on an organization's impacts in a trustworthy manner that is comparable across time and in comparison, to other organizations. The organization can assess its strategies and policies using the furnished data or employ it for decision-making purposes, including the formulation of goals and objectives.

## 5.5. Carbon Reporting

It is acknowledged that the finest businesses in the world are adopting sustainability as a business necessity and integrating ESG issues into their goals and missions. As this ESG momentum grows, an increasing number of organizations are incorporating carbon emissions data into their sustainability reports. As a result, carbon reporting presents a chance to quicken the shift to a low-carbon society.

First off, the Paris Agreement[14], an international agreement aimed at combating climate change, supports the movement to monitor carbon emissions. In an international effort to keep global temperature increases to two degrees Celsius above pre-industrial levels by 2040, the 189 nations that signed the Paris Agreement agreed to take actions to cut their carbon emissions. All these nations must work toward switching from energy sources with heavy emissions, including coal, to renewable energy sources if they are to fulfill their legally binding Paris promises.

Investors are also expecting reporting on carbon emissions. Investors are becoming increasingly conscious of the fact that businesses that disclose and cut their carbon

[14] https://unfccc.int/process-and-meetings/the-paris-agreement

footprints are frequently better assets[15]. This is due to a variety of factors, such as the significance of thorough disclosure of all corporate activities, cost savings from reduced carbon emissions, and business potential related to reduced emissions. Additionally, more ESG investors are realigning their investments in light of the effects of climate change.

### 5.5.1. GHG Emissions

There are three types of greenhouse gas emissions: scope 1, scope 2, and scope 3. These scopes were developed by the Greenhouse Gas Protocol as part of its Corporate Accounting Reporting Standard to offer a universal framework for calculating and controlling GHG emissions for all kinds of companies. With the aid of this approach, it is possible to avoid "double-counting" emissions in business reporting.

When humans engage in activities like burning fuel, they produce emissions, which are gases and other particles that are released into the atmosphere. Typically, automobiles and industrial processes are the most likely sources of these emissions. Infrared energy can be absorbed by greenhouse gases when they are discharged into the environment. As a result, this process will cause heat to be trapped and held in the Earth's atmosphere, leading to global warming. Carbon dioxide ($CO2$), methane ($CH4$), nitrous oxide ($NO2$), and fluorinated gases are the most harmful greenhouse gases produced by humans. The release of one or more of these greenhouse gases into the atmosphere is referred to as a greenhouse gas emission. Tones of greenhouse gas emissions are converted into carbon dioxide equivalent

[15] He, Yu, Qingliang Tang, and Kaitian Wang. "Carbon disclosure, carbon performance, and cost of capital." *China Journal of Accounting Studies* 1.3-4 (2013): 190-220.

(CO2e), a standard unit for measuring carbon footprints, and used to calculate a carbon footprint (also known as carbon emissions). The carbon footprint is represented as CO2e, which has the same global warming potential as the sum of the three primary gases that have been detected.

### 5.5.2. Scope 1

All direct emissions produced by sources that an organization directly owns, or controls are under scope 1[16]. The use of liquid fuels to power a fleet of privately owned automobiles, the usage of natural gas at domestic or foreign locations, or the release of gases from air conditioning and refrigeration systems are a few examples. A firm that delivers food could estimate its diesel usage from its own delivery vans, for instance. These can be categorized into four groups:

- Stationary combustion - this category includes all fuels and heating sources that emit greenhouse gases.
- Mobile combustion - consists of all greenhouse gas emissions from vehicles that a firm owns or controls.
- Fugitive emissions - this category includes leakage of greenhouse gases from sources like air conditioners and refrigerators.
- Process emissions - this category comprises greenhouse gas emissions from on-site manufacturing and industrial activities.

[16] Teske, Sven, et al. "Scopes 1, 2, and 3 Industry Emissions and Future Pathways." *Achieving the Paris Climate Agreement Goals: Part 2: Science-based Target Setting for the Finance industry—Net-Zero Sectoral 1.5˚ C Pathways for Real Economy Sectors*. Cham: Springer International Publishing, 2022. 315-336.

Companies that want to cut their Scope 1 emissions frequently concentrate on increasing energy efficiency and converting their fleet to electric vehicles.

### 5.5.3. Scope 2

Scope 2[17] greenhouse gas emissions are those that result from the production of energy that is obtained from a utility provider. Most businesses exclusively use electricity as a source of Scope 2 emissions. Businesses who are committed to cutting their Scope 2 emissions frequently buy their energy from utilities that offer sustainable energy solutions and offset their carbon emissions. Location-based or market-based measurements of these emissions are both possible.

Based on the location of the electricity consumer, location-based emissions employ the typical fuel mix of the electrical system. The mechanism that produces electricity and then distributes it to end users is known as the "grid." The mix of substances used to produce electricity is known as the fuel. (% of coal, gas, oil, nuclear, biomass, and renewables). The average fuel mixture employed for electricity generation throughout the reporting year is considered.

Market-based emissions take into consideration the tariff that an organization pays and are more tailored to the actual supply that is used by that organization. Therefore, when calculating the emissions, the proportion of coal, gas, oil, nuclear, biomass, and renewable energy sources in the mix purchased is taken into account.

A legal firm might request an electrical bill from the manager of its office building, for instance. They gather the number of kilowatt hours (kWh) of electricity used within a specific time period from the bill. To find the supplier's gasoline grid mix,

[17] https://ghgprotocol.org/scope-2-guidance

they also do searches on the supplier's website. They can compute their market-based scope 2 emissions thanks to this.

### 5.5.4. Scope 3

All indirect emissions that occur upstream and downstream in the reporting company's value chain but are not included by scope 2 are referred to as scope 3 emissions[18]. Alternatively put, emissions related to business operations. Scope 3 emissions are broken down into 15 categories under the GHG convention. Companies that are focused on lowering their Scope 3 emissions frequently encourage workers to work from home, reduce business travel, use climate-friendly transportation throughout the company, and reduce waste production, activities that they neither own nor have control over. The majority of an organization's carbon footprint often comes from these.


*Figure 31* https://www.compareyourfootprint.com/difference-scope-1-2-3-emissions/

[18] Teske, Sven, et al. "Scopes 1, 2, and 3 Industry Emissions and Future Pathways." *Achieving the Paris Climate Agreement Goals: Part 2: Science-based Target Setting for the Finance industry—Net-Zero Sectoral 1.5˚ C Pathways for Real Economy Sectors*. Cham: Springer International Publishing, 2022. 315-336.

### 5.5.5. Upstream Activities

The several types of upstream activities[19] include business travel as one of the most significant to record (including air travel, cabs, and buses). Additionally, employee commuting must be reported because it involves emissions from getting to and from work. By using public transit and a home office, it can be reduced. Waste produced during operations is related to wastewater treatment and waste transferred to landfills. Methane (CH4) and nitrous oxide (N2O), which are released during the disposal of waste, are more harmful than CO2 emissions. All upstream emissions from the manufacturing of the goods and services the company acquired in the same year are included in the term "purchased goods and services." Purchasing items (materials, components, and parts) linked to production should be distinguished from purchasing items unrelated to production (office furniture and IT support). The value chain's upstream (suppliers) and downstream (customers) aspects both involve transportation and distribution. It covers emissions related to third-party warehousing as well as emissions from land, sea, and air transportation.

The production of fuels and energy that the reporting company acquired and used during the reporting year that is not covered by scopes 1 and 2 is considered a fuel and energy-related activity. Capital goods are finished goods with a long lifespan that the business uses to fabricate items, deliver services, store, sell, and deliver goods. Capital goods include assets like buildings, cars, and machines. Companies shouldn't depreciate, discount, or amortize the emissions from the creation of capital goods for the purposes of accounting for scope 3 emissions. Instead,

[19] https://www.persefoni.com/learn/upstream-vs-downstream

businesses ought to take into account all cradle-to-gate emissions of capital items in the year of purchase.

### 5.5.6. Downstream Activities[20]

While financial institutions typically include investments in their reporting, other organizations also have the option to do so. Equity investments, debt investments, project finance, managed investments, and client services are the four categories under which investments are classified in GHG accounting. Franchises are companies that are allowed to sell or distribute another company's products or services in a certain area. Franchisees (i.e., businesses that run franchises and pay a fee to the franchisor) should include emissions resulting from activities under their direct control. Franchisees have the option of disclosing upstream scope 3 emissions linked to the franchisor's operations (i.e., the franchisor's scope 1 and scope 2 emissions) under category 1 (bought goods and services).

Assets under lease include those given to other organizations as well as those leased by the reporting organization (upstream). Depending on the type of leased asset, the intricate calculation method must be disclosed under scope 1 or scope 2. Regarding "in-use" products that are sold to customers, used products that have been sold are included. Even though there are wide variations, it quantifies emissions brought on by product usage. For instance, it will take many years for the emissions from using an iPhone to match those produced during production. Likewise, "waste generated during operations" is reported similarly to "end of life treatment," which relates to products sold to customers.

[20] https://www.persefoni.com/learn/upstream-vs-downstream

Firms need to evaluate how their products are disposed of, which can be challenging because it typically depends on the consumer. This motivates businesses to develop recyclable items that reduce waste sent to landfills.

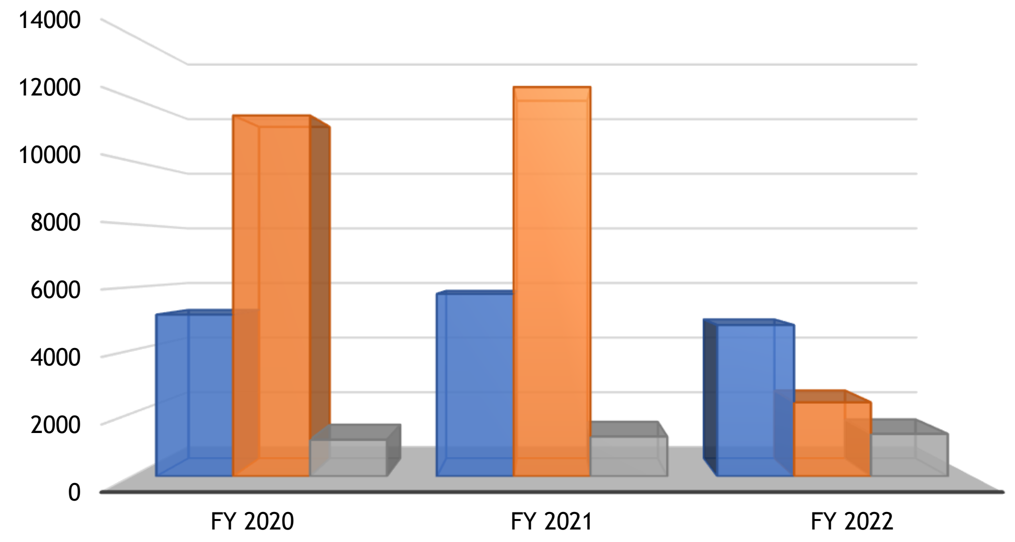
Apple is a good illustration because it shows how important it is to have access to all three carbon reporting scopes. 76% of the company's Scope 3 emissions come from its outsourced product production operations, which account for the majority of the company's emissions. ESG investors will find this material interesting as it identifies the various risks and opportunities that Apple is exposed to. For instance, there is unquestionably a sizable possibility for Apple to utilize less material overall and more recycled materials in its outsourced manufacturing operations. That presents both a financial and environmental opportunity.

## Elica Case no. 7

### Environmental Sustainability

**Greenhouse Gas Emissions**: Elica's greenhouse gas emissions are categorized into Scope 1 (direct emissions from owned or controlled sources), Scope 2 (indirect emissions from the generation of purchased energy), and Scope 3 (all other indirect emissions that occur in a company's value chain). The significant reduction in Scope 2 emissions from 12,346 tons in 2021 to 2,349 tons in 2022 is a clear testament to Elica's commitment to reducing its carbon footprint. This could be attributed to the company's strategic initiatives such as energy conservation measures, efficiency improvements in operations, and a shift towards renewable sources of energy. The slight decrease in Scope 1 emissions and the increase in

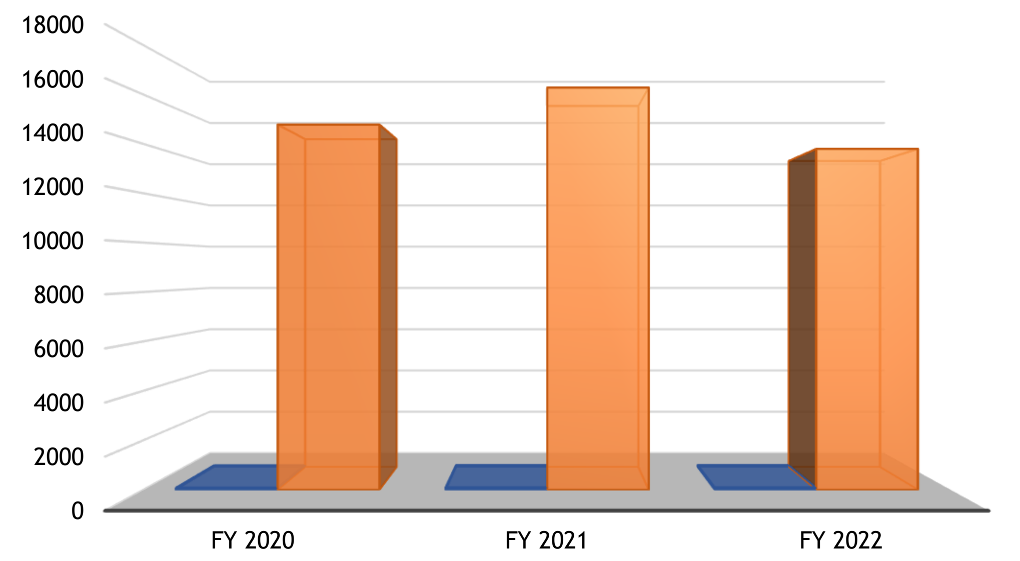
Scope 3 emissions suggest that Elica is not only focusing on its direct emissions but also taking responsibility for emissions in its value chain, which include emissions from suppliers, transportation, and end-of-life treatment of sold products.




| | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|
| - Scope 1 | 5130 | 5788 | 4800 |
| - Scope 2 | 11447 | 12346 | 2349 |
| - Scope 3 | 1164 | 1264 | 1350 |

*Figure 32 GHG Emissions*

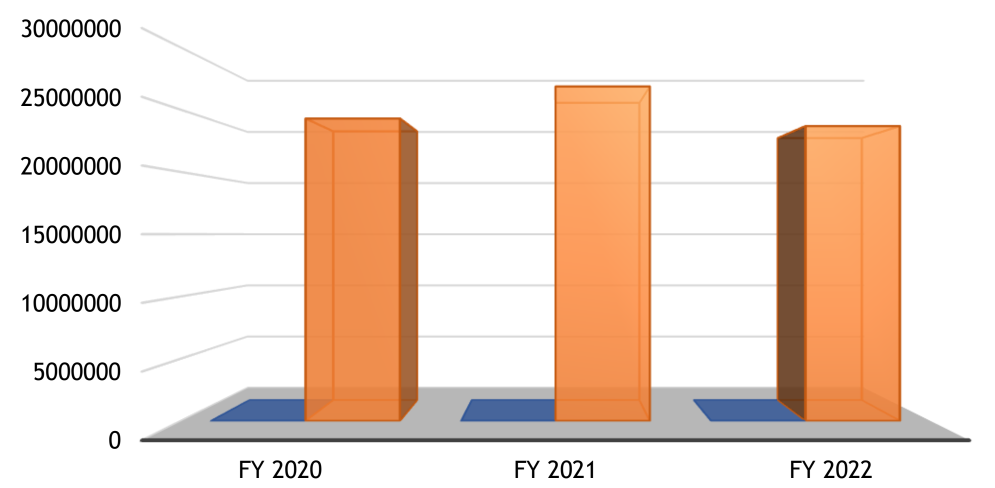
**Waste Management**: the company's waste recycling rate has shown a steady increase, indicating a strong commitment to waste reduction and the principles of a circular economy. The increase from 80.4% in 2020 to 94.2% in 2022 suggests that Elica is effectively managing its waste, through waste minimization strategies, recycling initiatives, and partnerships with waste management companies. The decrease in total waste generated from 16,274 tons in 2021 to 13,792 tons in 2022 further underscores this commitment.




| | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|
| Waste recycled rate (%)* | 80.4 | 93.2 | 94.2 |
| Wastes (tons) | 14775 | 16274 | 13792 |

*Figure 33 Waste Rate*

**Renewable Energy**: the significant increase in the percentage of electricity from renewables on total consumption, from 3.6% in 2021 to 78.3% in 2022, is a clear indication of Elica's transition towards green energy. This transition not only reduces the company's dependence on fossil fuels but also aligns with global efforts to combat climate change. It also positions Elica as a responsible and forward-thinking company in the eyes of its stakeholders.

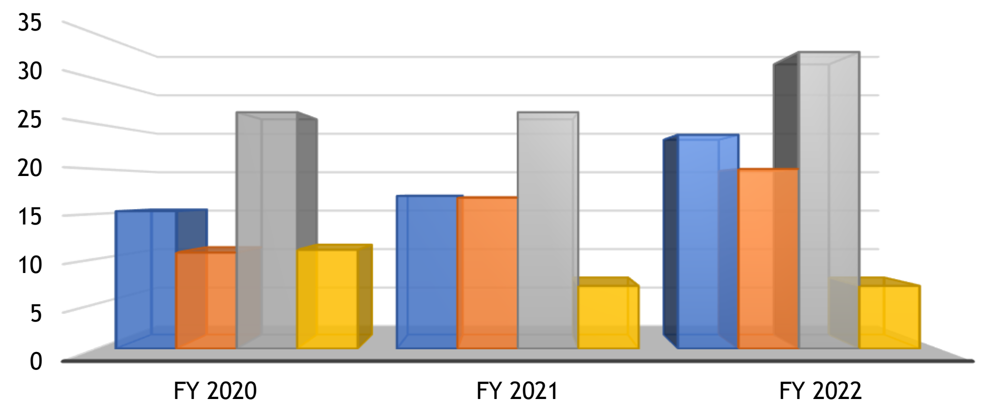



| | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|
| - Electricity from renewables on total consumption (%) | 7.4 | 3.6 | 78.3 |
| Energy Consumption (Gj) | 24286221 | 26860532 | 23679946 |

*Figure 34 Energy Rate*

**Social Sustainability**

**Gender Diversity**: the increase in the percentage of women in leadership roles from 15.3% in 2020 to 23.8% in 2022 is a positive sign of Elica's commitment to gender equality. This progress suggests that Elica is actively promoting diversity and inclusion in its leadership, which can lead to better decision-making and a more inclusive corporate culture.




| | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|
| Women in leadership roles* (%) | 15.3 | 17 | 23.8 |
| Training hrs per capita (No.) | 10.7 | 16.8 | 20 |
| Turnover ratio (%) | 26.3 | 26.3 | 33 |
| Work-related injuries (editable) | 11 | 7 | 7 |

*Figure 35 People*

**Employee Development**: the increase in training hours per capita from 10.7 in 2020 to 20 in 2022 indicates that Elica is investing in its employees' professional development. This investment can enhance the skills and capabilities of its workforce, improve employee satisfaction and retention, and ultimately contribute to the company's performance and competitiveness.

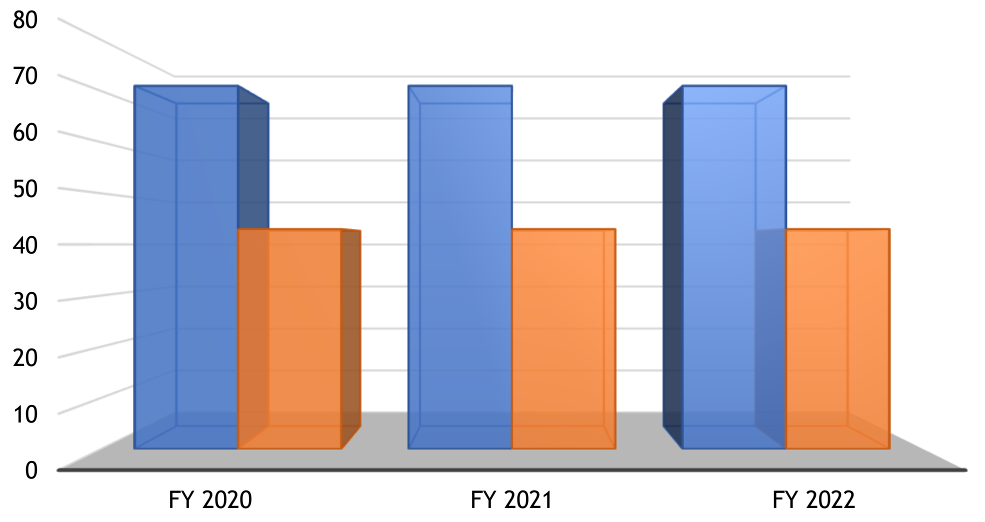
**Employee Turnover**: the increase in the turnover ratio from 26.3% in 2020 and 2021 to 33% in 2022 could suggest a higher rate of employee turnover. While a certain level of turnover is normal and can bring in fresh ideas and perspectives, a high turnover rate could indicate issues with employee satisfaction, engagement, or retention. Elica may need to investigate the reasons for this increase and implement strategies to improve employee retention.

**Workplace Safety**: the stable number of work-related injuries suggests that Elica is maintaining its focus on occupational health and safety. However, any number of injuries is a cause for concern, and Elica should continue to prioritize workplace safety and strive to reduce these injuries through safety training, hazard identification and mitigation, and promoting a culture of safety.

**Governance**

**Board Independence**: the stable rate of independent directors at 71% suggests that Elica is maintaining a high level of independence in its Board of Directors. Independent directors can provide objective and unbiased oversight and decision-making, which is crucial for protecting the interests of all shareholders.

**Board Diversity**: the stable rate of women in the Board of Directors at 43% suggests that Elica is maintaining gender diversity in its board. Gender diversity in the boardroom can lead to a broader range of perspectives, better decision-making, and improved board performance.




| | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|
| Independent directors' rate (%) | 71 | 71 | 71 |
| Women in BoD (%) | 43 | 43 | 43 |

*Figure 36 Corporate Governance*

In conclusion, Elica's non-financial disclosures reflect its commitment to environmental stewardship, social responsibility, and good corporate governance. These commitments are not only ethically and morally right but also strategically important in today's business environment, where stakeholders increasingly expect companies to demonstrate their commitment to sustainability and social responsibility. Elica's performance in these areas contributes to its reputation, stakeholder relationships, and long-term success.

# CONCLUSIONS

The journey through the intricacies of investor relations, corporate governance, investor relations technical tools, and corporate sustainability has unraveled a tapestry of complexities and opportunities that companies must navigate in today's business landscape. This thesis has provided a comprehensive and critical analysis, by offering a deep understanding of these domains and sparking thought-provoking insights for further exploration.

Investor relations (IR) professionals have emerged as the linchpin in fostering effective communication and building relationships between companies and their stakeholders. As the bridge between the company and the investment community, IR professionals bear the responsibility of conveying vital financial and non-financial information, ensuring transparency, and fostering trust. However, the paradigm shift in the investment landscape, characterized by an increasing emphasis on Environmental, Social, and Governance (ESG) factors and the rise of sustainable investing, presents new challenges and demands for IR professionals. They must proactively adapt their strategies, engage with diverse stakeholders, and meet the growing expectations of investors, regulators, and society at large.

Elica S.p.A., the focal point of the case study, epitomizes the dynamic nature of contemporary business operations. With a diverse portfolio of business units, a robust brand presence, and a rich historical background, Elica has successfully navigated various challenges. These include exposure to foreign currencies, the imperative for continuous innovation and sustainability, and the intricate management of a vast distribution system. Elica's success lies not only in its ability to adapt to shifting market dynamics but also in its commitment to geographical expansion and the cultivation of strong relationships with stakeholders. Nevertheless, Elica must remain vigilant in identifying and managing risks while capitalizing on emerging opportunities to sustain its competitive edge.

The investor relations technical kit has served as a valuable compendium of essential financial metrics and tools employed by IR professionals. From the widely utilized EBITDA and EBIT to comprehensive cash flow analyses and the intricacies of discounted cash flow (DCF) modeling, these tools offer profound insights into a company's financial performance and future prospects. However, it is crucial to acknowledge the limitations and drawbacks inherent to each metric and exercise caution when interpreting and comparing them. The choice of which metric to employ must be contextual and purpose-driven, considering relevant factors such as industry dynamics, growth potential, and capital structure. IR professionals must leverage their expertise to present accurate and meaningful information, aiding investors in making informed decisions.

Corporate governance has emerged as a pivotal component in establishing transparent and accountable business practices. Adherence to sound governance principles is instrumental in building trust among stakeholders, mitigating risks associated with misconduct, and fostering long-term sustainability. The composition of the board of directors (BoD), its independence, and the implementation of effective corporate governance models play pivotal roles in shaping a company's governance framework. However, instances of corporate governance failures have underscored the importance of continuous monitoring, evaluation, and enhancement of governance practices. Companies must learn from past shortcomings, adapt to emerging trends, and embrace innovative approaches to foster a culture of good governance that safeguards the interests of all stakeholders.

The examination of shareholders' meetings has shed light on the significance of these gatherings in facilitating effective communication and decision-making between a company's management and its shareholders. Different types of meetings, including ordinary and extraordinary shareholders' meetings, serve distinct purposes, ranging from financial reporting and dividend distribution to strategic decisions and corporate restructuring. The presence of key stakeholders, such as shareholders, board members, and auditors, ensures transparency, accountability, and checks and balances. However, there is ample room for improvement in terms of shareholder engagement and participation. Companies must embrace innovative approaches, leverage technology, and create platforms for enhanced shareholder involvement to foster a more democratic and inclusive decision-making process.

The issue of insider trading and internal dealing has raised concerns regarding the integrity of capital markets and the equitable treatment of all investors. Instances of misconduct in this domain highlight the need for stringent regulations, robust compliance mechanisms, and ethical practices. Regulators must continuously monitor and enforce fair trading practices, and companies must instill a strong culture of ethics, transparency, and accountability. By doing so, they can safeguard the trust and confidence of investors while fostering a level playing field in the financial markets.

Corporate sustainability has emerged as a transformative force, compelling companies to integrate environmental, social, and governance considerations into their strategies and operations. The adoption of sustainable practices not only aligns companies with global goals such as the United Nations' Sustainable Development Goals (SDGs) but also enhances their competitiveness, risk resilience, and long-term value creation. The pillars of sustainability, encompassing economic viability, social responsibility, and environmental stewardship, require companies to embrace innovation, engage with stakeholders, and contribute positively to society. However, challenges such as materiality analysis, reporting frameworks, and accurate measurement of environmental impact persist. Companies must invest in robust sustainability practices, collaborate with stakeholders, and seize the opportunities presented by sustainable business models.

ESG investing has gained significant traction, with investors increasingly considering environmental, social, and governance factors in their investment decisions. Companies that proactively address ESG issues and embed them into their business strategies stand to attract and retain capital, enhance their reputation, and mitigate risks. The materiality of ESG topics varies across industries, necessitating tailored approaches to identify, measure, and report on these factors. Furthermore, the harmonization of reporting frameworks and the development of standardized metrics are essential to ensure comparability and enable investors to make informed choices.

The sustainability report serves as a crucial communication tool, providing stakeholders with a comprehensive overview of a company's sustainability performance and progress. Materiality analysis, an integral part of the reporting process, enables companies to identify and prioritize the most relevant sustainability topics. The European Union's perspective on sustainability reporting underscores the importance of standardization and accountability. Frameworks such as the Global Reporting Initiative (GRI) offer comprehensive guidelines for reporting, enabling companies to disclose their environmental, social, and governance impacts systematically. However, continuous improvement in reporting practices, the integration of emerging sustainability trends, and the harmonization of reporting standards remain imperative.

Carbon reporting, particularly greenhouse gas (GHG) emissions measurement and management, has assumed heightened importance in the context of climate change mitigation. Companies must measure and report their emissions across all scopes, incorporating both upstream and downstream activities. Robust carbon reporting enables companies to identify emission hotspots, set reduction targets, and track progress towards their climate goals. Through transparent carbon reporting, companies can enhance their environmental performance, respond to investor expectations, and contribute to global efforts to combat climate change.

In conclusion, the intricacies of investor relations, corporate governance, investor relations technical tools, and corporate sustainability intertwine to shape the success, resilience, and reputation of companies in today's dynamic business landscape. Companies and their stakeholders must embrace a proactive and holistic approach, aligning their strategies and practices with the principles of transparency, accountability, and sustainable development. Through effective communication, stakeholder engagement, and continual improvement, companies can unlock opportunities, mitigate risks, and position themselves as catalysts for positive change. The future of business lies in the convergence of financial performance, ethical conduct, and environmental and social responsibility—a future that demands the relentless pursuit of excellence and the collective commitment to building a more inclusive, resilient, and sustainable global economy.

In the ever-evolving landscape of business, where challenges and opportunities intertwine, one thing remains constant: the imperative for companies to adapt, innovate, and lead with purpose. As we conclude this exploration of investor relations, corporate governance, investor relations technical tools, and corporate sustainability, we are confronted with a call to action.

The path forward is not without obstacles. Companies must navigate through the complexities of a globalized economy, changing investor expectations, and the urgency of addressing pressing environmental and social issues. However, within these challenges lie tremendous possibilities for those willing to embrace a transformative mindset.

The companies that will thrive in the future are those that dare to go beyond mere compliance and harness the power of transparency, stakeholder engagement, and responsible leadership. They are the ones that embed sustainability into their DNA, driving innovation, shaping markets, and redefining success. They are the beacons of good governance, fostering trust, accountability, and long-term value creation.

The future belongs to those who embrace a broader purpose—a purpose that extends beyond financial gains to encompass the well-being of people, planet, and prosperity. It is a future where companies not only navigate change but also become agents of change, pioneering new models of business that empower communities, preserve our natural resources, and inspire generations to come.

As we bid farewell to the realm of investor relations, corporate governance, and corporate sustainability, let us carry with us a renewed sense of purpose and the conviction that businesses have the power to shape a better world. Let us forge ahead with determination, resilience, and unwavering commitment to the principles of transparency, accountability, and sustainability.

For it is in our collective actions, as companies, investors, and individuals, that we can create a legacy of positive impact—a legacy that transcends profits and defines our shared humanity. Together, let us embark on this transformative journey, knowing that the choices we make today will shape the world we leave behind for future generations.

The time is now. The opportunity is within our grasp. Let us seize it, guided by the principles of excellence, integrity, and sustainability, and build a future where business becomes a force for good—a future that will be remembered not only for its achievements but also for its profound impact on the world we inhabit.

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# FIGURES

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With sincere thanks and warm regards,

Michele