

Product Sustainability

Product quality and safety

In the entire history of the Group, rather than an objective to pursue, quality has been the actual starting point.

The Group has two Quality Functions, one for the Heating division and one for the Metering division, which, in addition to ensuring the normal control and prevention on processes and products, continuously ensures that company processes are in line with the best standards in terms of quality, safety and environmental certifications - including controls on hazardous substances and the sourcing of materials from war zones.

Among the first in Italy to achieve ISO 9001 Quality Certification, in 1988, the Group has, over the years, pursued steady growth aimed at adapting to and often anticipating the emerging needs of the market. In this regard, all of the Group's operating facilities are certified to ISO 9001 in its latest 2015 revision⁸.

Monitoring by certification authorities has borne out the organisation's ability to keep product quality consistent with the international standards of reference.

In order to maintain the certifications, the Group submits to annual notified body audits of its Management System and corporate and production processes. This activity is supplemented by an internal audit regularly conducted on all corporate processes and functions, and main suppliers. In addition, the SIT Group regularly analyses all customer feedback.

All Group companies are fully supported and encouraged in maintaining the corporate Quality System, in order to ensure that they design, build, check and supply products with exactly the same degree of care, competence and dedication.

To achieve this goal, the Group promotes the continuous improvement of the Quality System and the development connected programmes, in order to optimize the control, efficiency and precision of its processes.

The commitment to investing in quality is essential in order to compete in the global market, and even more so for a Group that designs, produces and sells components and products for which safety is a fundamental element.

Quality and safety constitute the earliest stages in a product's life cycle, involving the very latest methods to improve robustness and prevent errors that might otherwise lead to higher costs if not identified in time. The Group also provides for continuous and strict controls on the safety of its products.

On an annual basis, corporate quality goals are defined and then formalized in an Annual Quality Plan. The KPIs of such goals include the quality of the finished product as perceived by customers, the efficiency of internal processes, and the performance of suppliers. During the year, performances are continuously monitored against targets in order to verify project progress and identify new actions deemed necessary.

⁸ Note that MeterSIT updated to ISO 9001:2015 in 2018.

The most relevant product quality issues regard mechanical parts, metrology, electronic boards and software.

Software quality, in particular, is managed by the Group through structured testing and validation methodologies aimed at preventing potential criticalities.

In addition to the aforementioned certifications, the Metering Division's Rovigo plant is certified to Annex IV of the "Atex Directive" as a guarantee of Production Quality Assurance regarding instruments and systems used in potentially explosive atmospheres. Furthermore, MeterSit S.r.l.'s Rovigo and Brasov plants are certified to Module D of the Measuring Instruments Directive as a guarantee of Production Quality Assurance.

Regarding mechanisms for handling complaints and notifications, the Group has an "After Sales" department which acts as the receiving point for all customer complaints. A dedicated team analyses every complaint received to verify any correlation with defects on returned products attributable to the company.

Research and Development

The SIT Group develops and manufactures high-tech systems and components. Investing in Research and Development is therefore essential to maintaining a competitive advantage over other players in a market that continually demands more innovative and highly performing products capable of guaranteeing the highest energy classes. From a manufacturing perspective, the SIT Group is also constantly engaged in research into using smaller quantities of materials, in order to make production cycles more efficient and to reduce environmental impacts. Researching new technological solutions and developing new and better performing products is therefore the best way to continue leading the market and strengthening a brand image globally recognized as a synonym for quality and innovation.

In 2018, the Group invested approximately 3% of its revenue, amounting to Euro 10.8 million, into research and development.

As of the end of 2018, the SIT Group owns⁹ 75 patents, while a further 15 are pending in 2019.

The Group has chosen to adopt a matrix management organizational structure in which specialized professionals define development processes and scout new technologies in the fields of electronics, mechanics, testing methods and technical documentation development. In particular, the Heating Division employs four platform managers for the management of all project and product development phases, from conceptualization to production.

Furthermore, demands for an increasingly reduced time-to-market requires the adoption of the latest methods and tools in order to design products faster while guaranteeing the highest standards of reliability and quality.

Our product development process follows a stage-gate methodology, characterized by the following phases:

- Concept - definition of the design and product specifications;
- Development - concept realization;
- Verification and certification - stringent product testing and controls to assess performance and behaviour under extreme conditions;
- Release and production.

The process minimizes various main risks in the development of a new product, such as incompatibility with international regulations or the quality demanded by customers, and delays in its development and production release.

Operating in an international technological context, the Group can take numerous opportunities to establish collaborations with research institutions and customers. Indeed, for years, the Group has collaborated with leading Italian universities, such as the Polytechnic University of Milan, the University of Padua and the University of Ferrara, and with leading global players in co-design and development activities.

These opportunities have allowed the Group to keep pace with global technological developments, developing and exploiting new competences and products both with and for its own customers.

Numerous research collaborations with universities are currently active on the development of innovative technologies aimed at significantly reducing energy consumption and pollution, while guaranteeing ever better temperature control comfort for users.

⁹All patent families for which the first filing was granted are considered.

Heating Division

Within the Heating division, the research is focused on the development of electronic and mechanical solutions that are increasingly integrated, intelligent, able to communicate with the external environment through the most modern internet of things technology (IOT), easy to use and, at the same time capable of maximising comfort performance while reducing energy consumption as much as possible.

During 2018, the main projects included:

- The development of an innovative Combustion Management System (CMS) valve able to significantly increase modulation ratio performance, allowing for more precise adjustments and greater energy savings;
- The development of a new ventilation architecture aimed at increasing performance while minimizing the use of space and materials;
- The development of a new valve platform for domestic boilers with a simplified and versatile architecture adaptable and customizable to various applications and markets in a shorter time and with less production investment requirements;
- Expansion of the range of adapters and bends used to connect the various boiler models.

Smart Metering Division

The Metering Division's research and development department has defined specific medium and long-term goals to focus development and resource investments on:

- The development of a mechanical and electronic modular product platform for the global market.
- The strengthening of collaboration with the Group's central strategic sourcing department in order to take advantage of all cost optimization opportunities.
- Improve the measuring sensor.
- Preliminary analysis on new measurement technologies.

In particular, 2018 saw the certification of a new domestic meter. It entered into production for foreign markets together with a new commercial and industrial sector meter platform. Development also began on a new meter to complete the Group's offer of smart meters for the commercial and industrial segment. Finally, product cost reduction activities continued, with a particular focus on the Italian domestic market.

Regarding environmental sustainability, the Metering Division's technological research in the monitoring field allows end users to benefit from a greater awareness of their own consumption, therefore empowering them in making energy savings.

SIT Group supply chain

Each SIT Group division has a Central Procurement Department for the procurement of raw materials, components, semi-finished products and services for all of the divisions' companies.

The two division departments share the goal of procuring components, materials and services at the right price, in agreed times, at a high level of quality and in compliance with criteria of ethics and sustainability.

In the pursuit of this goal, the Group strives to consolidate partnerships with its suppliers aimed at protecting supply quality and promoting safety, innovation and technological development. Such strategic partnerships are beneficial for both parties in terms of competitive advantages, proactive cooperation in resolving problems and the development of know-how and innovative solutions for market needs.

Direct materials suppliers are, in terms of both numbers and expenditure, those with the greatest impact.

Percentage of suppliers by supply type ¹⁰	2017	2018
Electromechanical and chemical	21%	24%
Electronic components	20%	19%
Metals and raw materials	28%	27%
Production site services	31%	30%

Suppliers are selected according to various criteria guaranteeing the highest standards of quality, costs and execution times.

In addition, in order to guarantee compliance with ethical standards in its supply chain, the Group has defined a **Code of Conduct for Suppliers and Third- party Intermediaries**, which expresses the basic principles third parties, individuals and entities must comply with in supplying goods or services, or brokering goods transactions between the seller and SIT S.p.A. or any of the SIT Group's subsidiaries. The Code is distributed to suppliers during the stipulation of the supply contract, and must be returned signed for acknowledgment. This Policy is available on the Group website in the "Corporate Governance" section: <http://www.sitgroup.it/codici-condotta-policies/>.

The Code's principles define the Group's commitment to operating in compliance with applicable legislation and with respect for human rights, child labour prevention, employee health and safety, environmental protection and sustainability, conflict mineral use prohibitions, conflict of interest and corruption prevention, fair competition and anti-trust measures, information confidentiality, and property rights.

The Group has defined a **Conflict Minerals Policy** in order to avoid indirect tolerance of human right violations in certain countries, thus undertaking to use and acquire only materials not containing minerals from conflict zones, such as the Democratic Republic of Congo and other countries

¹⁰ The table shows only direct materials suppliers and their share of the total number of Group suppliers.

categorized as “Covered Countries”. In particular, the Group requires its suppliers to complete a Conflict Mineral Reporting Template (CMRT) indicating the origin of the materials in their supply chain.

Furthermore, in addition to other actions implemented to protect human health and the environment, the Group has defined the standard SIT 4900000. This standard summarizes supply materials requirements, including those deriving from the REACH regulation and RoHS directive, which Group suppliers are required to comply with.

In coherence with SIT Group’s aim of being a versatile and innovative player in the global market, suppliers are required to:

- React quickly and effectively to market changes
- Maximize reliability, functionality and punctuality
- Minimise execution times
- Optimize lot sizes

As SIT Group products are extremely specific safety products, component suppliers are subjected to rigorous testing and must guarantee reliable supply standards. The Group pursues a policy aimed at guaranteeing supply continuity through the identification of multiple sources, contractual coverage, and back-up and supply interruption risk mitigation plans.

The following table indicates expenditure in the Group’s production facilities on local suppliers. Local suppliers are used most in Italy and the Netherlands, accounting for an average of 45% of expenditure. However, Romania and Mexico have low percentages of local suppliers. In particular, Romania mainly procures materials from Italy, while Mexico procures from the USA. Given the specificity of its products, the SIT Group applies a procurement strategy that favours the quality of procured materials over the geographical proximity of the supplier to production sites. It should also be noted that a high percentage of procurement for the Heating Division’s final products is intercompany, as sizeable volumes of components are manufactured directly by SIT Group companies.

Portion of spending from local suppliers¹¹	2017	2018
Italy	50%	46%
Romania	2%	2%
Netherlands	33%	35%
Mexico	3%	3%
China	19%	12%

¹¹ The percentage is calculated from expenditure on direct suppliers, considering local suppliers to be located in the same geographical region reported, in addition the calculation consider also intercompany movement. Countries with significant operations are those where the Group has production facilities.