

# Red Eléctrica Corporación, S.A. and Subsidiaries

Consolidated Annual Accounts  
31 December 2017

Consolidated Directors' Report  
2017

(With Independent Auditor's Report Thereon)

(Translation from the originals in Spanish. In the event of discrepancy, the Spanish-language versions prevail.)



KPMG Auditores, S.L.  
Paseo de la Castellana, 259 C  
28046 Madrid

## **Independent Auditor's Report on the Consolidated Annual Accounts**

(Translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

To the Shareholders of Red Eléctrica Corporación, S.A.

### **REPORT ON THE CONSOLIDATED ANNUAL ACCOUNTS**

#### **Opinion**

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We have audited the consolidated annual accounts of Red Eléctrica Corporación and subsidiaries (together the "Group"), which comprise the consolidated balance sheet at 31 December 2017, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and consolidated notes.

In our opinion, the accompanying consolidated annual accounts give a true and fair view, in all material respects, of the consolidated equity and consolidated financial position of the Group at 31 December 2017 and of its consolidated financial performance and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) and other provisions of the financial reporting framework applicable in Spain.

#### **Basis for Opinion**

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We conducted our audit in accordance with prevailing legislation regulating the audit of accounts in Spain. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Annual Accounts* section of our report.

We are independent of the Group in accordance with the ethical requirements, including those regarding independence, that are relevant to our audit of the consolidated annual accounts in Spain pursuant to the legislation regulating the audit of accounts. We have not provided any non-audit services, nor have any situations or circumstances arisen which, under the aforementioned regulations, have affected the required independence such that this has been compromised.

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



**Key Audit Matters**

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the consolidated annual accounts of the current period. These matters were addressed in the context of our audit of the consolidated annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

<b>Property, plant and equipment: Euros 8,747,376 thousand</b> <b>See note 6 to the consolidated annual accounts</b>	
<i>Key Audit Matters</i>	<i>How the Matter was Addressed in Our Audit</i>
<p>Most of the Group's property, plant and equipment pertain to Red Eléctrica de España, the regulated activity of which mainly consists of managing the transmission network of the Spanish electricity system. Each year, Red Eléctrica de España makes substantial investments in property, plant and equipment in accordance with the Electricity Transmission Network Development Plan for 2015 – 2020 approved by agreement of the Council of Ministers on 16 October 2015. In 2017 additions totalled Euros 470,583 thousand.</p> <p>Considering the nature of Red Eléctrica de España's business, remuneration is set by the Ministry of Energy, Tourism and the Digital Agenda (MINETAD). The calculation method is stipulated in legislation and takes into account the costs necessary to construct, operate and maintain the technical electricity facilities, in accordance with Electricity Industry Law 24/2013 of 26 December 2013. As part of the Group's revenues are directly related to the recognised electricity transmission facilities, and bearing in mind the significance of the asset values in the consolidated annual accounts, we have considered the measurement of property, plant and equipment to be a relevant aspect of the audit.</p>	<p>Our audit procedures included evaluating the relevant controls associated with processes involving fixed assets and acquisitions, as well as performing substantive procedures on property, plant and equipment. We also assessed the compliance of the Group's accounting policies on fixed assets with the applicable accounting framework.</p> <p>Our procedures for evaluating and analysing the control environment were focused on:</p> <ul style="list-style-type: none"> <li>- Testing the design, implementation and effective operation of key manual and automated controls related to the cycles of "additions and disposals of fixed assets", "calculation of depreciation charges and provisions for fixed assets", and "acquisition of assets and services, building stage certificates".</li> </ul> <p>Our substantive procedures on fixed assets mainly consisted of:</p> <ul style="list-style-type: none"> <li>- Analysing additions during the year and assessing the accuracy of their accounting recognition. We analysed documentation supporting the cost allocation for a sample of projects in progress, as well as documentation supporting stage certificates.</li> <li>- We assessed the depreciation charges for the year by means of analytical tests, considering the useful lives of these assets.</li> </ul> <p>We also assessed whether the disclosures in the consolidated annual accounts meet the requirements of the financial reporting framework applicable to the Company.</p>

**Financial debt: hedging instruments (assets: Euros 12,970 thousand; liabilities: Euros 61,437 thousand)**

See note 17 to the consolidated annual accounts

<i>Key Audit Matters</i>	<i>How the Matter was Addressed in Our Audit</i>
<p>Net financial debt totals Euros 4,791,798 thousand, of which Euros 539,695 thousand is in foreign currency. The Group arranges financial instruments, including foreign currency and interest rate derivatives, to hedge exposures to exchange rate and interest rate fluctuations.</p> <p>Derivatives designated as accounting hedges must meet strict criteria with respect to documentation and the effectiveness of the hedge on inception.</p> <p>Furthermore, the fair value of derivative financial instruments is determined using valuation techniques that may take into consideration, among other factors, unobservable market data or complex pricing models that require a high degree of judgement.</p> <p>Given the complexity of complying with the legislation in force governing the identification and measurement of hedging instruments and the correct measurement of their effectiveness, we have considered this to be a key audit matter.</p>	<p>Our audit procedures included evaluating the relevant controls associated with the classification and measurement of hedging instruments, and performing substantive procedures thereon. We also assessed the compliance of the Group's accounting policies on financial instruments with the applicable accounting framework.</p> <p>Our procedures for evaluating the control environment were focused on:</p> <ul style="list-style-type: none"> <li>- Testing the design, implementation and effective operation of key controls related to the cycles of "derivative financial instruments" and "recognition of financial transactions", as well as the controls in place to monitor these items.</li> </ul> <p>Our substantive procedures on hedging derivatives mainly consisted of:</p> <ul style="list-style-type: none"> <li>- Performing substantive tests to evaluate whether derivative financial instruments have been correctly measured. Our specialists in financial instruments were involved in these procedures.</li> <li>- Assessing compliance with hedge accounting criteria under International Accounting Standard (IAS) 39 as regards identifying hedging instruments and positions to be hedged. Our specialists in financial instruments were involved in these procedures.</li> <li>- We assessed the reasonableness of the measurement of the effectiveness of the Group's accounting hedges and whether the outcome is within the range defined by accounting legislation. Our specialists in financial instruments were involved in these procedures.</li> </ul> <p>We also assessed whether the disclosures in the consolidated annual accounts meet the requirements of the financial reporting framework applicable to the Company.</p>



## **Other Information: Consolidated Directors' Report**

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Other information solely comprises the 2017 Consolidated Directors' Report, the preparation of which is the responsibility of the Parent's Directors and which does not form an integral part of the consolidated annual accounts.

Our audit opinion on the consolidated annual accounts does not encompass the consolidated directors' report. Our responsibility as regards the content of the consolidated directors' report is defined in the legislation regulating the audit of accounts, which establishes two different levels:

- a) A specific level applicable to the consolidated statement of non-financial information and to certain information included in the Annual Corporate Governance Report, as defined in article 35.2. b) of Audit Law 22/2015, which consists solely of verifying that the aforementioned information has been provided in the director's report, or where applicable, in a separate report for the same year to which reference is made in the directors' report, and if not, to report on this matter.
- b) A general level applicable to the rest of the information included in the directors' report, which consists of assessing and reporting on the consistency of this information with the consolidated annual accounts, based on knowledge of the Group obtained during the audit of the aforementioned consolidated accounts and without including any information other than that obtained as evidence during the audit. Also, assessing and reporting on whether the content and presentation of this part of the consolidated directors' report are in accordance with applicable legislation. If, based on the work we have performed, we conclude that there are material misstatements, we are required to report them.

Based on the work carried out, as described in the preceding paragraph, we have verified that the specific information referred to in paragraph a) above has been provided in the directors' report and the rest of the information contained in the consolidated directors' report is consistent with that disclosed in the consolidated annual accounts for 2017, and that the content and presentation of the report are in accordance with applicable legislation.

In accordance with the requirements set forth in article 540 of the Revised Spanish Companies Act and Spanish National Securities Market Commission (CNMV) Circular 7/2015 of 22 December 2015, which provides the models for the Annual Corporate Governance Report for listed corporations, and for the purposes of the description of the System of Internal Control over Financial Reporting in Annual Corporate Governance Reports, and as mentioned in section F.7.1 of the Annual Corporate Governance Report, which forms part of the accompanying consolidated directors' report for 2017, on 19 February 2018, at the Company's request, we issued our Independent Reasonable Assurance Report on the System of Internal Control over Financial Reporting (ICOFR) of the Red Eléctrica Group for 2017, based on our examination, which was performed in accordance with ISAE 3000 (International Standard on Assurance Engagements 3000, Assurance Engagements Other than Audits or Reviews of Historical Financial Information) issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) for the issue of reasonable assurance reports.



## **Directors' Responsibility for the Consolidated Annual Accounts**

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The Parent's Directors are responsible for the preparation of the accompanying consolidated annual accounts in such a way that they give a true and fair view of the consolidated equity, consolidated financial position and consolidated financial performance of the Group in accordance with IFRS-EU and other provisions of the financial reporting framework applicable to the Group in Spain, and for such internal control as they determine is necessary to enable the preparation of consolidated annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated annual accounts, the Parent's Directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The Parent's audit committee is responsible for overseeing the preparation and presentation of the consolidated annual accounts.

## **Auditor's Responsibilities for the Audit of the Consolidated Annual Accounts**

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Our objectives are to obtain reasonable assurance about whether the consolidated annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with prevailing legislation regulating the audit of accounts in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence economic decisions of users taken on the basis of these consolidated annual accounts.

As part of an audit in accordance with prevailing legislation regulating the audit of accounts in Spain, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.



- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Parent's Directors.
- Conclude on the appropriateness of the Parent's Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated annual accounts, including the disclosures, and whether the consolidated annual accounts represent the underlying transactions and events in a manner that achieves a true and fair view.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated annual accounts. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the audit committee of the Parent regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Parent's audit committee with a statement that we have complied with the applicable ethical requirements, including those regarding independence, and to communicate with them all matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated to the audit committee of the Parent, we determine those that were of most significance in the audit of the consolidated annual accounts of the current period and which are therefore the key audit matters.

We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.



## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Additional Report to the Audit Committee of the Parent\_\_\_\_\_**

The opinion expressed in this report is consistent with our additional report to the Parent's audit committee dated 19 February 2018.

### **Contract Period\_\_\_\_\_**

We were appointed as auditor of the Group by the shareholders at the ordinary general meeting on 15 April 2016 for a period of three years, from the year commenced 1 January 2016.

Previously, we were appointed for a period of three years, by consensus of the shareholders at their general meeting, and have been auditing the annual accounts since the year ended 31 December 2013.

KPMG Auditores, S.L.  
On the Spanish Official Register of  
Auditors ("ROAC") with No. S0702

*(Signed on the original in Spanish)*

Ana Fernández Poderós  
On the Spanish Official Register of Auditors ("ROAC") with number 15547

19 February 2018





RED ELÉCTRICA GROUP  
 CONSOLIDATED STATEMENT OF FINANCIAL POSITION  
 AT 31 December 2017 AND 2016  
 IN THOUSANDS OF EUROS

<b>ASSETS</b>	<b>31/12/2017</b>	<b>31/12/2016</b>
Intangible assets (note 5)	154,939	134,572
Property, plant and equipment (note 6)	8,747,376	8,776,711
Investment property (note 7)	2,385	2,429
Equity-accounted investees (note 8)	172,727	200,757
Non-current financial assets (note 16)	108,235	111,861
Deferred tax assets (note 20)	27,824	28,903
Other non-current assets	752	1,532
<b>NON-CURRENT ASSETS</b>	<b>9,214,238</b>	<b>9,256,765</b>
Inventories (note 9)	39,753	39,467
Trade and other receivables (note 10)	1,013,355	962,122
Trade receivables	14,940	15,052
Other receivables	994,627	943,376
Deferred tax assets (note 20)	3,788	3,694
Other current financial assets (note 16)	80,668	40,575
Cash and cash equivalents	569,869	251,421
<b>CURRENT ASSETS</b>	<b>1,703,645</b>	<b>1,293,585</b>
<b>TOTAL ASSETS</b>	<b>10,917,883</b>	<b>10,550,350</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Capital	3,157,494	2,965,210
Reserves	270,540	270,540
Own shares and equity holdings (-)	2,384,396	2,222,906
Profit attributable to the Parent	(29,769)	(36,739)
Interim dividend (-)	669,836	636,920
Interim dividend (-)	(137,509)	(128,417)
<b>Valuation adjustments</b>	<b>(64,104)</b>	<b>(62,156)</b>
Available-for-sale financial assets	15,435	16,125
Hedging transactions	(77,241)	(83,801)
Translation differences and other	(2,298)	5,520
<b>EQUITY ATTRIBUTABLE TO THE PARENT</b>	<b>3,093,390</b>	<b>2,903,054</b>
<b>Non-controlling interests</b>	<b>59</b>	<b>17,495</b>
<b>TOTAL EQUITY (note 11)</b>	<b>3,093,449</b>	<b>2,920,549</b>
Grants and other (note 12)	597,122	547,941
Non-current provisions (note 13)	100,982	94,651
Non-current financial liabilities (note 16)	4,692,352	5,034,400
Loans and borrowings, bonds and other marketable securities	4,630,691	4,960,556
Other non-current financial liabilities	61,661	73,844
Deferred tax liabilities (note 20)	472,475	486,570
Other non-current liabilities (note 14)	87,019	64,225
<b>NON-CURRENT LIABILITIES</b>	<b>5,949,950</b>	<b>6,227,787</b>
Current financial liabilities (note 16)	1,471,957	1,066,909
Loans and borrowings, bonds and other marketable securities	824,497	384,044
Other current financial liabilities	647,460	682,865
Trade and other payables (note 18)	402,527	335,105
Suppliers	343,694	301,272
Other payables	47,974	19,787
Deferred tax liabilities (note 20)	10,859	14,046
<b>CURRENT LIABILITIES</b>	<b>1,874,484</b>	<b>1,402,014</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>10,917,883</b>	<b>10,550,350</b>

Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



RED ELÉCTRICA GROUP  
CONSOLIDATED INCOME STATEMENT  
2017 AND 2016  
IN THOUSANDS OF EUROS

<b>CONSOLIDATED INCOME STATEMENT</b>	<b>2017</b>	<b>2016</b>
Revenue (note 21-a)	1,941,165	1,932,343
Self-constructed assets	66,757	40,398
Supplies (note 21-b)	(61,110)	(49,222)
Other operating income	29,450	21,264
Personnel expenses (note 21-c)	(148,693)	(145,145)
Other operating expenses (note 21-b)	(308,071)	(313,589)
Depreciation and amortisation (notes 5, 6 and 7)	(515,151)	(504,200)
Non-financial and other capital grants (note 12)	23,441	21,318
Impairment and gains/(losses) on disposal of fixed assets (note 6)	3,627	121
<b>RESULTS FROM OPERATING ACTIVITIES</b>	<b>1,031,415</b>	<b>1,003,288</b>
Finance income (note 21-d)	9,236	10,970
Finance costs (note 21-d)	(151,738)	(162,003)
Exchange losses	(88)	(313)
Impairment and gains/(losses) on disposal of financial instruments	18	-
<b>NET FINANCE INCOME/COST</b>	<b>(142,572)</b>	<b>(151,346)</b>
Share in profit/(loss) of equity-accounted investees (note 8)	1,397	(1,154)
<b>PROFIT BEFORE INCOME TAX</b>	<b>890,240</b>	<b>850,788</b>
Income tax (note 20)	(220,421)	(212,181)
<b>CONSOLIDATED PROFIT FOR THE YEAR</b>	<b>669,819</b>	<b>638,607</b>
<b>A) CONSOLIDATED PROFIT FOR THE YEAR ATTRIBUTABLE TO THE PARENT</b>	<b>669,836</b>	<b>636,920</b>
<b>B) PROFIT FOR THE YEAR ATTRIBUTABLE TO NON-CONTROLLING INTERESTS</b>	<b>(17)</b>	<b>1,687</b>
<b>EARNINGS PER SHARE IN EUROS</b>		
Basic earnings per share in Euros (note 30) (*)	1.24	1.18
Diluted earnings per share in Euros (note 30)	1.24	1.18

Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



RED ELÉCTRICA GROUP  
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME  
2017 AND 2016  
IN THOUSANDS OF EUROS

<b>CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME</b>	<b>2017</b>	<b>2016</b>
<b>A) CONSOLIDATED PROFIT IN THE YEAR (from the statement of profit and loss)</b>	<b>669,819</b>	<b>638,607</b>
<b>B) OTHER COMPREHENSIVE INCOME – ITEMS NOT RECLASSIFIED TO PROFIT AND LOSS IN THE YEAR:</b>	<b>(2,991)</b>	<b>(1,592)</b>
1. Revaluation/(revaluation reversal) of property, plant and equipment and intangible assets	-	-
2. Actuarial gains and losses	(3,989)	(2,123)
3. Share in Other comprehensive income recognised from investments in jointly-controlled businesses and associates	-	-
4. Rest of income and expenses not reclassified to profit and loss in the year	-	-
5. Tax effect	998	531
<b>C) OTHER COMPREHENSIVE INCOME – ITEMS THAT MAY SUBSEQUENTLY BE RECLASSIFIED TO PROFIT AND LOSS IN THE YEAR:</b>	<b>(1,948)</b>	<b>(32,215)</b>
<b>1. Available-for-sale financial assets:</b>	<b>(1,833)</b>	<b>(2,242)</b>
a) Valuation gains/(losses)	(1,833)	(2,242)
b) Amounts transferred to the income statement	-	-
c) Other reclassifications	-	-
<b>2. Cash flow hedges:</b>	<b>14,626</b>	<b>(39,902)</b>
a) Valuation gains/(losses)	13,253	(41,082)
b) Amounts transferred to the income statement	1,373	1,180
c) Amounts transferred to the initial value of the hedged items	-	-
d) Other reclassifications	-	-
<b>3. Translation differences:</b>	<b>(10,451)</b>	<b>3,103</b>
a) Valuation gains/(losses)	(10,451)	3,103
b) Amounts transferred to the income statement	-	-
c) Other reclassifications	-	-
<b>4. Share in Other comprehensive income recognised from investments in jointly-controlled businesses and associates:</b>	<b>(4,389)</b>	<b>(5,263)</b>
a) Valuation gains/(losses)	(4,389)	(5,263)
b) Amounts transferred to the income statement	-	-
c) Other reclassifications	-	-
<b>5. Rest of income and expenses that may subsequently be reclassified to profit and loss in the year</b>	<b>-</b>	<b>-</b>
a) Valuation gains/(losses)	-	-
b) Amounts transferred to the income statement	-	-
c) Other reclassifications	-	-
<b>6. Tax effect</b>	<b>99</b>	<b>12,089</b>
<b>TOTAL COMPREHENSIVE INCOME IN THE YEAR (A + B + C)</b>	<b>664,880</b>	<b>604,800</b>
a) Attributable to the parent company	664,897	602,655
b) Attributable to minority interests	(17)	2,145

Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



**RED ELÉCTRICA GROUP**  
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**AT 31 December 2017 AND 2016**  
**IN THOUSANDS OF EUROS**

EQUITY	Current period									
	Equity attributable to the Parent							Equity attributable to the Parent	Non-controlling interests	Total equity
	Subscribed capital	Reserves	Interim dividend	Own shares	Profit attributable to the Parent	Valuation adjustments				
<b>Balance at 01 January 2017</b>	270,540	2,222,906	(128,417)	(36,739)	636,920	(62,156)	2,903,054	17,495	2,920,549	
<b>I. Comprehensive income for the year</b>	-	(2,991)	-	-	669,836	(1,948)	664,897	(17)	664,880	
<b>II. Transactions with shareholders or owners</b>	-	(335,265)	(9,092)	6,970	(128,417)	-	(465,804)	-	(465,804)	
- Distribution of dividends (note 11)	-	(335,740)	(9,092)	-	(128,417)	-	(473,249)	-	(473,249)	
- Transactions with own shares (note 11)	-	475	-	6,970	-	-	7,445	-	7,445	
<b>III. Other changes in equity</b>	-	499,746	-	-	(508,503)	-	(8,757)	(17,419)	(26,176)	
- Transfers between equity line items	-	508,503	-	-	(508,503)	-	-	-	-	
- Other variations (note 2.g)	-	(8,757)	-	-	-	-	(8,757)	(17,419)	(26,176)	
<b>Balance at 31 December 2017</b>	270,540	2,384,396	(137,509)	(29,769)	669,836	(64,104)	3,093,390	59	3,093,449	

EQUITY	Prior period									
	Equity attributable to the Parent							Equity attributable to the Parent	Non-controlling interests	Total equity
	Subscribed capital	Reserves	Interim dividend	Own shares	Profit attributable to the Parent	Valuation adjustments				
<b>Balance at 01 January 2016</b>	270,540	2,051,350	(120,082)	(33,076)	606,013	(29,482)	2,745,263	15,350	2,760,613	
<b>I. Comprehensive income for the year</b>	-	(1,591)	-	-	636,920	(32,674)	602,655	2,145	604,800	
<b>II. Transactions with shareholders or owners</b>	-	(313,270)	(8,335)	(3,663)	(120,082)	-	(445,350)	-	(445,350)	
- Distribution of dividends (note 11)	-	(313,745)	(8,335)	-	(120,082)	-	(442,162)	-	(442,162)	
- Transactions with own shares (note 11)	-	475	-	(3,663)	-	-	(3,188)	-	(3,188)	
<b>III. Other changes in equity</b>	-	486,417	-	-	(485,931)	-	486	-	486	
- Transfers between equity line items	-	485,931	-	-	(485,931)	-	-	-	-	
- Other changes	-	486	-	-	-	-	486	-	486	
<b>Balance at 31 December 2016</b>	270,540	2,222,906	(128,417)	(36,739)	636,920	(62,156)	2,903,054	17,495	2,920,549	

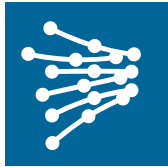
Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



RED ELÉCTRICA GROUP  
 CONSOLIDATED STATEMENT OF CASH FLOWS  
 2017 AND 2016  
 IN THOUSANDS OF EUROS

<b>CONSOLIDATED STATEMENT OF CASH FLOWS</b>	<b>2017</b>	<b>2016</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>1,153,255</b>	<b>1,007,130</b>
<b>Profit before tax</b>	<b>890,240</b>	<b>850,788</b>
<b>Adjustments for:</b>	<b>641,492</b>	<b>647,262</b>
Depreciation and amortisation (notes 5, 6 and 7)	515,151	504,200
Other adjustments (net)	126,341	143,062
Equity-accounted holdings (profit and loss)	(1,397)	1,154
(Gains)/losses on disposal/impairment of non-current assets and financial instruments	(3,645)	(121)
Accrued finance income (note 21-d)	(9,254)	(10,970)
Accrued finance costs (note 21-d)	151,738	162,003
Charge to/surplus provisions for liabilities and charges (note 13)	8,637	9,013
Capital and other grants taken to income (note 12)	(19,738)	(18,017)
<b>Changes in operating assets and liabilities</b>	<b>(30,319)</b>	<b>(144,304)</b>
Changes in inventories, receivables, prepayments for current assets and other current assets	(71,478)	44,624
Changes in trade payables, current revenue received in advance and other current liabilities	41,159	(188,928)
<b>Other cash flows used in operating activities:</b>	<b>(348,158)</b>	<b>(346,616)</b>
Interest paid	(156,091)	(157,508)
Dividends received (note 21-d)	3,881	3,881
Interest received	4,944	6,350
Income tax paid	(196,419)	(190,351)
Other proceeds from and payments for operating activities	(4,473)	(8,988)
<b>CASH FLOWS USED IN INVESTING ACTIVITIES</b>	<b>(536,410)</b>	<b>(587,605)</b>
<b>Payments for investments</b>	<b>(545,588)</b>	<b>(599,048)</b>
Property, plant and equipment, intangible assets and investment property (notes 5, 6 and 7)	(472,654)	(364,355)
Group companies, associates and jointly-controlled entities (note 8)	(27,184)	(200,616)
Other financial assets (note 16)	(45,750)	(34,077)
<b>Proceeds from sale of investments</b>	<b>882</b>	<b>875</b>
Property, plant and equipment, intangible assets and investment property (notes 5, 6 and 7)	24	-
Other financial assets (note 16)	858	875
<b>Other cash flows from investing activities</b>	<b>8,296</b>	<b>10,568</b>
Other proceeds from investing activities (note 12)	8,296	10,568
<b>CASH FLOWS USED IN FINANCING ACTIVITIES</b>	<b>(294,597)</b>	<b>(555,879)</b>
<b>Proceeds from/(payments for) equity instruments (note 11)</b>	<b>7,445</b>	<b>(3,188)</b>
Acquisition	(32,387)	(93,975)
Disposal	39,832	90,787
<b>Proceeds from/(payments for) financial liability instruments (note 16)</b>	<b>176,381</b>	<b>(111,041)</b>
Issue and drawdowns	537,559	1,047,939
Redemption and repayment	(361,178)	(1,158,980)
<b>Dividends and interest on other equity instruments paid (note 11)</b>	<b>(463,189)</b>	<b>(432,834)</b>
<b>Other cash flows used in financing activities</b>	<b>(15,234)</b>	<b>(8,816)</b>
<b>EFFECT OF EXCHANGE RATE FLUCTUATIONS ON CASH AND CASH EQUIVALENTS</b>	<b>(3,800)</b>	<b>914</b>
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>318,448</b>	<b>(135,440)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>251,421</b>	<b>386,861</b>
<b>Cash and cash equivalents at year end</b>	<b>569,869</b>	<b>251,421</b>

Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



**RED**  
**ELÉCTRICA**  
CORPORACIÓN

# **RED ELÉCTRICA GROUP** **Consolidated Annual** **Accounts**

**2017**

This version of our Annual Accounts is a free translation from the original, which was prepared in Spanish. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.



## Contents

<b>1. ACTIVITIES OF THE GROUP COMPANIES.....</b>	<b>8</b>
<b>2. BASIS OF PRESENTATION OF THE CONSOLIDATED ANNUAL ACCOUNTS</b>	<b>8</b>
<b>3. INDUSTRY REGULATIONS.....</b>	<b>15</b>
<b>4. SIGNIFICANT ACCOUNTING PRINCIPLES .....</b>	<b>21</b>
<b>5. INTANGIBLE ASSETS.....</b>	<b>33</b>
<b>6. PROPERTY, PLANT AND EQUIPMENT .....</b>	<b>34</b>
<b>7. INVESTMENT PROPERTY .....</b>	<b>37</b>
<b>8. EQUITY-ACCOUNTED INVESTEEES.....</b>	<b>38</b>
<b>9. INVENTORIES .....</b>	<b>38</b>
<b>10. TRADE AND OTHER RECEIVABLES.....</b>	<b>39</b>
<b>11. EQUITY .....</b>	<b>40</b>
<b>12. GRANTS AND OTHER.....</b>	<b>45</b>
<b>13. NON-CURRENT PROVISIONS .....</b>	<b>46</b>
<b>14. OTHER NON-CURRENT LIABILITIES .....</b>	<b>47</b>
<b>15. FINANCIAL RISK MANAGEMENT POLICY.....</b>	<b>48</b>
<b>16. FINANCIAL ASSETS AND FINANCIAL LIABILITIES.....</b>	<b>51</b>
<b>17. DERIVATIVE FINANCIAL INSTRUMENTS.....</b>	<b>60</b>
<b>18. TRADE AND OTHER PAYABLES .....</b>	<b>62</b>
<b>19. AVERAGE PAYMENT PERIODS TO SUPPLIERS. ADDITIONAL PROVISION THREE. "REPORTING REQUIREMENT" OF LAW 15/2010 OF 5 JULY 2010 ...</b>	<b>62</b>
<b>20. TAXATION.....</b>	<b>63</b>
<b>21. INCOME AND EXPENSES.....</b>	<b>68</b>
<b>22. TRANSACTIONS WITH ASSOCIATES AND RELATED PARTIES.....</b>	<b>71</b>
<b>23. REMUNERATION OF THE BOARD OF DIRECTORS.....</b>	<b>73</b>
<b>24. MANAGEMENT REMUNERATION .....</b>	<b>77</b>



<b>25. SEGMENT REPORTING .....</b>	<b>78</b>
<b>26. INVESTMENTS IN JOINT ARRANGEMENTS.....</b>	<b>79</b>
<b>27. GUARANTEES AND OTHER COMMITMENTS WITH THIRD PARTIES AND OTHER CONTINGENT ASSETS AND LIABILITIES .....</b>	<b>79</b>
<b>28. ENVIRONMENTAL INFORMATION .....</b>	<b>79</b>
<b>29. OTHER INFORMATION .....</b>	<b>80</b>
<b>30. EARNINGS PER SHARE.....</b>	<b>81</b>
<b>31. SHARE-BASED PAYMENTS.....</b>	<b>81</b>
<b>32. EVENTS AFTER 31 DECEMBER 2017 .....</b>	<b>82</b>
<b>APPENDIX I.....</b>	<b>83</b>





## 1. ACTIVITIES OF THE GROUP COMPANIES

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Red Eléctrica Corporación, S.A. (hereinafter the Parent or the Company) is the Parent of a Group formed by subsidiaries. The Group is also involved in joint operations along with other operators. The Parent and its subsidiaries form the Red Eléctrica Group (hereinafter the Group or Red Eléctrica Group). The Company's registered office is located in Alcobendas (Madrid) and its shares are traded on the Spanish automated quotation system as part of the selective IBEX-35 index.

The Group's principal activity is electricity transmission, system operation and management of the transmission network for the Spanish electricity system. These regulated activities are carried out through Red Eléctrica de España, S.A.U. (hereinafter REE).

The Group also carries out electricity transmission activities outside Spain through Red Eléctrica Internacional S.A.U. (hereinafter, REI), and its investees. Likewise, the Group provides telecommunications services to third parties in Spain through Red Eléctrica Infraestructuras de Telecomunicación S.A.U. (hereinafter, REINTEL), primarily by leasing dark backbone fibre, both from electric power transmission infrastructure and railway networks.

In addition the Group carries out activities through its subsidiaries aimed at financing its operations and covering risks by reinsuring its assets and activities. It also conducts construction activities through its subsidiaries and/or investees, of infrastructure and electric power facilities through Red Eléctrica Infraestructuras en Canarias, S.A.U. (REINCAN) and Sociedad de Interconexión Eléctrica Francia-España, S.A.S. (INELFE).

Appendix I provides details of the activities and registered offices of the Parent and its subsidiaries, as well as the direct and indirect investments held by the Parent in the subsidiaries.

## 2. BASIS OF PRESENTATION OF THE CONSOLIDATED ANNUAL ACCOUNTS

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### a) General information

The accompanying consolidated annual accounts have been prepared by the directors of the Parent to give a true and fair view of the consolidated equity and consolidated financial position of the Company and its subsidiaries at 31 December 2017, as well as the consolidated results of operations and consolidated cash flows and changes in consolidated equity for the year then ended.

The accompanying consolidated annual accounts, authorised for issue by the Company's directors at their board meeting held on 16 February 2018, have been prepared on the basis of the individual accounting records of the Company and the other Group companies, which together form the Red Eléctrica Group (see Appendix I). Each company prepares its annual accounts applying the accounting principles and criteria in force in its country of operations. Accordingly, the adjustments and reclassifications necessary to harmonise these principles and criteria with International Financial Reporting Standards adopted by the European Union (IFRS-EU) have been made on consolidation. The accounting policies of the consolidated companies are changed when necessary to ensure their consistency with the principles adopted by the Company.

The consolidated annual accounts for 2016 were approved by the shareholders at their general meeting held on 31 March 2017. The consolidated annual accounts for 2017 are currently pending approval by the shareholders. However, the directors of the Company consider that these consolidated annual accounts will be approved with no changes.



These consolidated annual financial statements have been prepared on the historical cost basis, except in the case of available-for-sale financial assets and derivative financial instruments at fair value through profit or loss, and for business combinations.

The figures disclosed in the consolidated annual financial statements are expressed in thousands of Euros, the Parent's functional and presentation currency, rounded off to the nearest thousand. The consolidated annual financial statements have been prepared in accordance with IFRS-EU, and other applicable provisions of the financial reporting framework.

The Group has not omitted any mandatory accounting principle with a material effect on the consolidated annual accounts.

#### **b) New IFRS-EU and IFRIC**

The consolidated annual financial statements were prepared in accordance with IFRS-EU.

The following amendments have been applied for the first time in 2017:

- Amendments to IAS 12 "Income taxes. Recognition of Deferred Tax Assets for Unrealised Losses". Standard effective for annual periods beginning on or after 01 January 2017.
- Amendments to IAS 7 "Statement of Cash Flows. Disclosure Initiative". Standard effective for annual periods beginning on or after 01 January 2017.
- Annual Improvements to 2014–2016 Cycle (Amendments to IFRS 12 ). Effective for annual periods beginning on or after 1 January 2017.

The application of these standards and interpretations did not have a significant impact on these consolidated annual accounts.

The standards approved by the European Union for which application is not mandatory in 2017 are as follows:

- IFRS 9 "Financial Instruments". Effective for annual periods beginning on or after 1 January 2018.

The Group has assessed the impact of adopting IFRS 9 on the basis of its positions at 31 December 2017 and the hedging relationships designated in 2017 under IAS 39, whose accounting effects on first application are recognised in reserves; the main findings were as follows:

Classification of financial assets: IFRS 9 provides a new approach to the classification and measurement of financial assets reflecting the business model in which the assets are managed and their cash flow characteristics. IFRS 9 includes three main classification categories for financial assets: measured at amortised cost, at fair value through Other comprehensive income (FVTOCI), and at fair value through profit and loss (FVTPL). The standard removes the categories under IAS 39 of held-to-maturity, loans and receivables and available-for-sale. Based on the assessment, the Group does not believe that, if the new classification requirements were applied at 31 December 2017, they would have a material impact on the accounting for trade receivables, loans, investments in debt instruments and investments in equity instruments managed on the basis of their fair value. At 31 December 2017, the Group held equity investments classified as available-for-sale with a fair value of Euros 86 million, the bulk of which correspond to the Group's 5% stake in its investee Redes Energéticas Nacionais, SGPS (hereinafter, REN). The Group could classify this investment as either FVTOCI or FVTPL.



Classification of financial liabilities: IFRS 9 broadly conserves the requirements of IAS 39 for the classification of financial liabilities. The Group's assessment revealed that there would be no material impact if the requirements of IFRS 9 concerning the classification of financial liabilities were applied at 31 December 2017. However, application of IFRS 9 concerning operations to restructure financial liabilities would have an initial impact estimated at Euros 45 million for emissions restructuring and of Euros 2 million for the restructuring of other payables, in both cases as an increase in Reserves.

Impairment. IFRS 9 introduces a new impairment model based on expected loss, unlike the incurred loss model under IAS 39. The impairment model is pivotal upon a dual measurement approach in which the impairment provision is based either on estimated losses for the next 12 months or estimated losses throughout the asset's life time. Given the high credit quality of the Group's financial assets, the estimated impact is very moderate, and in no case is it material.

Hedge accounting. IFRS 9 will require that the Group ensures that the accounting hedging relationships are aligned with its risk management goals and strategy and that it applies a more qualitative, forward-looking approach to assess the efficacy of hedges. Consequently, we estimate that IFRS 9 will increase the alignment with the Group's risk management and entail a more qualitative approach than IAS 39, and we do not envisage any material impact on the Company's financial statements.

- IFRS 15 Revenue from Contracts with Customers. Effective for annual periods beginning on or after 1 January 2018.

In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers issued". IFRS 15 replaced IAS 11 "Construction Contracts", IAS 18 "Revenue", IFRIC 13 "Customer Loyalty Programmes", IFRIC 15 "Agreements for the Construction of Real Estate", IFRIC 18 "Transfers of Assets from Customers" and SIC-31 "Revenue: Barter Transactions Involving Advertising Services". IFRS 15 is effective for annual periods commencing from 1 January 2018.

The new standard provides an integrated framework for the recognition of revenue from contracts with customers issued, establishing the principles for the disclosure of useful information to users of financial statements regarding the nature, amount, calendar and uncertainty of revenue and cash flows from contracts between a company and its customers, delivered in a five-step model framework: identify the contract(s) with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract and recognise revenue when (or as) the entity satisfies a performance obligation.

The Group assessed the impact of the application of this Standard, and concluded that the adoption of IFRS 15 will not imply material changes in the recognition of revenue. The most significant types of revenue and associated contracts analysed were, among others:

Regulated Transmission and System Operation revenue in Spain, which account for 93% of the Group's net turnover: The Group's subsidiary, Red Eléctrica de España, S.A.U., is the Company designated by the regulator of the electricity sector in Spain (currently the Ministry of Energy, Tourism and Digital Agenda, MINETAD) to exclusively conduct electricity transmission and system operation activities, both of which are regulated by Law 24/2013 of the Electricity Sector. Said Law, subsequently enacted through a Royal Decree, established the revenue receivable



(remuneration) shall be set annually by MINETAD, at the proposal of the Spanish National Markets and Competition Commission (hereinafter CNMC) in order to cover the services that the Company provides in uninterrupted manner to the rest of Agents involved in the Electricity Sector. Entry into force of IFRS 15 will have no impact on the recognition of that revenue.

Revenue associated with the telecommunications business representing 4% of the Group's net turnover. The accounting for revenue associated with the telecommunications business will not be changed as a result of the entry into force of the new IFRS.

Revenue at international subsidiaries under the concession formula, which represent 1% of the Group's net turnover. According to the analysis, the entry into force of the new rule will have no impact on the accounting for revenue at international subsidiaries under the concession formula.

- IFRS 16 Leases. Effective for annual periods beginning on or after 01 January 2019.

IFRS 16 replaces IAS 17 Leases. IFRS 16 shall be effective for annual periods commencing from 1 January 2019. This standard establishes that companies acting as lessors must recognise in the statement of financial position the assets and liabilities deriving from all lease contracts (with the exception of short-term lease agreements and those referring to low-value assets).

The Group is currently in the process of estimating the impact of this new standard, although the volume of contracts in which it acts as a lessor is not significant and the amendments introduced by IFRS 16 are not expected to have a material impact on the Group's financial statements.

### c) Estimates and assumptions

The preparation of the consolidated annual accounts in accordance with IFRS-EU requires Group management to make judgements, estimates and assumptions that affect the application of accounting standards and the amounts of assets, liabilities, income and expenses. Estimates and judgements are assessed continually and are based on past experience and other factors, including expectations of future events that are considered reasonable given the circumstances. Actual results could differ from these estimates.

The consolidated annual accounts for 2017 occasionally include estimates calculated by management of the Group and of the consolidated companies, and subsequently endorsed by their directors, to quantify certain assets, liabilities, income, expenses and commitments disclosed therein.

These estimates are essentially as follows:

- Estimated asset recovery, calculated by determining the recoverable amount thereof. The recoverable amount is the higher of fair value less costs to sell and value in use. Asset impairment is generally calculated using discounted cash flows based on financial projections used by the Group. The discount rate applied is the weighted average cost of capital, taking into account the country risk premium (see note 6.)
- Estimated useful lives of property, plant and equipment (see note 4.b.).
- The assumptions used in the actuarial calculations of liabilities and obligations to employees (see note 13).



- Liabilities are generally recognised when it is probable that an obligation will give rise to an indemnity or a payment. The Group assesses and estimates amounts to be settled in the future, including additional amounts for income tax, contractual obligations, pending lawsuit settlements and other liabilities. These estimates are subject to the interpretation of existing facts and circumstances, projected future events and the estimated financial effect of those events (see note 13).

In the absence of International Financial Reporting Standards (IFRSs) that give guidance on the accounting treatment for a particular situation, in accordance with IAS 8, management uses its best judgement based on the economic substance of the transaction and considering the most recent pronouncements of other standard-setting bodies that use the same conceptual framework as IFRS. Accordingly, as tax credits for investments are not within the scope of IAS 12 and IAS 20, after analysing the related facts and circumstances, Group management has considered that credits for investments granted to the Group by public entities are similar to capital grants. Therefore, in these cases management has taken into account IAS 20 on grants (see note 4j).

To facilitate comprehension of the consolidated annual accounts, details of the different estimates and assumptions are provided in each separate note.

The Company has taken out insurance policies to cover the risk of possible claims that might be lodged by third parties in relation to its activities.

Although estimates are based on the best information available at 31 December 2017, future events may require increases or decreases in these estimates in subsequent years, which would be accounted for prospectively in the corresponding consolidated income statement as a change in accounting estimates, as required by IFRS.

#### **d) Consolidation principles**

The types of companies included in the consolidated group and the consolidation method used in each case are as follows:

- Subsidiaries

Subsidiaries are entities, including structured entities, over which the Company, either directly or indirectly through subsidiaries, exercises control. The Company controls a subsidiary when it is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary. The Company has power over a subsidiary when it has existing substantive rights that give it the ability to direct the relevant activities. The Company is exposed, or has rights, to variable returns from its involvement with the subsidiary when its returns from its involvement have the potential to vary as a result of the subsidiary's performance.

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

The income, expenses and cash flows of subsidiaries are included in the consolidated annual accounts from the date of acquisition, which is when the Group takes control. The subsidiaries are excluded from consolidation from the date that control ceases.



Transactions and balances with Group companies and unrealised gains or losses have been eliminated on consolidation. Nevertheless, unrealised losses have been considered as an indicator of impairment of the assets transferred.

- Joint arrangements

Joint arrangements are those in which there is a contractual agreement to share the control over an economic activity, in such a way that decisions about the relevant activities require the unanimous consent of the Group and the remaining venturers or operators. The existence of joint control is assessed considering the definition of control over subsidiaries.

The Group assesses all the facts and circumstances relating to each joint arrangement for the purpose of its classification as a joint venture or joint operation, including whether the arrangement contains rights over the assets and obligations for liabilities.

For joint operations, the Group recognises the assets, including its share of any assets held jointly, the liabilities, including its share of any liabilities incurred jointly with the other operators, the revenue from the sale of its share of the output arising from the joint operation, its share of the revenue from the sale of the output by the joint operation and the expenses, including its share of any expenses incurred jointly, in the consolidated annual accounts.

Joint arrangements are those agreements in companies for which there is a contract with a third party to share control of their activity, and strategic decisions concerning the activity, whether at financial or operating level, require the unanimous consent of all parties sharing control. The Group's interests in jointly controlled companies are accounted for using the equity method in accordance with IFRS 11.

In sales or contributions by the Group to the joint operation, it recognises the resulting gains and losses only to the extent of the other parties' interests in the joint operation. When such transactions provide evidence of a reduction in net realisable value or an impairment loss of the assets transferred, such losses are recognised in full.

In purchases by the Group from a joint operation, it only recognises the resulting gains and losses when it resells the acquired assets to a third party. However, when such transactions provide evidence of a reduction in net realisable value or an impairment loss of the assets, the Group recognises its entire share of such losses.

- Associates

Associates are entities over which the Company, either directly or indirectly through subsidiaries, exercises significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. The existence of potential voting rights that are exercisable or convertible at the end of each reporting period, including potential voting rights held by the Group or other entities, are considered when assessing whether an entity has significant influence.

Investments in associates are accounted for using the equity method from the date that significant influence commences until the date that significant influence ceases. However, if on the acquisition date all or part of the investment qualifies for recognition as non-



current assets or disposal groups held for sale, it is recognised at fair value less costs of disposal.

Investments in associates are initially recognised at cost of acquisition, including any cost directly attributable to the acquisition and any consideration receivable or payable contingent on future events or on compliance with certain conditions. Any excess of the cost of the investment over the Group's share of the net fair value of the associate's identifiable net assets at the acquisition date is recognised as goodwill under associates in the consolidated statement of financial position. Any excess of the Group's share of the net fair value of the associate's identifiable net assets over the cost of the investment at the acquisition date (bargain purchase) is recognised as income in the period in which the investment is acquired.

Appendix I provides details of the Company's subsidiaries, joint arrangements and associates, as well as the consolidation or measurement method used in preparing the accompanying consolidated annual accounts and other relevant information.

The financial statements of the subsidiaries, joint arrangements and associates used in the consolidation process have the same reporting date and refer to the same period as those of the Parent.

The operations of the Company and its subsidiaries have been consolidated applying the following basic principles:

- The accounting principles and criteria used by the Group companies have been harmonised with those applied by the Parent.
- Translation of foreign operations:
  - Balances in the financial statements of foreign companies have been translated using the closing exchange rate for assets and liabilities, the average exchange rate for income and expenses and the historical exchange rate for capital and reserves.
  - All resulting exchange differences are recognised as translation differences in other comprehensive income.
  - These criteria are also applicable when translating the financial statements of equity-accounted companies, with translation differences attributable to the Group recognised in other comprehensive income.
- All balances and transactions between fully consolidated companies have been eliminated on consolidation.
- Margins on invoices between Group companies for capitalisable goods or services were eliminated at the transaction date.

#### **e) Non-controlling interests**

Non-controlling interests in subsidiaries are recognised at the acquisition date at the proportional part of the fair value of the identifiable net assets. Non-controlling interests are disclosed in consolidated equity separately from equity attributable to shareholders of the Company. Non-controlling interests' share in consolidated profit or loss for the year and in consolidated comprehensive income for the year is disclosed separately.



Transactions with non-controlling interests are recognised as transactions with equity holders of the Group. As such, the difference between the consideration paid in the acquisition of a non-controlling interest and the corresponding proportion of the carrying amount of the subsidiary's net assets is recognised in equity. Similarly, the gains or losses on disposal of non-controlling interests are also recognised in the Group's equity.

#### **f) Comparative information**

Group management has included comparative information for 2016 in the accompanying consolidated annual accounts. As required by IFRS-EU, these consolidated annual accounts for 2017 include comparative figures for the prior year.

#### **g) Changes in the consolidated Group**

The changes in the consolidated Group in 2017 are as follows:

- On 19 January 2017 the company REI acquired 45% of the shares in REDESUR from the infrastructure investment fund AC Capitales. The Group thereby increased its ownership of this Peruvian company and its subsidiaries to 100%. The economic effects of this acquisition are recognised from 1 January this year.
- On 1 June 2017, REI transferred its stakes in TESUR 2 and TESUR 3 to REDESUR, which now owns 100% of both companies. This operation does not have an accounting impact on the consolidated financial statements, since the Group already owned 100% of both companies.
- On 5 July 2017, Red Eléctrica Chile SpA. and Cobra Instalaciones y Servicios S.A., incorporated the company Red Eléctrica del Norte S.A. (REDENOR), which is fully consolidated by the Group. The Group owns a 69.9% interest in the company and the rest belongs to external shareholders. The company's purpose is to design, finance, build, operate and maintain various transmission facilities in the Far North Interconnected System (Sistema Eléctrico del Norte Grande – SING).

The changes in the consolidated Group in 2016 are as follows:

- On 27 January 2016, Red Eléctrica Chile SpA acquired 50% of the shares in Transmisora Eléctrica del Norte, S.A. (hereinafter, TEN) which focuses mainly on the construction of the Mejillones-Cardones transmission line in northern Chile and its related sub-stations. Since it is a Joint Venture, it has been equity-accounted since that date (note 8).
- Transmisora Eléctrica del Sur 3, S.A. (TESUR 3), with registered office in Lima (Peru), was incorporated on 10 February 2016. Its principal activity comprises electricity transmission and the operation and maintenance of electricity transmission networks. Upon its incorporation, this company was wholly owned by REI and is fully consolidated.

### **3. INDUSTRY REGULATIONS**

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#### **Spanish electricity sector**

The electricity sector regulatory reform that had been carried out in past years was completed in 2013 with the publication of Electricity Industry Law 24/2013 of 26 December 2013, which repeals





Law 54/1997, with the exception of certain additional provisions, and the regulatory developments of this law approved in the last three years.

Electricity Industry Law 24/2013 has a two-fold objective. On the one hand, it aims to compile into a single piece of legislation all of the statutory provisions introduced by the different regulations published to reflect the fundamental changes occurring in the electricity sector since Law 54/1997 came into force. On the other, it intends to provide measures to guarantee the long-term financial sustainability of the electricity sector, with a view to ensuring the structural balance between the system's revenues and costs.

Law 24/2013 also reviews the set of provisions that made up Law 54/1997, in particular those concerning the remit of the General State Administration, the regulation of access and connection to the networks, the penalty system, and the nomenclature used for the tariffs applied to vulnerable consumers and those still availing of the regulated tariff.

With respect to regulation of the activities conducted by the Company, the new Law 24/2013 maintains the Company's appointment as the sole transmission agent and system operator, as well as assigning it the role of transmission network manager. Furthermore, Law 24/2013 upholds the current corporate structure for these activities since it does not repeal the twenty-third additional provision of Law 54/1997, which specifically mentioned the Group's Parent, Red Eléctrica Corporación, S.A., and assigned to the subsidiary Red Eléctrica de España, S.A.U. the functions of sole transmission agent, system operator and transmission network manager, the latter activity being conducted through a specific organisational unit that is sufficiently segregated from the transmission activity for accounting and functional purposes.

Other relevant aspects of the regulation pursuant to Law 24/2013 of the activities performed by the Company are as follows:

- This Law acknowledges the natural monopoly in the transmission activity, arising from the economic efficiency afforded by a sole grid. Transmission is liberalised by granting widespread third-party access to the network, which is made available to the different electricity system agents and consumers in exchange for payment of an access charge.

Remuneration for this activity has been set by the government on the basis of the general principles laid down in the law, as developed in Royal Decree 1047/2013 of 27 December 2013, which set out the new remuneration system for the transmission activity, and by Royal Decree 1073/2015 of 27 November 2015, which amends certain provisions in Royal Decree 1047/2013.

The remuneration model for the transmission activity is completed with Ministry of Industry, Energy and Tourism Order IET/2659/2015 of 11 December 2015, approving standard facilities and benchmark unit values for investment, operation and maintenance by asset that are to be used in calculating the remuneration allocable to companies that own electricity transmission facilities, and with the publication in 2016 of various resolutions required for effective implementation of the Order. Accordingly, since 2016, the recognised cost of the transmission activity is calculated on an annual basis in accordance with the new remunerative model defined in the aforementioned Royal Decree 1047/2013.

- As electricity system operator and transmission network manager, the Company's main function is to guarantee the continuity and security of the electricity supply, as well as to



ensure the correct coordination of the production and transmission system, exercising its duties in cooperation with the operators and agents of the Spanish electricity market (Mercado Ibérico de la Energía Eléctrica) while observing the principles of transparency, objectivity and independence.

In 2015 the certification process for Red Eléctrica as transmission network manager for the Spanish electricity system, as provided in article 31.1 of Law 24/2013, was completed following publication in the Official Journal of the European Union of 12 February 2015 of the Notification of the Spanish Government pursuant to article 10(2) of Directive 2009/72/EC of the European Parliament and of the Council ('Electricity Directive') concerning common rules for the internal market in electricity regarding the designation of Red Eléctrica de España, S.A.U. as transmission system operator in Spain.

The Company has also been entrusted with developing and expanding the high-voltage transmission network so as to guarantee the maintenance and improvement of a grid based on standardised and consistent criteria, managing the transit of electricity between external systems that use the Spanish electricity system networks, and refusing access to the transmission network in the event of insufficient capacity.

The Company is also responsible for the functions of settlement, notification of payments and receipts, and management of guarantees relating to security of supply and the effective diversion of units generated and consumed, as well as for short-term energy exchanges aimed at maintaining the quality and security of supply.

Furthermore, the Company manages the technical and economic dispatch for electricity supply from non-mainland electricity systems (Balearics, Canaries, Ceuta and Melilla), and is responsible for the settlements of payments and receipts arising from the economic dispatch of electricity generated by these systems.

In addition, regarding the Company's remit in the non-mainland electricity systems, in 2015 the Soria-Chira 200 MW hydroelectric pumping power plant project in Gran Canaria was transferred to the system operator, as stipulated in Order IET/728/2014 of 28 April 2014. Once Red Eléctrica had assumed ownership of the project in 2016, and pursuant to Law 17/2013, for the purposes of implementing a new energy model in Gran Canaria to improve security of supply, system security and the integration of renewable energies, a revised project was submitted in 2016, which includes technical and environmental improvements. The revised project was declared to be of strategic interest by the Regional Government of the Canary Islands in 2016 and has been submitted for consideration by the government. As such, it is estimated that construction may begin soon.

### **International electricity sector**

The Red Eléctrica Group has built electricity transmission facilities through REI. At international level, it now operates and maintains these facilities in Peru and Chile. Likewise, at the end of 2017, REI's subsidiaries were building various transmission facilities in both Peru and Chile.

- **Peruvian Electricity Sector**



Peru has liberalised its electricity industry and applies a regulation model based on regulated tariffs for the transmission activity.

Regulation of the electricity industry in Peru is mostly set out in the Electricity Concessions Law, Decree Law No. 25844, enacted in 1992, as well as the pertinent regulations, Supreme Decree No. 009-93-EM, enacted in 1993, and the various amendments and/or extensions thereto, including Law No. 28832, “Law for the Efficient Development of Electricity Generation”, enacted in 2016, and Supreme Decree No. 027-2007-EM “Transmission Regulation”.

Under the Electricity Concessions Law, the National Interconnected System (SEIN) is divided into three major segments: generation, transmission and distribution. Pursuant to this law and the Law for the Efficient Development of Electricity Generation, the operations of generation power plants and transmission systems are subject to the provisions of the System Economic Operation Committee of the National Interconnected System (COES-SINAC), which coordinates operations at minimum cost, so as to ensure the security of electricity supply and enhance the use of energy resources, as well as plan development of the National Interconnected System (SEIN) and administrate the short-term market.

Concession contracts signed by the companies (Red Eléctrica del Sur S.A., Transmisora Eléctrica del Sur S.A.C, Transmisora Eléctrica del Sur 2 S.A.C and Transmisora Eléctrica del Sur 3 S.A.C) in Peru are governed by Supreme Decree No. 059-96-PCM (Public Works Concessions Law), and its implementing Regulation, Supreme Decree No. 060-96-PCM. Nevertheless, that legal framework has been repealed and replaced by a similar framework comprising Supreme Decree No. 254-2017-EF, approved in the Single Ordered Text of Decree Law No. 1224, the Framework Decree Law for Promoting Private Investment through Public-Private Partnerships and Projects in Assets and its Regulation, approved by Supreme Decree No. 410-2015-EF.

These standards, along with Law No. 28832, make up overall the legal framework enabling the State to provide special guarantees to concessionaires and to ensure that tariffs set throughout the duration of the respective contracts uphold the amounts provided in the bids presented during the process to promote private investment whereby the projects were adjudicated.

Under these conditions, the amounts for investment and operation and maintenance stipulated in the Group's concession arrangements are adjusted each year or when appropriate (according to the tariff regime) in line with the variation in the Finished Goods Less Food and Energy index (Series: ID: WPSSOP3500) published by the Bureau of Labor Statistics of the United States Government.

The “Procedures for Setting Regulated Prices” were approved through OSINERGMIN (Peruvian Supervisory Body for Energy and Mining Investment) Resolution No. 080-2012-OS/CD and amendments thereto. These rules contain information relating to the bodies involved in setting regulated prices, their competences and obligations, the price-setting deadlines, the administrative appeals that may be filed, the terms for filing and resolving such appeals, as well as the body responsible for their resolution.

The rules on “Tariffs and Remuneration for Secondary Transmission Systems (STS) and Complementary Transmission Systems (CTS)” were approved through OSINERGMIN Resolution No. 050-2011-OS/CD and amendments. These rules set forth the criteria and methodology for determining the tolls and remuneration for the STS and/or CTS services.

Lastly, Resolutions OSINERGMIN No. 335-2004-OS/CD, No. 200-2010-OS/CD and No. 004-2015-OS/CD approved the “Annual Procedures for the Settlement of Revenue from the Electricity Transmission Service” corresponding to: (i) “Main Transmission System (SPT) and Secondary Transmission System (SST) with BOOT contract modality”; (ii) “Guaranteed Transmission System



(SGT)”; and, (iii) “Supplementary Transmission System (SCT)”, respectively; in which remuneration is adjusted annually in accordance with the differences originating primarily between the amounts established in the Concession Contracts (in US Dollars) and the tariff system in Peru established in local currency (Soles).

- **Chilean Electricity Sector**

The legal framework governing the electricity transmission system in Chile is provided in Decree with Force of Law No.4 of 2006 (DFL No. 4/2006), establishing the Restated, Coordinated and Structured text of Decree with Force of Law No. 1 of 1982, the General Electricity Services Act (DFL No. 1/1982) and its subsequent modifications, including law 20,257 on Unconventional Renewable Energy Sources, Law 20,701 on the Procedure to grant Electricity Concessions, Law 20,698 Promoting the Diversification of the Energy Mix through Unconventional Renewable Energy Sources, Law 20,726 Promoting the Interconnection of Independent Electricity Systems, Law 20,805 perfecting the Electricity Supply Tender System for Price-Regulated Customers, and Law 20,936 Establishing a New Electricity Transmission System and Creating an Independent Coordinating Body for the National Electricity System, published on 20 July 2016.

DFL No. 4 is supplemented by the “Regulation of the General Electricity Services Law”, Supreme Decree No. 327/1997 and its respective modifications, the “Supplementary Services Regulation”, Supreme Decree No. 130 of the Energy Ministry and the “Technical Service Quality and Security Standard” and its subsequent modifications.

The last modification of the General Electricity Services Law, by means of Law 20,936, modifies the Law in connection with electricity transmission and creates an independent coordinator of the National Electricity System. With regard to electricity transmission, it redefines the electricity transmission systems in five segments: National Transmission System (previously backbone), Zonal Transmission System (previously sub-transmission), Dedicated Systems (previously additional transmission), Systems for Strategic Development Areas and International Interconnection Systems.

Law 20,936 takes a long-term approach to transmission and regulates tariffs for the national and zonal systems, for strategic development areas and payment for the use of dedicated transmission facilities by users subject to regulated prices. The prices associated with the payment for the use of the national and zonal transmission systems are determined by Chile's National Energy Commission (CNE) every four years, by means of processes involving enterprises from the sector, interested users and institutions and the Panel of Experts in the event of discrepancies.

Tariffs recognised efficient acquisition and installation costs at market prices, updated annually considering a useful life determined every three tariff periods (12 years) and a variable discount rate calculated by the CNE every 4 years. The owners of regulated transmission facilities must receive the Annual Transmission Value by Tranche, based on the sum of real tariff revenue and a single usage charge associated with each segment and applied directly to its final users.

Law 20,936 provides for a new system of payment for usage of national facilities entering into force from 1 January 2019, commencing on that date with a transition period running until 31 December 2034.

On 3 February 2016, Decree 23T of the Energy Ministry was published, establishing the backbone system facilities (now the national system) and the new Investment Values (VI), the Annual Investment Value Instalments (AVI) and the Cost of Operation, Maintenance and Administration



(COMA), plus the Annual Transmission Value per Tranche (VATT) of backbone facilities, for the period commencing on 1 January 2016 and until 31 December 2019 and the indexing formulae applicable to that period.

According to the provisions of transitory article eleven of Law 20,936, during the period between 1 January 2016 and 31 December 2017, Decree No. 14/2013 and the sub-transmission (zonal) tariffs established therein shall remain in force. The Energy Ministry was obliged to issue a decree with the adjustments to Decree No. 14/2013 for the seamless and consistent implementation of Decree No. 14/2013 along with the application of Decree 23T.

On 27 May 2017, the Energy Ministry issued Decree No. 1T, pursuant to the provisions of Decree 14/2013 as provided by the transitory articles of Law 20,936. Decree No. 1T stipulates that, within 45 days of the publication of the decree, the Coordinator must perform the relevant settlements for revenue and the distribution of revenue among zonal enterprises for the period between 1 January 2016 and the date of publication of the decree.

In accordance with the provisions of transitory article twelve of Law 20,936, for the extended duration of Decree No. 14 the process of setting the new zonal transmission tariffs was continued and completed, to remain in force from 1 January 2018 to 31 December 2019. On 28 March 2017, the National Energy Commission published Exempt Resolution No. 149, approving the Final Technical Report Determining the Annual Value of the Zonal Transmission and Dedicated Transmission systems for the period 2018-2019.

On 27 July 2017, Energy Ministry Exempt Resolution No. 380 was published, establishing the periods, requirements and conditions applicable to the valuation process of the transmission facilities for the 2020-2023 period, and Exempt Resolution No. 385, providing the periods, requirements and conditions applicable to the collection, payment and remuneration of the transmission systems.

On 15 September 2017, the Energy Commission, via Exempt Resolution No. 512, stipulated the facilities associated with the interconnection of the SING and SIC systems, as provided in transitory article 25 of Law 20,936.

On 2 October 2017, the National Energy Commission approved the Technical Report establishing the charges for the payment of transmission systems, a report that was subsequently modified with Exempt Resolution No. 744, dated 22 December 2017.

On 21 November 2017, by means of Exempt Resolution 668, the National Energy Commission announced the launch of the operation of the National Electricity System (SEN), a product of the interconnection of the SING and SIC systems, with the Group company Transmisora Eléctrica del Norte S.A. (hereinafter, TEN) being in charge of the construction, operation and maintenance of that interconnection.

### **Telecommunications**

The telecommunications sector in Spain is governed by General Telecommunications Law (LGT) 9/2014, of 9 May, whose main goal is to foster competition in the market and guarantee access to the networks, and Royal Decree 330/2016, of 9 September, concerning measures to reduce the real cost of rolling out high-speed electronic communications networks. The aforementioned Law



9/2014 is implemented through Royal Decree 123/2017, of 24 February, approving the Regulation on the use of radio spectrum.

The European framework comprises Directive 2009/136/EC, by the European Parliament and the Council, of 25 November 2009 (Users' Rights), and Directive 2009/140/EC, of the European Parliament and the Council, of 25 November 2009 (Improved Regulation). Based on this regulation, the General Telecommunications Law introduces measures aimed at creating an adequate framework for investing in next-generation network rollout, enabling operators to offer innovative services more technologically adequate to people's needs.

In accordance with the latter, it is also worth highlighting Directive 2014/61/EU of the European Parliament and the Council, of 15 May 2014, concerning the measures to reduce the cost of rolling out high-speed electronic communications networks whose main goal is to fast track implementation of the European Union's "Digital Agenda" (published in May 2010). This Directive was transposed through Royal Decree 330/2016, of 9 September, concerning measures to reduce the cost of rolling out high-speed electronic communications networks.

As regards competition, in accordance with the European Commission Recommendation of 9 October 2014, (concerning markets for products and services in the electronic communications sector that might be subject to regulation, Directive 2002/21/EC), the Spanish National Markets and Competition Commission (CNMC) periodically defines the various telecommunications markets and assesses the existence of operators with sufficient market power. These tasks, which are considered in the LGT, may lead to the implementation of specific regulations for that market.

To this end, and in order to authorise the acquisition by the Company of the rights to use and manage the operation of railway infrastructure administrator ADIF's fibre optic cables, the CNMC analysed the dark fibre backbone network lease activity, concluding that the environment was sufficiently competitive and this activity may therefore be conducted on a free competition basis.

The regulation also stipulates that access to infrastructure that may be used to host public communications networks must be guaranteed. National and European Law obliges REINTEL to meet all access requests under fair and reasonable terms and conditions. This obligation is fulfilled in view of the nature of the dark fibre business.

#### **4. SIGNIFICANT ACCOUNTING PRINCIPLES**

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The accounting principles used in preparing the accompanying consolidated annual accounts have been applied consistently to the reported periods presented and are as follows:

##### **a) Business combinations**

The Group has applied IFRS 3 "Business Combinations", revised in 2008, to transactions carried out on or after 1 January 2010.

The Group applies the acquisition method for business combinations.

The acquisition date is the date on which the Group obtains control of the acquiree. The consideration transferred in a business combination is calculated as the sum of the acquisition-date fair values of the assets transferred, the liabilities incurred or assumed, the equity instruments issued and any consideration contingent on future events or compliance with certain conditions in exchange for control of the acquiree. The consideration transferred excludes any payment that



does not form part of the exchange for the acquiree. Acquisition costs are recognised as an expense when incurred.

For business combinations achieved in stages, the excess of the consideration given, plus the value assigned to non-controlling interests and the fair value of the previously held interest in the acquiree, over the net value of the assets acquired and liabilities assumed, is recognised as goodwill. Any shortfall, after assessing the consideration given, the value assigned to non-controlling interests and to the previously held interest, and after identifying and measuring the net assets acquired, is recognised in profit or loss. The Group recognises the difference between the fair value of the previously held interest in the acquiree and the carrying amount in consolidated profit or loss, in accordance with its classification. The Group also reclassifies amounts deferred in other comprehensive income relating to the previously held interest to consolidated profit or loss or reserves, based on the nature of each item.

#### **b) Property, plant and equipment**

Property, plant and equipment primarily comprise technical electricity facilities and are measured at cost of production or acquisition, as appropriate, less accumulated depreciation and impairment. This cost includes the following items, where applicable:

- Borrowing costs directly attributable to property, plant and equipment under construction accrued on external financing solely during the construction period. Nevertheless, capitalisation of borrowing costs is suspended when active development is interrupted for extended periods, unless the delay is necessary in order to bring the asset to a working condition.
- Operating costs directly related with property, plant and equipment under construction for projects executed under the supervision and management of Group companies.

The Group companies follow the principle of transferring work in progress to property, plant and equipment in use once these items come into service and provided that the assets are in working condition and able to generate income.

Subsequent to initial recognition of the asset, only those costs incurred which will generate probable future profits and for which the amount may reliably be measured are capitalised. Repair and maintenance costs are recognised in consolidated profit or loss as incurred.

Property, plant and equipment is depreciated by allocating the depreciable amount of the asset on a straight-line basis over its useful life, which is the period during which the companies expect to use the asset and generate income.

Property, plant and equipment are depreciated applying the following rates:



	Annual depreciation rate
Buildings	2%-10%
Technical telecommunications facilities	5%
Technical electricity facilities	2.5%-8.33%
Other installations, machinery, equipment, furniture and other items	4%-25%

The Group periodically assesses the depreciation criteria taking into account the useful life of its assets. There have been no significant changes in the depreciation criteria compared to the prior year.

Property, plant and equipment primarily comprise technical electricity facilities. The majority of undepreciated property, plant and equipment will be depreciated at a rate of 2.5%.

The Group reviews the residual values and useful lives of assets and adjusts them, if necessary, at the end of each reporting period. The Group will perform complementary analyses of these indicators in view of the entry into force of the new remuneration regime applicable to electricity transmission assets in Spain, once all the parameters of the new regime have been definitively established and are effectively applied (see note 3).

The Group measures and determines impairment to be recognised or reversed in respect of the value of its cash generating units (CGUs) based on the criteria in section h) of this note.

### c) Intangible assets

Intangible assets are recognised at acquisition cost, which is periodically reviewed and adjusted in the event of a decline in value. Intangible assets include the following:

- Administrative concessions

The Group operates various assets, primarily in Peru, under service concession contracts awarded by different public entities. Based on the characteristics of the contracts, the Group analyses whether they fall within the scope of IFRIC 12, Service Concession Arrangements.

For concession arrangements subject to IFRIC 12, construction and other services rendered are recognised using the criteria applicable to income and expenses.

The consideration received by the Group is recognised at the fair value of the service rendered, as a financial asset or intangible asset, based on the contract clauses. The Group recognises the consideration received for construction contracts as an intangible asset to the extent that it is entitled to pass on to users the cost of access to or use of the public service, or it has no unconditional contractual right to receive cash or another financial asset.





The contractual obligations assumed by the Group to maintain the infrastructure during the operating period, or to carry out renovation work prior to returning the infrastructure to the transferor upon expiry of the concession arrangement, are recognised using the accounting policy described for provisions, to the extent that such activity does not generate revenue.

Concession arrangements not subject to IFRIC 12 are recognised using general criteria.

Administrative concessions have a finite useful life and the associated cost is recognised as an intangible asset. Details of the useful and residual lives of these concessions are provided in note 5.

- Computer software

Computer software licences are capitalised at cost of acquisition or cost of preparation for use.

Computer software maintenance costs are charged as expenses when incurred. Computer software is amortised on a straight-line basis over a period of three to five years from the date on which each program comes into use.

- Development expenses

Development expenses directly attributable to the design and execution of tests for new or improved computer programs that are identifiable, unique and likely to be controlled by the Group, are recognised as intangible assets when it is probable that the project will be successful, based on its economic and commercial feasibility, and the associated costs can be estimated reliably. Costs that do not meet these criteria are charged as expenses when incurred. Development expenses are capitalised and amortised, from the date the associated asset comes into service, on a straight-line basis over a period of no more than five years. Computer software maintenance costs are charged as expenses when incurred.

- Intangible assets under development

Administrative concessions at the construction stage are recognised as intangible assets under development and measured in line with the amount to be disbursed until completion of the works, in accordance with IFRIC 12.

#### **d) Investment property**

The Group companies measure their investment property at cost of acquisition. The market value of the Group's investment property is disclosed in note 7 to the accompanying consolidated annual accounts.

Investment property, except land, is depreciated on a straight-line basis over the estimated useful life, which is the period during which the companies expect to use the assets. Investment property is depreciated over a period of 50 years.



### e) Leases

The Group classifies leases on the basis of whether substantially all the risks and rewards incidental to ownership of the leased asset are transferred.

Leases under which the lessor maintains a significant part of the risks and rewards of ownership are classified as operating leases.

Leases under which the significant risks and rewards of ownership of the goods are transferred to the Group are classified as finance leases. Assets recognised as finance leases are presented in the consolidated statement of financial position based on the nature of the leased asset.

### f) Financial assets and financial liabilities

Financial instruments are classified on initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the economic substance of the contractual arrangement and the definitions of a financial asset, a financial liability and an equity instrument in IAS 32 "Financial Instruments: Presentation".

The Group recognises financial instruments when it becomes party to the contract or legal transaction, in accordance with the terms set out therein.

Financial instruments are classified into the following categories: financial assets and financial liabilities at fair value through profit or loss, separating those initially designated from those held for trading, loans and receivables, held-to-maturity investments, available-for-sale financial assets and financial liabilities at amortised cost. Financial instruments are classified into different categories based on the nature of the instruments and the Group's intentions on initial recognition.

- Financial assets: The Group classifies financial assets, excluding equity-accounted investments, into the following categories:

- Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those classified in other financial asset categories.

Loans and receivables are initially recognised at fair value, including transaction costs, and are subsequently measured at amortised cost using the effective interest method.

Loans and receivables arising from ordinary activities, for which the inflow of cash or cash equivalents is deferred, are measured at the fair value of the consideration, determined by discounting all future receipts using an imputed rate of interest.

The Company tests the assets for impairment at each reporting date. The impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the loss is recognised in consolidated profit or loss.

- Available-for-sale financial assets: The Group classifies in this category non-derivative financial instruments that are designated as such or which do not qualify for recognition in the aforementioned categories. These are basically investments that the Company intends to hold for an unspecified period of time which are likely to be disposed of to meet one-off liquidity needs or in response to interest rate fluctuations. They are classified as non-current, unless they are expected to be disposed of in less than one



year and such disposal is feasible. These financial assets are initially recognised at fair value plus transaction costs directly attributable to the acquisition. They are subsequently measured at fair value, which is the quoted price at the reporting date in the case of securities quoted in an active market. Any gains or losses arising from changes in the fair value of these assets at the reporting date are recognised directly in equity until the assets are disposed of or impaired, whereupon the accumulated gains and losses are recognised in profit or loss. Impairment, where applicable, is calculated on the basis of discounted expected future cash flows. A significant or prolonged decline in the quotation of listed securities below their cost is also objective evidence of impairment.

Dividends from equity investments classified as available-for-sale are recognised in the consolidated income statement when the Company's right to receive payment is established.

- Cash and cash equivalents: Cash and cash equivalents include cash on hand and demand deposits in financial institutions. They also include other short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. An investment normally qualifies as a cash equivalent when it has a maturity of less than three months from the date of acquisition.
- Financial liabilities: Financial liabilities, which include loans, payment obligations and similar commitments, are initially recognised at fair value less any transaction costs incurred. Such debt is subsequently measured at amortised cost, using the effective interest method, except in the case of transactions for which hedges have been arranged (see section n).

Financial debt is classified under current liabilities unless the debt falls due more than 12 months after the reporting date, in which case it is classified as non-current.

The Group derecognises all or part of a financial liability when it either discharges the liability by paying the creditor, or is legally released from primary responsibility for the liability either by process of law or by the creditor.

The exchange of debt instruments between the Group and the counterparty or substantial modifications of initially recognised liabilities are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability, providing the instruments have substantially different terms.

The Group considers the terms to be substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

If the exchange is accounted for as an extinguishment of the financial liability, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

The difference between the carrying amount of a financial liability, or part of a financial liability, extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in profit or loss.



The fair value measurements of financial assets and financial liabilities are classified on the basis of a hierarchy that reflects the relevance of the inputs used in measuring the fair value. The hierarchy comprises three levels:

- Level 1: measurement is based on quoted prices for identical instruments in active markets.
- Level 2: measurement is based on inputs that are observable for the asset or liability.
- Level 3: measurement is based on inputs derived from unobservable market data.

#### **g) Inventories**

Inventories of materials and spare parts are measured at cost of acquisition, which is calculated as the lower of weighted average price and net realisable value. The Group companies assess the net realisable value of inventories at the end of each reporting period, recognising impairment in the consolidated income statement when cost exceeds market value or when it is uncertain whether the inventories will be used. When the circumstances that previously caused inventories to be written down no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the previously recognised impairment is reversed and recognised as income.

#### **h) Impairment**

The Group companies analyse the recoverability of their assets at each reporting date and whenever events or changes in circumstances indicate that the carrying amount might not be recoverable. Impairment is deemed to exist when the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the consolidated income statement. An impairment loss is the difference between the carrying amount of an asset and its recoverable amount. The recoverable amount of the assets is the higher of their fair value less costs of disposal and their value in use. Value in use is calculated on the basis of expected future cash flows. Impairment is calculated for individual assets. Where the recoverable amount of an individual asset cannot be determined, the recoverable amount of the cash-generating unit (CGU) to which that asset belongs is calculated. Any reversals are recognised in the consolidated income statement. Impairment losses on goodwill are not reversed in subsequent years.

#### **i) Share capital, own shares and dividends**

The share capital of the Company is represented by ordinary shares. The cost of issuing new shares, net of taxes, is deducted from equity.

Own shares are measured at cost of acquisition and recognised as a reduction in equity in the consolidated statement of financial position. Any gains or losses on the purchase, sale, issue or redemption of own shares are recognised directly in equity.

Interim dividends are recognised as a reduction in equity for the year in which the dividend is declared, based on the consensus of the board of directors. Supplementary dividends are not deducted from equity until approved by the shareholders at their general meeting.



## **j) Grants**

Non-refundable government capital grants awarded by different official bodies to finance the Group's fixed assets are recognised once the corresponding investments have been made.

The Group recognises these grants under non-financial and other capital grants each year during the period in which depreciation is charged on the assets for which the grants were received.

Government assistance provided in the form of income tax deductions and considered as government capital grants is recognised applying the general criteria described in the preceding sections.

## **k) Non-current revenue received in advance**

Non-current revenue received in advance, generally arising from long-term contracts or commitments, is recognised under revenue or other gains, as appropriate, over the term of the contract or commitment.

## **l) Provisions**

- Employee benefits

- Pension obligations

The Group has defined contribution plans, whereby the benefit receivable by an employee upon retirement – usually based on one or more factors such as age, fund returns, years of service or remuneration – is determined by the contributions made. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity, and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. The contributions are recognised under employee benefits when accrued.

- Other long-term employee benefits

Other long-term employee benefits include defined benefit plans for benefits other than pensions (such as medical insurance) for certain serving and retired personnel of the Group. The expected costs of these benefits are recognised under provisions over the working life of the employees. These obligations are measured each year by independent qualified actuaries. Changes in actuarial assumptions are recognised, net of taxes, in reserves under equity in the year in which they arise, while the past service cost is recorded in the income statement.

This item also includes deferred remuneration schemes and the Structural Management Plan, which are measured each year. In 2015 the Company's Appointments and Remuneration Committee approved the implementation of a Structural Management Plan (hereinafter the "Plan") for certain members of the management team, with the aim of processing, in an orderly and efficient manner, the replacement and administration of the management positions covered in the Plan. The executives included in the Plan will be entitled to receive an amount equal to a maximum of 3.5 times their annual salary, depending on their category and annual fixed and variable remuneration at the date of leaving the Group. Participation in the



Plan is subject to meeting certain conditions, and the Plan may be modified or withdrawn by the Group under certain circumstances, including a prolonged decline in the Group's results (see note 13).

- Other provisions

The Group makes provision for present obligations (legal or constructive) arising as a result of a past event whenever it is probable that an outflow of resources will be required to settle those obligations and a reliable estimate can be made of the amount of the obligations. Provision is made when the liability or obligation is recognised.

Provisions are measured at the present value of the estimated expenditure required to settle the obligation using a pre-tax risk-free discount rate that reflects assessments of the time value of money. The increase in the provision due to the passage of time is recognised as an interest expense in the income statement.

#### **m) Transactions in currency other than the Euro**

Transactions in currency other than the Euro are translated by applying the exchange rate in force at the transaction date. Exchange gains and losses arising during the year due to balances being translated at the exchange rate at the transaction date rather than the exchange rate prevailing on the date of collection or payment are recognised as income or expenses in the consolidated income statement.

Fixed income securities and balances receivable and payable in currencies other than the Euro at 31 December each year are translated at the closing exchange rate. Any exchange differences arising are recognised under exchange gains/losses in consolidated profit or loss.

Transactions conducted in foreign currencies for which the Group has chosen to mitigate currency risk by arranging financial derivatives or other hedging instruments are recorded using the criteria for derivative financial instruments and hedging transactions.

#### **n) Derivative financial instruments and hedging transactions**

Derivative financial instruments are initially recognised in the consolidated statement of financial position at their fair value on the date the arrangement is executed (acquisition cost) and this fair value is subsequently adjusted as necessary. The criterion used to recognise the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the hedged item.

The total fair value of the derivative financial instruments is recognised under non-current assets or liabilities if the residual maturity of the hedged item is more than 12 months, and under current assets or liabilities if the residual maturity is less than 12 months.

In this respect, IFRS 13 "Fair Value Measurement", defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, whether that price is directly observable or estimated using another valuation technique.



At the inception of the hedge the Group formally designates and documents the hedging relationships and the objective and strategy for undertaking the hedges. Hedge accounting is only applicable when the hedge is expected to be highly effective at the inception of the hedge and in subsequent years in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, throughout the period for which the hedge was designated (prospective analysis), and the actual effectiveness is within a range of 80%-125% (retrospective analysis) and can be reliably measured.

When a hedging instrument expires or is sold, or when it no longer qualifies for hedge accounting, any cumulative gain or loss recorded in equity at that time remains in equity, and is immediately reclassified to the consolidated income statement as and when changes in cash flows of the hedged item occur. Any cumulative gain or loss is also reclassified from equity to the consolidated income statement if the forecast transaction is no longer expected to occur.

The market value of the different derivative financial instruments is calculated as follows:

- The fair market value of derivative financial instruments quoted on an organised market is their quoted value at the reporting date.
- The Company calculates the fair value of derivative financial instruments that are not traded on organised markets using valuation techniques, including recent arm's length transactions between knowledgeable, willing parties, reference to other instruments that are substantially the same, discounted cash flow analyses using the market interest rates and exchange rates in force at the reporting date, and option pricing models enhanced to reflect the particular circumstances of the issuer.

The Group recognises the portion of the gain or loss on the measurement at fair value of a hedging instrument that is determined to be an effective hedge in other comprehensive income. The ineffective portion and the specific component of the gain or loss or cash flows on the hedging instrument, excluding the measurement of the hedge effectiveness, are recognised with a debit or credit to finance costs or finance income.

The separate component of other comprehensive income associated with the hedged item is adjusted to the lesser of the cumulative gain or loss on the hedging instrument from inception of the hedge and the cumulative change in fair value or present value of the expected future cash flows on the hedged item from inception of the hedge. However, if the Group expects that all or a portion of a loss recognised in other comprehensive income will not be recovered in one or more future periods, it reclassifies into finance income or finance costs the amount that is not expected to be recovered.

Details of the fair value of the hedging derivatives used are disclosed in note 17. Details of changes in equity are provided in note 11.

#### **o) Trade payables**

Trade payables are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method. Trade payables falling due in less than one year that have no contractual interest rate and are expected to be settled in the short term are measured at their nominal amount.

**p) Income and expenses**

Revenue is measured at the fair value of the consideration received or receivable. Income and expenses are recognised on an accruals basis, irrespective of payments and receipts. The majority of the Group's revenues are regulated revenues from transmission and system operation activities in Spain. Details of the implementing legislation governing the calculation of these revenues are provided in note 3 to the accompanying annual accounts.

Income from telecommunications and reinsurance services is recognised considering the degree of completion of the rendering at the balance sheet date, providing that the result of the transaction may be reliably estimated.

Revenue and expenses from construction contracts are recognised using the percentage of completion method, whereby revenue is recognised based on the percentage of the contract work completed at the end of the accounting period.

Interest income is recognised using the effective interest method.

Dividends are recognised when the right to receive payment is established.

**q) Taxation**

The income tax expense or tax income for the year comprises current tax and deferred tax. Current and deferred taxes are recognised as income or an expense and included in profit or loss for the year, except to the extent that the tax arises from a transaction or event that is recognised in the same year, directly in equity, or from a business combination.

Current tax is the estimated tax payable for the year using the enacted tax rates applicable to the current year and to any adjustment to tax payable in respect of previous years.

Tax credits and deductions arising from economic events occurring in the year are deducted from the income tax expense, unless there are doubts as to whether they can be realised.

Deferred taxes and the income tax expense are calculated and recognised using the liability method, based on temporary differences arising between the balances recognised in the financial information and those used for tax purposes. This method entails calculating deferred tax assets and liabilities on the basis of the differences between the carrying amount of the assets and liabilities and their tax base, applying the tax rates that are objectively expected to apply to the years when the assets are realised and the liabilities settled.

Deferred tax assets are recognised provided that it is probable that sufficient taxable profits will be available against which the deductible temporary differences can be utilised.

Deferred tax assets and liabilities are recognised in respect of the temporary differences that arise from investments in subsidiaries and associates, except where the Group is able to control the timing of the reversal of the temporary differences and it is probable that they will reverse in the foreseeable future.

The companies Red Eléctrica Corporación, S.A., Red Eléctrica de España, S.A.U., Red Eléctrica Financiaciones, S.A.U., Red Eléctrica Internacional, S.A.U., Red Eléctrica de Infraestructuras de Telecomunicación, S.A.U. and Red Eléctrica de Infraestructuras en Canarias, S.A.U. together form the Red Eléctrica Tax Group and file consolidated tax returns in Spain.





In addition to the factors to be considered for individual taxation, set out previously, the following factors are taken into account when determining the accrued income tax expense for the companies forming the consolidated tax group:

- Temporary and permanent differences arising from the elimination of profits and losses on transactions between Group companies, derived from the process of determining consolidated taxable income.
- Deductions and credits corresponding to each company forming the consolidated tax group. For these purposes, deductions and credits are allocated to the company that carried out the activity or generated the profit necessary to obtain the right to the deduction or tax credit.
- Temporary differences arising from the elimination of profits and losses on transactions between tax group companies are recognised by the company that generates the profit or loss, using the applicable tax rate.
- The Parent of the Group records the total consolidated income tax payable (recoverable) with a debit (credit) to receivables from (payables to) Group companies and associates.
- The amount of the debt (credit) relating to the subsidiaries is recognised with a credit (debit) to payables to (receivables from) Group companies and associates.

#### **r) Earnings per share**

Basic earnings per share are calculated by dividing the net profit for the year attributable to the Parent by the weighted average number of ordinary shares outstanding during the year, excluding own shares.

According to the consolidated annual accounts of the Red Eléctrica Group at 31 December 2017 and 2016, basic earnings per share are the same as diluted earnings per share, as no transactions that could have resulted in a change in those figures were conducted during those years.

#### **s) Insurance**

The Red Eléctrica Group companies have taken out various insurance policies to cover the risks to which the companies are exposed through their activities. These risks mainly comprise damage that could be caused to the Group companies' facilities and possible claims that might be lodged by third parties due to the companies' activities. Insurance premium expenses and income are recognised in the consolidated income statement on an accruals basis. Payouts from insurance companies in respect of claims are recognised in the consolidated income statement applying the matching of income and expenses principle.

#### **t) Environmental issues**

Costs derived from business activities intended to protect and improve the environment are charged as expenses in the year in which they are incurred. Property, plant and equipment acquired to minimise environmental impact and to protect and improve the environment are recognised as an increase in property, plant and equipment.



#### u) Share-based payments

The Group has implemented share purchase schemes whereby employees can opt to receive part of their annual remuneration in the form of shares in the Company. This remuneration is measured based on the closing quotation of these Company shares at the delivery date. The costs incurred on such schemes are recognised under personnel expenses in the consolidated income statement. All shares delivered as payment are taken from the own shares held by the Parent.

#### v) Contingent assets and liabilities

Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

Contingent liabilities are not recognised in financial statements. Contingent liabilities are assessed continually and if it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

## 5. INTANGIBLE ASSETS

Movement in intangible assets and details of accumulated amortisation during 2017 and 2016 are as follows:

RED ELÉCTRICA GROUP Changes in Intangible Assets 2017 and 2016 (expressed in thousands of Euros)							
	31 December 2015	Additions	Variations exchange rate	31 December 2016	Additions	Variations exchange rate	31 December 2017
Cost							
Administrative concessions	126.327	93	4.151	130.571	171	(15.818)	114.890
Development expenses and Computer software	17.668	-	3	17.671	11.278	(5)	29.327
Intangible assets under development	3.133	18.179	103	21.415	30.260	(2.594)	49.115
Total cost	147.128	18.272	4.257	169.657	41.709	(18.417)	193.332
Accumulated Depreciation							
Administrative concessions	(11.314)	(5.619)	(627)	(17.560)	(5.448)	2.413	(20.595)
Development expenses and Computer software	(17.343)	(182)	-	(17.525)	(275)	2	(17.798)
Total Accumulated Depreciation	(28.657)	(5.801)	(627)	(35.085)	(5.723)	2.415	(38.393)
Net carrying amount	118.471	12.471	3.630	134.572	35.986	(16.002)	(154.939)



Operating expenses of Euros 32,750 thousand incurred directly in connection with intangible assets were capitalised in 2017 (Euros 5,774 thousand in 2016).

In 2017, Euros 406 thousand in borrowing costs were capitalised as an increase in Intangible assets (no borrowing costs were capitalised as an increase in intangible assets in 2016)

At 31 December 2017, the Company has fully amortised intangible assets amounting to Euros 18,550 thousand, corresponding primarily to Software and development expenses.

Administrative concessions reflect the technical energy facilities constructed and operated by the Group under concession in Peru.

Intangible assets under development in 2017 and 2016 correspond primarily to TESUR 2 and TESUR 3 and are linked to the construction of concession facilities by both companies.

The net carrying value of intangible assets outside Spain amounted to Euros 143,434 thousand at 31 December 2017 (Euros 134,432 thousand in 2016).

Details of service concession contracts awarded by different public entities and under operation and/or construction at 31 December 2017 are as follows:

(In thousands of euros)	REDESUR	TESUR	TESUR 2	TESUR 3
Awarding body	Peruvian State	Peruvian State	Peruvian State	Peruvian State
Activity	Electricity Transmission	Electricity Transmission	Electricity Transmission	Electricity Transmission
Country	Peru	Peru	Peru	Peru
Concession period from commencement of commercial operation	30 years	30 years	30 years	30 years
Remaining useful life	14 years	27 years	3 months construction + 30 years operation	18 months construction + 30 years operation
Period of tariff review	On an annual basis	On an annual basis	On an annual basis	On an annual basis
Net carrying value 31/12/2017	38,516	56,213	45,693	2,988
Net carrying value 31/12/2016	46,829	66,182	19,669	1,746
Revenue (2017)	15,882	6,699	-	-
Profit for the year 2017	3,354	764	10	(23)
Options for renewal	Not established in the contract	Not established in the contract	Not established in the contract	Not established in the contract

## 6. PROPERTY, PLANT AND EQUIPMENT

Movement in property, plant and equipment and details of accumulated depreciation and impairment during 2017 and 2016 are as follows:



RED ELÉCTRICA GROUP  
Details of movements in Property, plant and equipment  
2017 and 2016  
(expressed in thousands of Euros)

	31 December <u>2015</u>	<u>Additions</u> and <u>Other</u>	Variations exchange <u>rate</u>	Derecognitions, disposals reductions and <u>writedowns</u>	<u>Transfers</u>	31 December <u>2016</u>	<u>Additions</u> y <u>Other</u>	Variations exchange <u>rate</u>	Derecognitions, disposals reductions and <u>writedowns</u>	<u>Transfers</u>	31 December <u>2017</u>
Cost											
Land and buildings	76.120	-	13	-	3.463	79.596	1.468	(47)	(598)	2.224	82.643
Technical telecommunications facilities	434.001	-	-	-	1.734	435.735	-	-	-	2.632	438.367
Technical electricity facilities	12.797.858	9.301	-	(34.560)	597.662	13.370.261	51.896	-	(6.061)	248.920	13.665.016
Other facilities, machinery, Equipment, furniture and other items	190.938	300	88	(171)	23.700	214.855	232	(177)	(353)	5.942	220.499
Technical electricity facilities in progress	739.890	367.116	-	-	(593.118)	513.888	384.357	-	420	(222.987)	675.678
Advances and Intangible Assets in progress	25.615	48.295	3	-	(33.441)	40.472	42.737	(7)	-	(37.114)	46.088
Total cost	14.264.422	425.012	104	(34.731)	-	14.654.807	480.690	(231)	(6.592)	(383)	15.128.291
Accumulated Depreciation											
Buildings	(20.265)	(1.344)	(2)	-	-	(21.611)	(1.380)	7	-	-	(22.984)
Technical telecommunications facilities	(23.953)	(21.730)	-	-	-	(45.683)	(21.845)	-	-	-	(67.528)
Technical electricity facilities	(5.109.104)	(459.530)	-	-	4.865	(5.563.769)	(468.572)	-	6.061	-	(6.026.280)
Other facilities, machinery, Equipment, furniture and other items	(142.877)	(15.751)	(41)	126	(4.865)	(163.408)	(17.587)	161	336	-	(180.498)
Total Accumulated Depreciation	(5.296.199)	(498.355)	(43)	126	-	(5.794.471)	(509.384)	168	6.397	-	(6.297.290)
Impairment	(83.625)	-	-	-	-	(83.625)	-	-	-	-	(83.625)
Net carrying amount	8.884.598	(73.343)	61	(34.605)	-	8.776.711	(28.694)	(63)	(195)	(383)	8.747.376



Technical electricity facilities are assets that are subject to regulated remuneration (see note 3). The main additions to technical electricity facilities in 2017 and 2016 are investments in electricity transmission facilities in Spain.

Technical telecommunication facilities essentially consist of the concession of the rights to use and manage the operation of the fibre optic cable network and other related items, pursuant to the 20-year agreement entered into with ADIF in 2014. The agreement has been classified as a finance lease, given that substantially all the risks and rewards incidental to ownership of the assets were transferred.

Property, plant and equipment are measured at cost of acquisition, less any accumulated depreciation and impairment. Cost of acquisition includes the price paid for the asset, personnel expenses, operating expenses and any borrowing costs directly attributable to the construction or manufacture of the asset.

At 31 December 2017, the amount recognised under Additions and others includes mainly the investments undertaken in the period, as well as the technical facilities received pursuant to agreements with third parties.

At 31 December 2017, the amount recognised under Derecognitions, disposals, reductions and writedowns corresponds mainly to the disposal of certain fully-depreciated assets. At 31 December 2016, the amount of Euros 34,731 thousand shown under Derecognitions, disposals, reductions and write-downs mainly reflects adjustments in the acquisition cost of transmission assets acquired from power distributors in previous years, based on the conditions of the signed agreements.

During 2017, the companies capitalised construction-related borrowing costs of Euros 5,096 thousand as an increase in property, plant and equipment (Euros 7,547 thousand in 2016). The weighted average rate used to capitalise borrowing costs was 1.5% in 2017 (2.0% in 2016).

Operating expenses of Euros 34,007 thousand incurred directly in connection with property, plant and equipment under construction were capitalised in 2017 (Euros 34,624 thousand in 2016). The Group's capitalised expenses directly related to the construction of facilities include all operating expenses incurred to provide support to the units directly involved in the activity.

At 31 December 2017 and 2016 impairment losses essentially comprise adjustments to the carrying amount of facilities for which there are doubts as to whether they will generate sufficient future income. In 2016 and 2017, after analysing both the external information available and the internal information on generating future revenue from assets, the company concluded that there is no evidence of impairment, so there are no changes in the impairment of property, plant and equipment.

The net carrying value of property, plant and equipment outside Spain amounted to Euros 3,754 thousand at 31 December 2017 (Euros 1,309 thousand at 31 December in 2016).

At 31 December 2017 the Company has fully depreciated property, plant and equipment amounting to Euros 1,509,105 thousand, of which Euros 1,377,264 thousand comprise technical electricity facilities (Euros 1,458,864 thousand in 2014, of which Euros 1,335,823 thousand consisted of technical electricity facilities).

Details of capital grants and other non-current revenue received in advance in relation to property, plant and equipment are provided in note 12.



The Group has taken out insurance policies to cover the risk of damage to its property, plant and equipment. These policies provide adequate protection against the risks covered.

The Company has no firm commitments to purchase significant amounts of property, plant and equipment relative to its present volume of assets, and to the investments it makes and plans to make. The Group periodically places orders to cover needs related to its investment plan. The various amounts in the aforementioned orders will normally materialise in the form of delivery orders as and when the different projects included in the plan are capitalised. Therefore, they do not constitute firm purchase commitments at the time of issue.

## 7. INVESTMENT PROPERTY

Movement in the Group's investment property in 2017 and 2016 is as follows:

RED ELÉCTRICA GROUP					
Details of movements in Investment property					
2017 and 2016					
(expressed in thousands of Euros)					
	31		31		31
	December		December		December
	<u>2015</u>	<u>Additions</u>	<u>2016</u>	<u>Additions</u>	<u>2017</u>
Cost					
Investment property (buildings)	2,910	-	2,910	-	2,910
	-----	-----	-----	-----	-----
Total cost	2,910	-	2,910	-	2,910
Accumulated Depreciation					
Investment property (buildings)	(437)	(44)	(481)	(44)	(525)
	-----	-----	-----	-----	-----
Total Accumulated Depreciation	(437)	(44)	(481)	(44)	(525)
	=====	=====	=====	=====	=====
Net carrying amount	2,473	(44)	2,429	(44)	2,385
	=====	=====	=====	=====	=====

Investment property has a market value of approximately Euros 3 million in both 2017 and 2016 and does not generate or incur significant operating income or expenses.



## 8. EQUITY-ACCOUNTED INVESTEEES

This heading includes the investment in Transmisora Eléctrica del Norte, S.A (TEN), which is 50%-owned by the Group via Red Eléctrica Chile SpA (see note 2.g). As a joint Venture, this company is equity-accounted in the Financial Statements of the Red Eléctrica Group (see note 2.d)

TEN was incorporated on 1 March 2007 and is responsible for the construction of a transmission line spanning approximately 580 km and its related sub-stations. Since November 2017, this project has connected the Far North Interconnected System (SING) with the Central Interconnected System (SIC) in Chile.

The acquisition price was US Dollars 217,560 thousand (Euros 199,816 thousand) and the following movements were recorded in 2016 and 2017:

Company	31 December 2015	Price acquisition	Profit/(loss) of the shareholding	Increase of the Investment	Variations exchange rate	adjustments for Change in Value	31 December 2016	Price acquisition	Profit/(loss) of the shareholding	Increase of the Investment	Variations exchange rate	Adjustments for Change in Value	31 December 2017
Transmisora Eléctrica del Norte S.A. (TEN)	-	199.816	(1.154)	800	6.558	(5.263)	200.757	-	1.397	-	(25.017)	(4.410)	172.727
	-	199.816	(1.154)	800	6.558	(5.263)	200.757	-	1.397	-	(25.017)	(4.410)	172.727

The key figures at 31 December 2017 and 2016 are:

Transmisora Eléctrica del Norte S.A. (TEN), in thousands of US Dollars	31 December 2017	31 December 2016
Non-current assets	791,674	647,651
Current assets	128,749	34,100
<b>ASSETS</b>	<b>920,423</b>	<b>681,751</b>
Non-current liabilities	880,831	513,701
Current liabilities	6,984	126,509
<b>EQUITY AND LIABILITIES</b>	<b>887,815</b>	<b>640,210</b>
<b>NET ASSETS</b>	<b>32,608</b>	<b>41,541</b>
EBITDA	5,255	(469)
Profit after tax	3,172	(2,413)

## 9. INVENTORIES

Details of inventories on the Consolidated Statement of Financial Position at 31 December 2017 and 2016 are as follows:



	Thousands of euros	
	<u>2017</u>	<u>2016</u>
Inventories	68,074	65,545
Impairment corrections	(28,321)	(26,078)
	-----	-----
	39,753	39,467
	=====	=====

Inventories mainly reflect the materials and spare parts related to the technical electricity facilities. The Group companies regularly test inventories for impairment based on the following assumptions:

- Impairment of old inventories, using inventory turnover ratios.
- Impairment for excess inventories, on the basis of estimated use in future years.

As a result, the Group recorded impairment losses of Euros 2,243 thousand in the consolidated income statement for 2017 (Euros 4,711 thousand in 2016).

## 10. TRADE AND OTHER RECEIVABLES

Details of trade and other receivables at 31 December 2017 and 2016 are as follows:

	Thousands of Euros	
	<u>2017</u>	<u>2016</u>
Trade receivables	14,940	15,052
Other receivables	994,627	943,376
Deferred tax assets (note 20)	3,788	3,694
	-----	-----
	1,013,355	962,122
	=====	=====

Other receivables at 31 December 2017 and 2016 reflect the trend in settlements made by the regulator in Spain for regulated activities in those years as a result of changes in collections and payments. At 31 December 2017 and 2016, this heading mostly comprises amounts pending invoicing and/or collection for regulated transmission and system operation activities. Under the settlement system set up by the Spanish regulator, some of these receivables are settled in the following year. This item also includes the revenue pending receipt derived from applying the methodology set forth in the remuneration model in force for the transmission business in Spain,





which stipulates that facilities entering into service in year 'n' are to be remunerated from year 'n+2' onwards.

There are no significant differences between the fair value and the carrying amount at 31 December 2016 and 2017. At 31 December 2017 and 2016 there are no significant amounts over 12 months past-due (see note 15).

## 11. EQUITY

### Capital risk management

The Group's management of its companies' capital is aimed at safeguarding their capacity to continue operating as a going concern, so as to provide shareholder remuneration while maintaining an optimum capital structure to reduce the cost of capital.

To maintain and adjust the capital structure, the Group can adjust the amount of dividends payable to shareholders, reimburse capital or issue shares.

The Group controls its capital structure on a gearing ratio basis, in line with sector practice. This ratio is calculated as net financial debt divided by the sum of the Group's equity and net financial debt. Net financial debt is calculated as follows:

	<u>Thousands of Euros</u>	
	<u>2017</u>	<u>2016</u>
Non-current payables	4,630,691	4,960,556
Current payables	735,317	294,051
Foreign exchange derivatives	(4,341)	(53,730)
Cash and cash equivalents	(569,869)	(251,421)
	-----	-----
Net financial debt	4,791,798	4,949,456
	-----	-----
Equity	3,093,449	2,920,549
	-----	-----
Gearing ratio	60.8%	62.9%
	=====	=====

At 31 December 2017, the financial covenants stipulated in the contracts have been met.

On 4 July 2017, the rating agency Standard & Poor's issued a new report on Red Eléctrica maintaining its rating and outlook. Following this announcement, the Company and its subsidiary Red Eléctrica de España, S.A.U. maintain long-term ratings of A- and short-term ratings of A-2, with a stable outlook.

On 18 September 2017, the rating agency Fitch Ratings confirmed Red Eléctrica Corporación, S.A.'s long-term rating of A, with a stable outlook. Following this announcement, the Company and its subsidiary Red Eléctrica de España, S.A.U. maintain long-term ratings of A and short-term ratings of F1, with a stable outlook.



## **Equity attributable to the Parent**

- **Equity**

- **Share capital**

At 31 December 2017 and 2016, the Company's share capital was represented by 541,080,000 book entry shares, fully subscribed and paid up, with the same economic and voting rights (notwithstanding the limits established in the following paragraph), and each with a par value of fifty-euro cents, admitted to trading in all four Spanish stock exchanges, in Spain's SIBE electronic trading platform.

On 11 July 2016 a 4-for-1 share split was carried out, reducing the par value of the Company's shares from Euros 2 to Euros 0.50 per share without modifying total share capital. The share split was approved by the shareholders at their ordinary general meeting on 15 April 2016.

The Parent's shares are quoted on the four Spanish stock exchanges. The Company is subject to the shareholder limitations stipulated in the twenty-third additional provision of Law 54/1997 of 27 November 1997 and article 30 of the Electricity Industry Law 24/2013 of 26 December 2013.

Pursuant to this legislation, any individual or entity may hold investments in the Company, provided that the sum of their direct or indirect interests in its share capital does not exceed 5% and their voting rights do not surpass 3%. These shares may not be syndicated for any purpose. Voting rights at the Parent are limited to 1% in the case of entities that carry out activities in the electricity sector, and individuals and entities that hold direct or indirect interests exceeding 5% of the share capital of such companies, without prejudice to the limitations for generators and suppliers set forth in article 30 of the Electricity Industry Law 24/2013 of 26 December 2013. The shareholder limitations with regard to the Parent's share capital are not applicable to Sociedad Estatal de Participaciones Industriales (SEPI), which in any event will continue to hold an interest of no less than 10%. At 31 December 2017 and 2016 SEPI holds a 20% interest in the Company's share capital.

- **Reserves**

This item includes:

- **Legal reserve**

Spanish companies are obliged to transfer 10% of the profits for the year to a legal reserve until such reserve reaches an amount equal to 20% of the share capital. This reserve is not distributable to shareholders, unless it exceeds the established limit, and may only be used to offset losses if no other reserves are available. Under certain circumstances, it may also be used to increase share capital. At 31 December 2017 and 2016 the legal reserve at the parent company amounts to 20% of share capital (Euros 54,199 thousand).

- **Other reserves**

Other reserves include voluntary reserves of the Parent, reserves in consolidated companies and first-time application reserves. These reserves totalled Euros 2,021,135 thousand at 31 December 2017 (Euros 1,875,051 thousand in 2016).



In addition, this item includes statutory reserves amounting to Euros 309,062 thousand (Euros 293,656 thousand in 2016), particularly the following:

- The property, plant and equipment revaluation reserve amounting to Euros 247,022 thousand created by the Parent in 1996 (this reserve may be used, free of taxation, to offset accounting losses and increase share capital or, ten years after its creation, it may be transferred to freely distributable reserves, in accordance with Royal Decree-Law 2607/1996). Nonetheless, this balance may only be distributed, indirectly or directly, when the revalued assets have been fully depreciated, transferred or derecognised.
- As provided for by article 25 of Law 27/2014 of 27 November 2014, the tax group headed by the Company has created a capitalisation reserve of Euros 44,516 thousand, corresponding to the years 2015 (Euros 29,110 thousand) and 2016 (15,406 thousand) which is held by REE and REC, as permitted by article 62.1 d) of the aforementioned Law. This reserve will be restricted for a period of five years. In 2017, each tax group company has adjusted corporate income tax for the year in connection with this reserve (see note 20).

- **Own shares and equity holdings**

At 31 December 2017 the Parent held 1,613,693 own shares representing 0.30% of its share capital, each with a par value of Euros 0.50, with a total par value of Euros 807 thousand and an average acquisition price of Euros 18.45 per share (at 31 December 2016 the Parent held 1,966,332 own shares representing 0.36% of its share capital, each with a par value of Euros 0.50, with a total par value of Euros 983 thousand and an average acquisition price of Euros 18.68 per share).

These shares have been recognised as a reduction in equity for an amount of Euros 29,769 thousand at 31 December 2017 (Euros 36,739 thousand in 2016).

The parent Company has complied with the requirements of article 509 of the Spanish Companies Act, which provides that, except in the event of the free acquisition of own shares, in listed companies the par value of treasury shares acquired directly or indirectly by the Company, together with those already held by the parent Company and its subsidiaries, must not exceed 10% of the share capital subscribed. The Group subsidiaries do not hold own shares or shares in the Parent.

- **Profit for the year attributable to the Parent**

Profit for 2017 totals Euros 669,836 thousand (Euros 636,920 thousand at 31 December 2016).

- **Interim dividends and proposed distribution of dividends by the Parent**

The interim dividend authorised by the board of directors in 2017 has been recognised as a Euros 137,509 thousand reduction in consolidated equity at 31 December 2017 (Euros 128,417 thousand at 31 December 2016) (see note 16).



On 31 October 2017 the Company's board of directors agreed to pay an interim dividend of Euros 0.2549 (gross) per share with a charge to 2017 profit, payable on 5 January 2018 (Euros 0.2382, gross, per share in 2016).

Details of the dividends paid during 2017 and 2016 are as follows:

	2017			2016		
	<u>% over the nominal amount,</u>	<u>Euros per share</u>	<u>Amount (in thousands of euros)</u>	<u>% over the nominal amount,</u>	<u>Euros per share</u>	<u>Amount (in thousands of euros)</u>
Ordinary shares	171.74%	0.8587	463,189	160.50%	0.8025	432,834
Total dividends paid	171.74%	0.8587	463,189	160.50%	0.8025	432,834
Dividends charged to profit	171.74%	0.8587	463,189	160.50%	0.8025	432,834

Likewise, the Parent's board of directors proposed to the shareholders at their general meeting the distribution of a supplementary dividend of Euros 0,9188 per share, which would result in a full-year dividend for 2017 of Euros 0,9188 per share (Euros 0.8587 per share in 2016).

- **Valuation adjustments**

- **Available-for-sale financial assets**

At 31 December 2017 and 2016 this item reflects valuation adjustments to available-for-sale financial assets due to fluctuations in the share price of the Group's 5% investment in the listed company Redes Energéticas Nacionais (hereinafter REN), the benchmark index for which is the portuguese PSI 20. At 31 December 2017 this item totals Euros 15,435 thousand (Euros 16,125 thousand in 2016).

- **Hedging transactions**

This line item reflects changes in the value of derivative financial instruments.

At 31 December 2017 this item totals Euros -77,241 thousand (Euros -83,801 thousand in 2016).

- **Translation differences and other**

This line item mainly comprises the exchange gains and losses arising from translation of the financial statements of foreign businesses, specifically the Peruvian companies TESUR, TESUR 2 TESUR 3, REA and REDESUR and the Chilean companies RECH, REDENOR and TEN. At 31 December 2017 they amount to Euros 2,298 thousand (5,520 thousand in 2016). This decrease is primarily due to the performance of the US Dollar against the Euro.



### **Non-controlling interests**

Non-controlling interests under equity in the accompanying Consolidated Statement of Financial Position reflect the non-controlling interests in the Chilean company REDENOR at 31 December 2017 and in the Peruvian companies TESUR, TESUR 2 and REDESUR at 31 December 2016. In 2017 they amount to Euros 59 thousand (Euros 17,495 thousand in 2016). Details of movements during 2017 and 2016 are as follows:

	<u>31</u> <u>December</u> <u>2015</u>	<u>Profit for the</u> <u>year</u>	<u>Translation</u> <u>net</u> <u>differences:</u>	<u>31</u> <u>December</u> <u>2016</u>	<u>Profit for</u> <u>the year</u>	<u>Translation</u> <u>net</u> <u>differences</u>	<u>Changes in</u> <u>perimeter</u> <u>and others</u>	<u>31</u> <u>December</u> <u>2017</u>
Non-controlling interests	15,350	1,687	458	17,495	(17)	1	(17,420)	59

With regard to the main non-controlling interests outlined above, their summary financial information for assets, liabilities and profit and loss at 31 December 2017 and 2016 is as follows:

(In thousands of euros)	<u>31 December</u> <u>2017</u> REDENOR
Non-current assets	807
Current assets	193
<b>ASSETS</b>	<b>1,000</b>
Non-current liabilities	-
Current liabilities	802
<b>EQUITY AND LIABILITIES</b>	<b>802</b>
<b>NET ASSETS</b>	<b>198</b>
Income	829
Expenses	906
EBITDA	(77)
Profit after tax	(55)
Profit attributable to non-controlling interests	(17)



(In thousands of euros)	31 December 2016		
	(REDESUR)	TESUR	TESUR 2
Non-current assets	97,632	66,805	19,803
Current assets	24,999	8,745	8,303
<b>ASSETS</b>	<b>122,631</b>	<b>75,550</b>	<b>28,106</b>
Non-current liabilities	74,125	36,338	-
Current liabilities	7,218	4,931	6,906
<b>EQUITY AND LIABILITIES</b>	<b>81,343</b>	<b>41,269</b>	<b>6,906</b>
<b>NET ASSETS</b>	<b>41,288</b>	<b>34,281</b>	<b>21,200</b>
Income	15,636	7,041	15,040
Expenses	4,766	1,441	15,272
EBITDA	10,870	5,600	(232)
Profit after tax	3,250	645	(196)
Profit attributable to non-controlling interests	1,788	355	(122)

## 12. GRANTS AND OTHER

Movement in grants and other in 2017 and 2016 is as follows:

RED ELÉCTRICA GROUP										
Breakdown of changes in Grants and other non-current advances										
2017 and 2016										
(expressed in thousands of Euros)										
	31 December 2015	Additions	Disposals	Amounts used	31 December 2016	Additions	Disposals	Amounts used	Transfers	31 December 2017
Capital grants	194.932	6.866	-	(8.022)	193.776	1.250	-	(8.063)	(397)	186.566
Other Grants and advances	353.666	14.420	(625)	(13.296)	354.165	72.352	(980)	(15.378)	397	410.556
	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====
	548.598	21.286	(625)	(21.318)	547.941	73.602	(980)	(23.441)	-	597.122
	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====

Capital grants includes the amounts received by REE for the construction of electric power facilities. Applications reflect the amounts taken to profit or loss on the basis of the useful life of the corresponding facilities and recognised under non-financial and other capital grants in the consolidated income statement.

Other grants and other prepayments include primarily the amounts or technical installations received as a result of agreements with third parties, as well as income tax deductions on investments in the Canary Islands, which are similar in nature to capital grants (see note 2c). Applications reflect the amounts taken to profit or loss on the basis of the useful life of the assets linked to the deductions, recognised under non-financial and other capital grants in the consolidated income statement.



### 13. NON-CURRENT PROVISIONS

Movement in 2017 and 2016 is as follows:

RED ELÉCTRICA GROUP										
Breakdown of changes in Grants and other non-current advances										
2017 and 2016										
(expressed in thousands of Euros)										
	31				31					31
	December				December					December
	2015	Additions	Disposals	Amounts used	2016	Additions	Disposals	Amounts used	Transfers	2017
Capital grants	194.932	6.866	-	(8.022)	193.776	1.250	-	(8.063)	(397)	186.566
Other Grants and advances	353.666	14.420	(625)	(13.296)	354.165	72.352	(980)	(15.378)	397	410.556
	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====
	548.598	21.286	(625)	(21.318)	547.941	73.602	(980)	(23.441)	-	597.122
	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====

Provisions for employee benefits comprise defined benefit plans, which essentially include the future commitments – specifically medical insurance – undertaken by the Group vis-à-vis its personnel from the date of their retirement, calculated using actuarial studies carried out by an independent expert. In 2017 and 2016 additions derive mainly from the annual accrual of these commitments, as well as changes in the actuarial assumptions used. These additions have been recognised as personnel expenses or finance costs, depending on their nature, and under reserves when they derive from changes in the actuarial assumptions (mainly in the case of obligations related to medical insurance) or in profit or loss (in the case of past service obligations). The personnel expenses recognised in the consolidated income statement for 2017 amount to Euros 1,461 thousand (Euros 1,453 thousand in 2016), and finance costs recognised in the consolidated income statement in 2017 totalled Euros 1,107 thousand (Euros 1,027 thousand in 2016), whilst the Reserves recognised in 2017 totalled Euros 3,989 thousand, net of tax (Euros 2,123 thousand in 2016).

The assumptions made with regard to 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
	Actuarial assumptions	Actuarial assumptions
Discount rate	1.80%	2.10%
Cost growth	3.0%	3.0%
Life expectancy table	PERM/F 2000 New production	PERM/F 2000 New production



Details of the effect of an increase/decrease of one percentage point in the cost of medical insurance are as follows:

(In thousands of euros)	2017	
	+1%	-1%
Cost of services in the current year	426	(329)
Net interest cost of post-employment medical insurance	9	(7)
Accumulated obligations for post-employment benefits deriving from medical insurance	14,193	(10,567)

Conversely, in 2017 the effect of a decrease of half a percentage point in the discount rate used for medical insurance costs from 1.80% to 1.30%, in thousands of Euros, is as follows:

(thousands of euros)	Discount rate		Sensitivity
	1.80%	1.30%	
Cost of services in the current year	1,347	1,536	189
Net interest cost of post-employment medical insurance	978	748	(230)
Accumulated obligations for post-employment benefits or deriving from the cost of medical insurance	50,780	57,313	6,533

Provisions for employee benefits also include deferred remuneration schemes (see note 4). At 31 December 2017 Euros 1,461 thousand were recognised under this heading of the income statement (Euros 1,889 thousand in 2016).

Other provisions basically include the amounts recorded by the Group every year to cover the potential unfavourable rulings relating mainly to administrative proceedings, mainly administrative disciplinary proceedings, judicial reviews of expropriation proceedings and out-of-court claims. The provisions recognised to cover these events are measured on the basis of the potential economic content of the ongoing appeals, litigation, claims and general legal or out-of-court proceedings to which the Group is party. The amount shown in transfers in 2016 (Euros 11,257 thousand) reflects provisions for current liabilities from prior years for which the estimated settlement period has been revised to non-current.

#### 14. OTHER NON-CURRENT LIABILITIES

Other non-current liabilities basically include the revenues received in advance from agreements with various telecommunications operators for the use of the telecommunications network capacity, recognised in the consolidated income statement based on the duration of the





agreements, with expiry dates up to 2035, and amounting to Euros 34,690 thousand at 31 December 2035 (Euros 38,579 thousand at 31 December 2016).

This item also includes the non-current liabilities arising from the compensation paid by Électricité de France (hereinafter EDF) under the agreement signed in 1997 for the adaptation of electricity supply contracts, which amounted to Euros 23,625 thousand at 31 December 2017 (Euros 23,625 thousand at 31 December 2016). These commitments pertain to more than one year and are therefore subject to the construction of facilities that were not completed at 31 December 2017.

## 15. FINANCIAL RISK MANAGEMENT POLICY

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The Group's financial risk management policy establishes principles and guidelines to ensure that any significant risks that could affect the objectives and activities of the Red Eléctrica Group are identified, analysed, assessed, managed and controlled, and that these processes are carried out systematically and adhering to uniform criteria.

A summary of the main guidelines that comprise this policy is as follows:

- Risk management should be fundamentally proactive and directed towards the medium and long term, taking into account possible scenarios in an increasingly global environment.
- Risk should generally be managed in accordance with consistent criteria, distinguishing between the importance of the risk (probability/impact) and the investment and resources required to reduce it.
- Financial risk management should be focused on avoiding undesirable variations in the Group's core value, rather than generating extraordinary profits.

The Group's finance management is responsible for managing financial risk, ensuring consistency with the Group's strategy and coordinating risk management across the various Group companies, by identifying the main financial risks and defining the initiatives to be taken, based on different financial scenarios.

The methodology for identifying, measuring, monitoring and controlling risk, as well as the management indicators and measurement and control tools specific to each risk, are documented in the financial risk manual.

The financial risks to which the Group is exposed are as follows:

### **Market risk**

Market risk reflects variations in the financial markets in terms of prices, interest and exchange rates, credit conditions and other variables that could affect short-, medium- and long-term finance costs.

Market risk is managed on the borrowings to be arranged (the currency, maturity and interest rates), and through the use of hedging instruments that allow the financial structure to be modified. Market risk specifically includes:



- Interest rate risk

Interest rate fluctuations change the fair value of assets and liabilities that accrue interest at fixed rates and the future cash flows from assets and liabilities indexed to floating interest rates. The structure of Financial debt at 31 December 2017 and 2016 is as follows:

	2017		2016	
	Thousands of euros		Thousands of euros	
	Fixed rate	Floating rate	Fixed rate	Floating rate
Long-term issues	3,003,117	14,919	3,414,492	14,912
Non-current bank borrowings	1,127,933	480,381	865,840	611,582
Short-term issues	602,998	-	3,882	200,064
Current bank borrowings	60,449	71,870	79,528	10,577
Total financial debt	4,794,497	567,170	4,363,742	837,135
Percentage	89%	11%	84%	16%

The financial debt structure is low risk with moderate exposure to fluctuations in interest rates, as a result of the debt policy implemented, which aims to bring the cost of debt into line with the financial rate of return applied to the Group's regulated assets, among other objectives.

The interest rate risk to which the Group is exposed at 31 December 2017 and 2016 derives from changes in the fair value of derivative financial instruments and mostly affects equity, but not profit for the year. A sensitivity analysis of this risk is as follows (in thousands of Euros):

	Effect on Consolidated Equity from variations in market interest rates (thousands of Euros) (in thousands of Euros)			
	2017		2016	
	+0.10%	-0.10%	+0.10%	-0.10%
Interest rate hedges:				
- Cash flow hedges				
Interest rate swap	4.416	(4.454)	6.040	(6.099)
Interest rate and exchange rate hedges:				
- Cash flow hedges				
Cross currency swap	278	(283)	(17)	14



This increase or decrease of 0.10% in interest rates would have decreased or increased profit by Euros 962 thousand in 2017 and by Euros 1,063 thousand in 2016.

The fair value sensitivity has been estimated using a valuation technique based on discounting future cash flows at prevailing market rates at 31 December 2017 and 2016.

- Currency risk

Currency risk management considers transaction risk, arising on cash inflows and outflows in currencies other than the Euro, and translation risk, i.e. a company's exposure when consolidating its subsidiaries and/or assets located in countries whose functional currency is not the Euro.

With a view to reducing the currency risk on issues in the US private placements (USPP) market, the Company has arranged cash flow hedges through US Dollar/Euro cross currency swaps on the principal and interest, which cover the amount and total term of the issue up to October 2035 (see note 17).

In order to mitigate the translation risk of assets located in countries whose functional currency is other than the euro, the Group finances part of said investments in the functional currency. Moreover, the Group has arranged net investment hedges in US Dollars through cross currency swaps until January 2021 (see note 17). As a result of these actions, at 31 December 2017 a 10% gain or loss in the exchange rate of the US Dollar against the Euro compared with year-end would have generated an increase or decrease in the parent's equity of approximately Euros 6 million (Euros 7 million at 31 December 2016).

### Credit risk

In light of the nature of revenues from electricity transmission and electricity system operation, and the solvency of the electricity system agents, the Group's principal activities are not significantly exposed to credit risk. For the Group's other activities, credit risk is mainly managed through instruments to reduce or limit such risk.

In any event, credit risk is managed through policies that contain certain requirements regarding counterparty credit quality, and further guarantees are requested when necessary.

At year end the Company's exposure to credit risk in connection with the fair value of its derivatives is insignificant, having entered into collateral assignment agreements with various counterparties since 2015 in order to mitigate this risk.

At 31 December, less than 1% of balances are past-due (1% in 2016), although the companies do not consider there to be any risk as regards recoverability. The credit quality of the receivables is considered to be high.

### Liquidity risk

Liquidity risk arises due to differences between amounts or the dates of collection and payment of the Group companies' assets and liabilities.



Liquidity risk is mostly managed by controlling the timing of financial debt and maintaining a considerable volume of available capital during the year, setting maximum limits of amounts falling due for each period defined. This process is carried out at Group company level, in accordance with the practices and limits set by the Group. The limits established vary according to the geographical area, so as to ensure that the liquidity of the market in which each company operates is taken into account. Furthermore, the liquidity risk management policy entails preparing cash flow projections in the main currencies in which the Group operates, taking into consideration the level of liquid assets and funds available according to these projections, and monitoring the liquidity indicators as per the consolidated statement of financial position and comparing these with market requirements.

The Group's financial debt at 31 December 2017 has an average maturity of 5.3 years (5.7 years at 31 December 2016). The breakdown of maturities of debt issues and bank borrowings is presented in note 16.

The Group's liquidity position for 2017 was based on its robust capacity to generate cash flows, supported by undrawn credit facilities amounting to Euros 1,658 million (non-current and current balances of Euros 1,117 million and Euros 541 million, respectively).

#### **Price risk**

The Group is exposed to price risk relating to capital investments classified as available for sale in the consolidated statement of financial position. Investments available for sale on quoted markets basically comprise the 5% interest held by the Group in REN. At 31 December 2017, a 10% appreciation or depreciation in the share price of Portuguese company REN would have generated an increase or decrease in equity of approximately Euros 6 million, respectively (Euros 5 million in 2016).

## **16. FINANCIAL ASSETS AND FINANCIAL LIABILITIES**

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### **Financial assets**

Details of the Red Eléctrica Group's current and non-current financial assets at 31 December 2017 and 2016 are as follows:



31/12/2017 (in thousands of euros)

	<u>Available- for-sale financial assets</u>	<u>Loans and receivables (1)</u>	<u>Hedge derivatives</u>	<u>Total</u>
Equity instruments	85,606	-	-	85,606
Derivatives	-	-	12,970	12,970
Other financial assets	-	9,659	-	9,659
	=====	=====	=====	=====
Long-term/non-current	85,606	9,659	12,970	108,235
	=====	=====	=====	=====
Derivatives	-	-	-	-
Other financial assets	-	80,668	-	80,668
	-----	-----	-----	-----
Short-term/current	-	80,668	-	80,668
	=====	=====	=====	=====
Total	85,606	90,327	12,970	188,903
	=====	=====	=====	=====

31/12/2016 (in thousands of euros)

	<u>Available- for-sale financial assets</u>	<u>Loans and receivables (1)</u>	<u>Hedge derivatives</u>	<u>Total</u>
Equity instruments	74,288	-	-	74,288
Derivatives	-	-	28,742	28,742
Other financial assets	-	8,831	-	8,831
	=====	=====	=====	=====
Long-term/non-current	74,288	8,831	28,742	111,861
	=====	=====	=====	=====
Derivatives	-	-	-	-
Other financial assets	-	40,575	-	40,575
	-----	-----	-----	-----
Short-term/current	-	40,575	-	40,575
	=====	=====	=====	=====
Total	74,288	49,406	28,742	152,436
	=====	=====	=====	=====

(1) Excluding trade receivables



- **Equity instruments**

Equity instruments essentially comprise the 5% interest held by the Group in REN, a holding company that encompasses the operation and use of electricity transmission assets and various gas infrastructure in Portugal. This interest was acquired in 2007 for Euros 98,822 thousand. In December 2017, the Group took part in the capital increase conducted at REN, subscribing to 6,659,563 new shares for Euros 12,500 thousand, enabling it to maintain a 5% stake in the company. Furthermore, the Group sold subscription rights to the aforementioned capital increase, generating a profit of Euros 18 thousand.

At 31 December 2016, REN's consolidated equity amounted to Euros 1,159,217 thousand and its profit before tax amounted to Euros 100,183 thousand.

The value of this investment is subject to the listed share price. In 2017, the fair value of this equity instrument decreased and the corresponding valuation adjustment was recognised directly under equity.

At 31 December 2017, the Company calculated the decrease resulting from the valuation adjustment recognised under Equity at Euros 1,833 thousand (decrease of 2,242 thousand in 2016).

This item also comprises the investment in economic interest groups (EIGs) measured at Euros 2,422 thousand (Euros 1,765 in 2014). These EIGs engage in the lease of assets operated by an unrelated party, which retains most of the rewards and risks of the activity, while the Group only avails of the tax benefits pursuant to Spanish legislation. The Company recognises the tax losses incurred by these EIGs against the investments, together with the corresponding finance income (see note 21d) reflecting the difference compared to income tax payable to the taxation authorities.

- **Derivatives**

Details of derivative financial instruments are provided in note 17.

- **Other financial assets**

At 31 December 2017, the balance corresponds mainly to the loan granted to the associate TEN for Euros 54,828 thousand (Euros 32,172 thousand at 31 December 2016), accruing interest linked to the LIBOR plus a spread of 270 basis points, as well as guarantees and loans granted by REE to its employees and maturing in the long term. There are no significant differences between the fair value and the carrying amount at 31 December 2017 and 2016.

### **Fair value hierarchy levels**

Details of the Group's financial assets measured at fair value using the inputs defined for this calculation at 31 December 2017 and 2016 are as follows:



	31/12/2017 (in thousands of euros)			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total amounts</u>
Equity instruments	82,698	-	2,908	85,606
Derivatives	-	12,970	-	12,970
Other financial assets	-	-	90,327	90,327

	31/12/2016 (in thousands of euros)			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total amounts</u>
Equity instruments	72,037	-	2,251	74,288
Derivatives	-	28,742	-	28,742
Other financial assets	-	-	49,406	49,406

Level 1 equity instruments reflect the 5% interest held by the Group in the listed company REN.

### **Financial liabilities**

Details of the Red Eléctrica Group's current and non-current financial liabilities at 31 December 2017 and 2016 are as follows:



	31/12/2017 (in thousands of euros)		
	<u>Trade and other payables<sup>(1)</sup></u>	<u>Hedge derivatives and others</u>	<u>Total</u>
Loans and borrowings	1,608,314	-	1,608,314
Bonds and other marketable securities	3,022,377	-	3,022,377
Derivatives	-	61,437	61,437
Other financial liabilities <sup>(2)</sup>	-	224	224
	-----	-----	-----
Long-term/non-current	4,630,691	61,661	4,692,352
	=====	=====	=====
Loans and borrowings	143,814	-	143,814
Bonds and other marketable securities	680,683	-	680,683
Derivados	-	-	-
Other financial liabilities	647,460	-	647,460
	-----	-----	-----
Short-term/current	1,471,957	-	1,471,957
	=====	=====	=====
Total	6,102,648	61,661	6,164,309
	=====	=====	=====

	31/12/2016 (in thousands of euros)		
	<u>Trade and other payables<sup>(1)</sup></u>	<u>Hedge derivatives and others</u>	<u>Total</u>
Loans and borrowings	1,477,422	-	1,477,422
Bonds and other marketable securities	3,483,134	-	3,483,134
Derivados	-	73,620	73,620
Other financial liabilities <sup>(2)</sup>	-	224	224
	-----	-----	-----
Long-term/non-current	4,960,556	73,844	5,034,400
	=====	=====	=====
Loans and borrowings	103,168	-	103,168
Bonds and other marketable securities	280,876	-	280,876
Derivados	-	-	-
Other financial liabilities	682,865	-	682,865
	-----	-----	-----
Short-term/current	1,066,909	-	1,066,909
	=====	=====	=====
Total	6,027,465	73,844	6,101,309
	=====	=====	=====

(1) Excluding trade receivables

(2) Corresponds to long-term deposits and guarantees received





- **Loans and borrowings, bonds and other marketable securities**

The carrying amount and fair value of loans and borrowings and issues of bonds and other marketable securities at 31 December 2017 and 2016 are as follows:

	Carrying amount		Fair value	
	Thousands of Euros		Thousands of Euros	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Issues in Euros	3,183,842	3,180,848	3,404,668	3,445,378
Issuance in US Dollars	441,533	506,232	524,465	601,740
Bank borrowings in Euros	1,638,130	1,527,879	1,665,141	1,551,109
Bank borrowings in foreign currencies	102,503	39,648	102,280	39,647
<b>Total</b>	<b>5,366,008</b>	<b>5,254,607</b>	<b>5,696,554</b>	<b>5,637,874</b>

The fair value of all loans and borrowings and issues of bonds and other marketable securities has been estimated using valuation techniques based on discounting future cash flows at market rates prevailing at each date (Level 2).

At 31 December 2017 the accrued interest payable amounts to Euros 89,180 thousand (Euros 89,993 thousand in 2016).

Issues in Euros at 31 December 2017 include:

- Eurobonds issued by Red Eléctrica Financiaciones S.A.U. (hereinafter REF), totalling Euros 3,183,842 thousand (Euros 2,980,784 thousand in 2016). One bond issue amounting to Euros 200 million was carried out in 2017 (one bond issue of Euros 300 million in 2016).
- In 2017, REF redeemed Euros 200,064 thousand in short-term promissory notes issued in the Euromarket by REF as part of the Euro Commercial Paper Programme (ECP Programme), which remained outstanding at 31 December 2016.

Issuance in US Dollars at 31 December 2017 amounts to Euros 441,533 thousand (Euros 506,232 thousand in 2016), comprising a US Dollars 500 million issue in the US private placement (USPP) market, of which US Dollars 430 million remained outstanding, as well as two US Dollar bond issues launched in Peru in 2015 for a total of US Dollars 110 million, of which Euros 99.7 million remained outstanding. (See currency risk analysis in note 15).

Bank borrowings in Euros at 31 December 2017 include non-current loans and credit facilities totalling Euros 1,508,178 thousand (Euros 1,382,653 thousand in 2016) and syndicated credit facilities amounting to Euros 129,952 thousand (Euros 145,226 thousand in 2016).



Details of the maturities of bond issues and bank borrowings at 31 December 2017 are as follows:

RED ELÉCTRICA GROUP								
Breakdown of maturities of Issues and Bank Loans								
31 December 2017								
(expressed in thousands of Euros)								
Thousands of Euros								
	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>Subsequent</u>	<u>Valuation</u>	<u>Total</u>
						<u>years</u>	<u>adjustments</u>	
Issues in Euros	599,400	284,100	550,000	-	400,000	1,390,000	(39,658)	3,183,842
Issuance in US Dollars	3,619	3,807	154,092	4,212	4,431	271,817	(445)	441,533
Bank borrowings in Euros	96,823	96,419	104,793	153,420	513,184	676,097	(2,606)	1,638,130
Bank borrowings in US Dollars	35,785	84	35,633	-	31,001	-	-	102,503
	735,627	384,410	844,518	157,632	948,616	2,337,914	(42,709)	5,366,008
	=====	=====	=====	=====	=====	=====	=====	=====

The average interest rate accrued on bank borrowings and issues in the year was 2.78% in 2017 (2.94% in 2016).

At 31 December 2017 Group companies have undrawn credit facilities amounting to Euros 1,658 million, of which Euros 1,117 million expire in the long term (Euros 1,258 million at 31 December 2016) and Euros 541 million in the short term (Euros 745 million at 31 December 2016).

Details of bonds and other marketable securities at 31 December 2017 and 2016 are as follows:



31/12/2017 (in thousands of euros)					
	<u>Opening</u> <u>outstanding</u> <u>balance.</u> <u>31/12/2016</u>	<u>(+)</u> <u>Premium</u>	<u>(-)</u> <u>Repurchases</u> <u>or</u> <u>redemption</u> <u>s</u>	<u>(+/-)</u> <u>Exchange</u> <u>rate</u> <u>adjustment</u> <u>s and others</u>	<u>Closing</u> <u>outstanding</u> <u>balance.</u> <u>31/12/2017</u>
Debt securities that have required the registration of an explanatory booklet	3,180,848	200,000	(200,070)	3,064	3,183,842
Debt securities that have not required the registration of an explanatory booklet	-	-	-	-	-
Other debt securities issued outside of an EU member state	506,232	-	(3,723)	(60,976)	441,533
<b>Total</b>	<b>3,687,080</b>	<b>200,000</b>	<b>(203,793)</b>	<b>(57,912)</b>	<b>3,625,375</b>
	=====	=====	=====	=====	=====
31/12/2016 (in thousands of euros)					
	<u>Opening</u> <u>outstanding</u> <u>balance.</u> <u>31/12/2015</u>	<u>(+)</u> <u>Premium</u>	<u>(-)</u> <u>Repurchases</u> <u>or</u> <u>redemption</u> <u>s</u>	<u>(+/-)</u> <u>Exchange</u> <u>rate</u> <u>adjustment</u> <u>s and others</u>	<u>Closing</u> <u>outstanding</u> <u>balance.</u> <u>31/12/2016</u>
Debt securities that have required the registration of an explanatory booklet	2,998,351	838,121	(660,467)	4,843	3,180,848
Debt securities that have not required the registration of an explanatory booklet	-	-	-	-	-
Other debt securities issued outside of an EU member state	493,684	-	(2,668)	15,216	506,232
<b>Total</b>	<b>3,492,035</b>	<b>838,121</b>	<b>(663,135)</b>	<b>20,059</b>	<b>3,687,080</b>
	=====	=====	=====	=====	=====

The outstanding balance at 31 December 2017 and 2016 of debt securities requiring a prospectus to be filed relates to issues registered in Dublin and Luxembourg.

Changes in liabilities in financing instruments in 2017, differentiating between those entailing any changes in cash flows and those which do not, were as follows:



	Thousands of Euros				
	31/12/2016	Change in cash flows	Changes not involving cash flow		31/12/2017
			Exchange rate fluctuations	Other changes	
Long-term issues	3,429,404	196,277	(8,555)	(594,749)	3,022,377
Non-current bank borrowings	1,477,422	179,985	(6,763)	(42,330)	1,608,314
Short-term issues	203,946	(200,070)	-	599,122	602,998
Current bank borrowings	90,105	189	(328)	42,353	132,319
<b>Total debt</b>	<b>5,200,877</b>	<b>176,381</b>	<b>(15,646)</b>	<b>4,396</b>	<b>5,366,008</b>

- **Derivatives**

Details of derivative financial instruments are provided in note 17.

- **Other current financial liabilities**

Details of other current financial liabilities at 31 December 2017 and 2016 are as follows:

	Thousands of Euros	
	<u>2017</u>	<u>2016</u>
Dividend payable (Note 11)	137,509	128,417
Suppliers of fixed asset and others	309,848	327,251
Other payables	200,103	227,197
	-----	-----
	647,460	682,865
	=====	=====

Suppliers of fixed assets essentially reflect balances incurred on the construction of electricity facilities.

Other payables basically comprise items pending settlement with respect to the Spanish electricity system and security deposits received.

### **Fair value hierarchy levels**

Details of the Group's financial liabilities, not included under Loans and borrowings, bonds and other marketable securities, measured at fair value using the inputs defined for this calculation at 31 December 2017 and 2016 are as follows:



	31/12/2017 (in thousands of euros)			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total amounts</u>
Derivatives	-	61,437	-	61,437
Other financial liabilities	-	-	6,775	6,775

	31/12/2016 (in thousands of euros)			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total amounts</u>
Derivatives	-	73,620	-	73,620
Other financial liabilities	-	-	39,620	39,620

Level 2 comprises foreign currency and interest rate derivatives. Level 3 comprises security deposits pledged. There are no significant differences between the fair value and the carrying amount at 31 December 2017 and 2016. Liabilities at amortised cost are not disclosed by fair value hierarchy level.

## 17. DERIVATIVE FINANCIAL INSTRUMENTS

In line with its financial risk management policy, Red Eléctrica Group has arranged derivative financial instruments of two types: Interest rate swaps and cross currency swaps. Interest rate swaps consist of exchanging debt at variable interest rates for debt at fixed rates, in a swap where the future cash flows to be hedged are the interest payments. Similarly, cross currency swaps allow fixed- or floating-rate debt in US Dollars to be exchanged for fixed- or floating-rate debt in Euros, thereby hedging future interest and capital flows in US Dollars.

The adoption of IFRS 13 (see note 4n) on derivative financial instruments and hedging transactions entails an adjustment to the valuation techniques used to calculate the fair value of derivative financial instruments. The Group has incorporated a credit risk adjustment to reflect own and counterparty risk in the fair value of derivative financial instruments using generally accepted measurement models.

To eliminate the credit risk from the cross currency swaps arranged to hedge the exchange rate for USPP issuance, pledge agreements with collateral swaps were entered into with the counterparties in 2015.

When determining the credit risk adjustment for other derivatives, the Group applied a technique based on calculating total expected exposure (which considers current and potential exposure) through the use of simulations, adjusted for the probability of default over time and for loss given default allocable to the Company and to each counterparty.

The total expected exposure of derivative financial instruments is determined using observable market inputs, such as interest rate curves, exchange rates and volatilities based on market conditions at the measurement date.



The inputs used to determine own and counterparty credit risk (probability of default) are mostly based on own credit spreads and those of comparable companies currently traded on the market (credit default swap curves, IRR of debt issues, etc.).

Furthermore, adjustments of fair value for credit risk take into account credit enhancements for guarantees and collateral when determining the loss given default to be used for each position. Loss given default is considered to be constant over time. A minimum recovery rate of 40% has been used in cases where there is no credit enhancement for guarantees or collateral.

Based on the hierarchy levels detailed in note 4, the Company has considered that the majority of the inputs used to determine the fair value of derivative financial instruments are categorised within Level 2, including the data used to calculate the own and counterparty credit risk adjustment.

The Company has observed that the impact of using Level 3 inputs for the overall measurement of derivative financial instruments is not significant. Consequently, the Company has determined that the entire derivative financial instrument portfolio can be categorised within level 2.

As regards observable inputs, the Group uses mid-market prices obtained from reputable external information sources in the financial markets.

Details of hedges at 31 December 2017 and 2016 in thousands of Euros are as follows:

	Principal	Term of maturity	Thousands of Euros				Thousands of Euros			
			2017		2016		2016		2016	
			Non-current Assets	Current Liabilities	Non-current Assets	Current Liabilities	Non-current Assets	Current Liabilities	Non-current Assets	Current Liabilities
Interest rate hedges:										
- Cash flow hedges:										
Interest rate swap	280,000 thousand euros (*)	Through 2020	-	(24,587.0)	-	-	-	(40,937)	-	-
Interest rate swap	65,940 thousand euros	Through 2021	-	(1,080)	-	-	-	(1,663)	-	-
Interest rate swap	140,000 thousand euros	Through 2025	-	(8,500)	-	-	-	(8,822)	-	-
Interest rate swap	400,000 thousand euros (**)	Through 2026	249	(5,835)	-	-	-	(17,684)	-	-
Foreign exchange hedges:										
- Net hedge:										
Cross currency swap	150,000 thousands of US dollars	Through 2021	12,721	-	-	-	-	(4,514)	-	-
Interest rate and exchange rate hedges										
- Cash flow hedges:										
(Cross currency swap)	430,000 thousands of US dollars	Through 2035	-	(25,776)	-	-	(24,988)	-	-	-
Interest rate hedge			-	4,341	-	-	53,730	-	-	-
Foreign exchange hedges										
			12,970	(61,437)	-	-	28,742	(73,620)	-	-
			=====	=====	=====	=====	=====	=====	=====	=====

(\*) 330,000 thousand Euros in 2016. Reduced by 50,000 thousand Euros in 2017.

(\*\*) 500,000 thousand Euros in 2016. Reduced by 100,000 thousand Euros in 2017.

Details of the estimated flows from derivatives, which are similar to their estimated impacts on profit and loss, by year of occurrence, are as follows:



	Principal	Plazo de vencimiento	Miles de euros					2022 y siguientes	Total
			2018	2019	2020	2021	2022		
Cobertura de tipo de interés:									
- Cobertura de flujos de caja:									
Swap de tipo de interés	280.000 miles de euros	Hasta 2020	-	-	(24.587)	-	-	(24.587)	
Swap de tipo de interés	65.940 miles de euros	Hasta 2021	-	-	-	(1.080)	-	(1.080)	
Swap de tipo de interés	140.000 miles de euros	Hasta 2025	-	-	-	-	(8.500)	(8.500)	
Swap de tipo de interés	400.000 miles de euros	Hasta 2026	-	-	-	-	(5.586)	(5.586)	
Cobertura de tipo de cambio:									
- Cobertura de inversión neta:									
Cross currency swap	150.000 miles de dólares americanos	Hasta 2021	-	-	-	12.721	-	12.721	
Cobertura de tipo de interés y de cambio									
- Cobertura de flujos de caja: (Cross currency swap)	430.000 miles de dólares americanos	Hasta 2035							
Cobertura de tipo de interés			-	-	(5.384)	-	(20.392)	(25.776)	
Cobertura de tipo de cambio			-	-	1.817	-	2.524	4.341	
			-	-	(28.154)	11.641	(31.954)	(48.467)	

## 18. TRADE AND OTHER PAYABLES

Details of trade and other payables at 31 December 2017 and 2016 are as follows:

	Thousands of Euros	
	2017	2016
Suppliers	343,694	301,272
Other payables	47,974	19,787
Deferred tax liabilities (note 20)	10,859	14,046
	402,527	335,105

Suppliers essentially reflect payables arising from repairs and maintenance work and modifications to electricity facilities, as well as balances pending settlement vis-à-vis Spanish electricity system agents.

The increase in other payables is due mainly to the increase in the item Tax authority, payables from VAT.

## 19. AVERAGE PAYMENT PERIODS TO SUPPLIERS. ADDITIONAL PROVISION THREE. "REPORTING REQUIREMENT" OF LAW 15/2010 OF 5 JULY 2010

The Spanish Accounting and Auditing Institute (ICAC) resolution of 29 January 2016, concerning the information that must be disclosed in the notes to the annual accounts in relation to the average



payment period for suppliers in commercial transactions, clarifies and systematises the information that trading companies must include in the notes to individual and consolidated annual accounts, in compliance with the reporting requirement of the third additional provision of Law 15/2010 of 5 July 2010, which amends Law 3/2004 of 29 December 2004, establishing measures to combat late payments in commercial transactions.

The scope of this resolution also extends to trading companies that prepare consolidated annual accounts, although only with respect to fully consolidated subsidiaries or equity-accounted investees registered in Spain, irrespective of the financial reporting framework under which the accounts are prepared.

The information concerning average payment periods to suppliers for 2017 and 2016 is as follows:

(in days)	2017	2016
Average payment period to suppliers	47.2	46.2
Ratio of transactions paid	48.7	47.5
Ratio of outstanding payment transactions	12.7	15.8
(thousands of euros)	2017	2016
Total payments made	375,210	384,927
Total payments outstanding	16,762	16,762

## 20. TAXATION

The tax group headed by Red Eléctrica Corporación, S.A. has filed consolidated tax returns in Spain since 2002. At 31 December 2017, the tax group includes the Parent, REE, REI, REF, REINTEL and REINCAN.

Companies that do not form part of the tax group are subject to the legislation applicable in their respective countries.

A reconciliation of the prevailing tax rate in Spain with the effective tax rate applicable to the Group is as follows:





	Thousands of Euros	
	2017	2016
Consolidated accounting profit/(loss) before taxes	890,240	850,788
Permanent differences and consolidation adjustments	(17,554)	(17,495)
Consolidated accounting basis for tax	872,686	833,293
	=====	=====
Tax rate	25%	25%
Result adjusted by tax rate	218,172	208,323
Effect of the application of different tax rates	1,302	1,623
Tax calculated based on the applicable rate in each country	219,474	209,946
Deductions	(906)	(1,419)
Other adjustments	1,853	3,654
	-----	-----
Corporate income tax	220,421	212,181
Current corporate income tax	232,340	224,069
Deferred corporate income tax	(11,919)	(11,888)
	=====	=====
Effective tax rate	24.76%	24.94%
	-----	-----
	--	--

The effective rate of income tax is influenced primarily by permanent differences and deductions. The effective rate is 24.76% in 2017 and 24.94% in 2016.

Permanent differences in 2017 and 2016 reflect the capitalisation reserve adjustment, as a result of the increase in equity, in accordance with article 25 of Corporate Income Tax Law 27/2014 of 27 November 2014. As permitted by article 62.1 d) of Law 27/2014, the capitalisation reserve for 2017 will be held in REC, as head of the tax group (see note 11).

Deductions mainly comprise those for research, development and technological innovation expenditure, as well as international double taxation relief.

Given the financial nature of the deduction for investments in fixed assets in the Canary Islands, it is treated as a grant, and its impact on the income statement is deferred over several years based on the useful lives of the assets for which it was awarded (see note 4j).



Deductions recognised as grants in 2017 amount to Euros 3,701 thousand (Euros 3,301 thousand in 2016) and the amount still to be recognised at 31 December 2017 is Euros 72,587 thousand (Euros 63,802 thousand in 2016)

Current receivables from and payables to public entities at 31 December 2017 and 2016 are as follows:

	Thousands of Euros	
	<u>2017</u>	<u>2016</u>
Current amounts receivable		
Tax Authority, VAT receivables	8,005	7,372
Tax Authority, Corporate income tax receivables (note 10)	3,788	3,694
Tax Authority, Corporate income tax refunds receivable	496	875
Current amounts payable		
Tax Authority, VAT payable (note 18)	29,470	594
Tax Authority, Corporate income tax payable (note 18)	10,859	14,046
Tax Authority, other accounts payable	4,553	4,726

In 2017 and 2016, adjustments were made to taxable income to reflect recognition of the EIGs in which the Group has interests, amounting to Euros 73,227 thousand and Euros 46,075 thousand, respectively.

Temporary differences in the recognition of income and expenses for accounting and tax purposes in the Red Eléctrica Group at 31 December 2017 and 2016, and the corresponding cumulative tax effect (assets and liabilities) are as follows:



	(Thousands of Euros) 2017		(Thousands of Euros) 2016	
	Consolidated income statement	Income and expenses recognised directly Equity	Consolidated income statement	Income and expenses recognised directly Equity
	<u>Increases</u>	<u>Increases</u>	<u>Increases</u>	<u>Increases</u>
<b>Deferred Tax Assets:</b>				
Originating in previous years	92,101	32,123	100,758	21,617
Changes over the financial year	(8,782)	(2,657)	(8,657)	10,506
Adjustments from tax rate fluctuations			-	-
Total deferred tax assets	83,319 =====	29,466 =====	92,101 =====	32,123 =====
<b>Deferred tax liabilities:</b>				
Originating in previous years	561,758	20,133	582,308	22,247
Changes over the financial year	(20,701)	(3,754)	(20,545)	(2,114)
Adjustments from tax rate fluctuations		-	-	-
Total deferred tax liabilities	541,057 =====	16,379 =====	561,758 =====	20,133 =====

Deferred tax assets and liabilities at 31 December 2017 and 2016 are as follows:

	Thousands of Euros	
	2017	2016
Retirements and commitments to employees	18,710	16,565
Grants	735	787
Financial derivatives	22,523	26,180
Tax loss carryforwards pending offsetting	2,868	1,899
Updating of balance sheets – Law 16/2012	24,833	27,986
Limits on deductibility of amortisation and depreciation – Law 16/2012	34,188	41,941
Other	8,928	8,865
Total deferred tax assets	112,785 =====	124,223 =====
Accelerated amortisation	523,305	535,489
Non-deductible assets	15,816	19,422
Other	18,315	26,979
Total deferred tax liabilities	557,436 =====	581,890 =====



In the consolidated statement of financial position the Group has offset deferred tax assets and deferred tax liabilities arising from the Spanish tax group in an amount of Euros 84,961 thousand, as permitted by IAS 12 (Euros 95,321 thousand in 2016).

The deferred tax assets and liabilities are expected to be recovered and settled as follows:

31/12/2017	Total	More than 1 year	Less than 1 year
Deferred tax assets	112,785	103,844	8,941
Deferred tax liabilities	557,436	533,741	23,695

The recovery/settlement of the Group's deferred tax assets/liabilities is dependent on certain assumptions, which could change.

Deferred tax assets include reversals of tax advances in 2013 and 2014 as a result of applying the limitation on the tax deductibility of depreciation and amortisation charges stipulated in article 7 of Law 16/2012 of 27 December 2012, which introduced several fiscal measures to consolidate public finances and boost economic activity, and as a result of the commencement, in 2015, of depreciation and amortisation for tax purposes of the net increase in value resulting from the revaluations applied to the balance sheet at 31 December 2012, pursuant to article 9 of the same Law. This item also comprises amounts relating to changes in value of cash flow hedges and long-term employee benefits.

Deferred tax liabilities essentially relate to the accelerated depreciation for tax purposes of certain fixed assets and the inclusion of the assets and liabilities of REDALTA and INALTA, the companies absorbed by REC in 2006. Deferred tax liabilities for accelerated depreciation as provided for in the 11th additional provision of Royal Legislative Decree 4/2004, and the 34th transitional provision of Income Tax Law 27/2014, amounted to Euros 464,469 thousand in 2017 (Euros 477,592 thousand in 2016).

The notes to REC's annual accounts for 2006 contain disclosures on the merger by absorption of REDALTA and INALTA, as required by article 86 of Law 27/2014. The notes to the 2008 annual accounts include disclosures on REC's contribution to REE of the branch of activities encompassing the duties of the system operator, transmission network manager and transmission agent of the Spanish electricity system.

The notes to the annual accounts of REC and REINTEL for 2015 also include the disclosures stipulated in article 86 of Law 27/2014, regarding the spin-off of the telecommunications services business from REI to REINTEL in 2015, and regarding the non-monetary contribution of shares in REN.

In accordance with current legislation, taxes cannot be considered definitive until they have been inspected and agreed by the taxation authorities or before the inspection period has elapsed.

Accordingly, generally the company's relevant taxes for 2014 and subsequent years are open for inspection, except for Corporate Income Tax, which is open for inspection from 2011 onwards, and income tax withholdings, open for inspection from 2012 onwards, due mainly to the partial verifications pending final completion by the Spanish tax authorities. However, this period may be different for Group companies that are subject to other tax legislation.



Tax-related procedures filed in Peru in connection with the revision of Income Tax for the years 2009 to 2011 were underway at 2017 year-end. The Group considers it reasonably probable that these appeals will be successful.

Due to the different possible interpretations of tax legislation, additional tax liabilities could arise as a result of ongoing and future inspections, which cannot be objectively quantified at present. Nevertheless, any additional liabilities that could arise therefrom are not expected to have a significant impact on the Company's future consolidated profits.

## 21. INCOME AND EXPENSES

### a) Revenue

Details of revenue in 2017 and 2016, by geographical area, are as follows:

	Thousands of Euros	
	<u>Current period</u>	<u>Prior period</u>
Domestic market	1,898,229	1,878,751
External markets	42,936	53,592
a) European Union	20,407	20,352
b) OECD countries	-	-
c) Rest of countries	22,529	33,240
TOTAL	----- 1,941,165 =====	----- 1,932,343 =====

Domestic market primarily includes the regulated revenue from transmission and electricity system operation services, which is set by the Ministry of Industry, Energy and Tourism and Digital Agenda, amounting to Euros 1,736,100 thousand in 2017 (Euros 1,737,315 thousand in 2016), as well as revenue from facilities that entered into service in the prior year. Also included under this heading is revenue from telecommunications services rendered in Spain in the amount of Euros 86,530 thousand (Euros 85,959 thousand at 31 December 2016).

External Markets in 2017 and 2016 include primarily revenue for the provision of transmission services by the Peruvian companies—both those whose assets are in service and those from revenue associated with the construction of facilities; reinsurance revenue is also included.



### b) Supplies and other operating expenses

Details of supplies and other operating expenses in 2017 and 2016 are as follows:

	Thousands of Euros	
	<u>2017</u>	<u>2016</u>
Supplies	61,110	49,222
Other operating expenses	308,071	313,589
	-----	-----
	369,181	362,811
	=====	=====

Supplies and other operating expenses mainly comprise repair and maintenance costs incurred at technical electricity facilities as well as IT, advisory, leasing and other services.

### c) Personnel expenses

Details of personnel expenses in 2017 and 2016 are as follows:

	Thousands of Euros	
	<u>2017</u>	<u>2016</u>
Wages, salaries and other remuneration	111,445	109,786
Social security benefits	24,504	23,418
Contributions to pension funds and other similar obligations	2,015	1,888
Other items and employee benefits	10,729	10,053
	-----	-----
	148,693	145,145
	=====	=====

Wages, salaries and other remuneration includes remuneration to employees and members of the board, termination benefits and accrual of deferred remuneration.

The Group companies have capitalised personnel expenses (see notes 5 and 6) totalling Euros 31,046 thousand at 31 December 2017 (Euros 32,756 thousand at 31 December 2016).



- **Workforce**

The average headcount of the Group in 2017 and 2016, distributed by professional category, is as follows:

	<u>2017</u>	<u>2016</u>
Management team	132	131
Senior technical staff and middle managers	556	525
Middle level technical staff	582	576
Specialists and administrative staff	531	533
	-----	-----
	1,801	1,765
	=====	=====

This distribution of the Group's employees at 31 December, by gender and category, is as follows:

	<u>2017</u>			<u>2016</u>		
	<u>% men</u>	<u>Women</u>	<u>Total</u>	<u>Men</u>	<u>Women</u>	<u>Total</u>
Management team	99	31	130	107	27	134
Senior technical staff and middle managers	364	201	565	343	187	530
Middle level technical staff	494	97	591	485	93	578
Specialists and administrative staff	418	111	529	422	109	531
	-----	-----	-----	-----	-----	-----
	1,375	440	1,815	1,357	416	1,773
	=====	=====	=====	=====	=====	=====

The average number of employees with a disability rating of 33% or higher in 2017 and 2016, distributed by gender and category, is as follows:



	2017			2016		
	Men	Women	Total	Men	Women	Total
Management team	-	-	-	-	-	-
Senior technical staff and middle managers	3	2	5	2	2	4
Middle level technical staff	6	-	6	5	-	5
Specialists and Administrative Staff	2	1	3	3	1	4
	-----	-----	-----	-----	-----	-----
	11	3	14	10	3	13
	=====	=====	=====	=====	=====	=====

At 31 December 2017 the board of directors, including the managing director, comprises 12 members (11 members in 2016), of which 8 are men and 4 are women (7 men and 4 women in 2016).

#### d) Finance income and costs

Finance income mainly comprises the dividends received on the Company's 5% interest in REN, amounting to Euros 4,566 thousand. Finance income amounting to Euros 2,708 thousand (Euros 1,678 thousand in 2016) was recognised in investments in EIGs (see notes 16 and 20) and finance income from loans granted to TEN (see note 22) amounting to Euros 1,724 thousand (Euros 4,389 thousand in 2016).

Finance costs basically reflect borrowing costs on loans and borrowings, net of any amounts capitalised, as well as bonds and other marketable securities for an amount of Euros 157,240 thousand (see note 16). Capitalised borrowing costs (see notes 5 and 6) totalled Euros 5,502 thousand in 2017 (Euros 7,547 thousand in 2016).

## 22. TRANSACTIONS WITH ASSOCIATES AND RELATED PARTIES

#### a) Balances and transactions with associates

The group has owned the associate TEN since 27 January 2016. All transactions with associates were carried out on an arm's length basis. The main transactions carried out by Group companies with equity-accounted investees in 2017 and 2016 were as follows:

	2017				2016			
	Balances		Transactions		Balances		Transactions	
	Receivables	Payables	Expenses	Income	Receivables	Payables	Expenses	Income
Transmisora Eléctrica del Norte S.A. (TEN)	54.828	82	85	1.724	32.172	2	2	4.389
	-----	-----	-----	-----	-----	-----	-----	-----
Total	54.828	82	85	1.724	32.172	2	2	4.389
	=====	=====	=====	=====	=====	=====	=====	=====





## b) Related party transactions

Related party transactions are carried out under normal market conditions. Details in thousands of Euros are as follows:

<u>2017</u>					
<b>FINANCE INCOME AND COSTS:</b>	<u>Significant shareholders</u>	<u>Directors and senior management</u>	<u>Individuals, companies or Group companies</u>	<u>Other related parties</u>	<u>Total</u>
Leases	-	-	85	-	85
Receipt of services	-	-	-	100	100
Other expenses	-	-	-	15,342	15,342
EXPENSES	-----	-----	-----	-----	-----
	=====	=====	=====	=====	=====
Finance income	-	-	1,724	143	1,867
INCOME	-----	-----	-----	-----	-----
	=====	=====	=====	=====	=====
<b>OTHER TRANSACTIONS:</b>					
Financing agreements, loans and capital contributions (borrower)	-	-	54,828	-	54,828
OTHER TRANSACTIONS	-----	-----	-----	-----	-----
	=====	=====	=====	=====	=====
<u>2016</u>					
<b>FINANCE INCOME AND COSTS:</b>	<u>Significant shareholders</u>	<u>Directors and senior management</u>	<u>Individuals, companies or Group companies</u>	<u>Other related parties</u>	<u>Total</u>
Leases	-	-	2	-	2
Receipt of services	-	-	-	126	126
Other expenses	-	-	-	16,436	16,436
EXPENSES	-----	-----	-----	-----	-----
	=====	=====	=====	=====	=====
Finance income	-	-	4,389	66	4,455
INCOME	-----	-----	-----	-----	-----
	=====	=====	=====	=====	=====
<b>OTHER TRANSACTIONS:</b>					
Financing agreements, loans and capital contributions (borrower)	-	-	32,172	-	32,172
OTHER TRANSACTIONS	-----	-----	-----	-----	-----
	=====	=====	=====	=====	=====



Transactions involving Persons, companies or entities belonging to the Group refer to those involving Transmisora Eléctrica del Norte (TEN) as specified in section a) of this note. In the balance of Financing agreements, loans and capital contributions (lender) corresponds to the loan at 31 December 2017 and 2016 (see note 16), arranged through a credit policy with TEN, the maximum amount drawn down in 2017 was Euros 54,726 thousand (Euros 190,046 thousand maximum in 2016).

The balance shown under other related parties in 2016 and 2017 mainly comprises investments in EIGs, and insurance and reinsurance transactions.

### **23. REMUNERATION OF THE BOARD OF DIRECTORS**

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At their meeting on 22 February 2017, the Company's directors approved the remuneration of the board of directors for 2017, as required by the articles of association and the regulations of the board of directors, based on a proposal from the Appointments and Remuneration Committee. Both the remuneration proposal for directors and the annual remuneration report were subsequently submitted for the approval of the shareholders at their general meeting on 31 March 2017. The aforementioned proposal maintains unchanged the remuneration of members of the board of directors, including the chairman and the managing director, except for the managing director's benefits scheme as detailed above.

Additionally, on 17 July 2015, at their extraordinary general meeting, the shareholders approved the appointment of Mr. Juan Lasala Bernad as executive director of the Company for a period of four years, as stipulated in the articles of association. At its meeting on 28 July 2015, the board of directors unanimously approved the appointment and agreed to jointly and indistinctly delegate to the executive director all such board of directors' powers that may be so delegated pursuant to the law and the articles of association.

For the purpose of disclosing the remuneration of the chairman and that of the managing director, 2016 was divided into two periods based on certain corporate milestones linked to the gradual transfer of executive duties from the former to the latter, culminating in the complete transfer of those duties at the ordinary general shareholders meeting on 15 April 2016:

- From 1 January 2016 to the date of the ordinary general shareholders meeting, whereupon the transitional period for the transfer of all executive duties to the managing director ended. The remuneration policy for this period followed the principles and criteria set forth in the remuneration policy for directors approved by the shareholders at their ordinary general meeting in 2015, and observed the agreements adopted by the shareholders at their extraordinary general meeting in 2015.
- The chairman of the board of directors ceased performing executive duties as of the date of the ordinary general shareholders meeting in 2016, and since that date all executive duties have been performed by the managing director. During this period the remuneration policy was adapted to the criteria approved by the shareholders at their general meeting in 2016.

Since 15 April 2016, the date of the general shareholders meeting, the chairman's remuneration has comprised a fixed annual amount for his duties as the Company's non-executive chairman, and the remuneration as a member of the board of directors. From that date onwards, the



remuneration scheme for this position consists solely of fixed components, with no annual or multi-year variable remuneration. Both remuneration components are under the same terms as in 2016.

The chairman's contract was proposed by the Corporate Responsibility and Governance Committee (currently the Appointments and Remuneration Committee) and approved by the Company's board of directors in March 2012. On completion of the transition period (General Shareholders' Meeting of 15 April 2016), the Company decided to automatically terminate the chairman's mercantile contract when the latter ceased to discharge executive duties. Furthermore, at the end of the transitional period as executive chairman, the chairman had accrued an indemnity corresponding to one year's remuneration as executive chairman, as stipulated in the contract. This indemnity will be payable once the chairman ceases to be a board member of the Company.

Likewise, since the general shareholders meeting of 15 April 2016, the remuneration of the managing director has also been reviewed, such that it is commensurate with having assumed all executive duties of the Company, as approved by the shareholders at their general meetings on 17 July 2015 and 15 April 2016. The managing director's remuneration includes the fixed and variable annual and multi-year components corresponding to executive duties and the fixed remuneration for being a member of the board of directors. Employee benefits will also continue to form part of the remuneration for this position. Part of the variable annual remuneration will be paid in the form of shares in the Company.

The managing director's contract was proposed by the Appointments and Remuneration Committee and approved by the Company's board of directors on 28 July 2015. At the proposal of the Appointments and Remuneration Committee, and with the approval of the board of directors on 23 February 2016, this contract was amended, in accordance with the remunerations policy, to reflect the new conditions after taking on all executive duties.

Pursuant to the remunerations policy and in line with standard market practices, this contract provides for termination benefits equal to one year's salary in the event that labour relations are terminated due to dismissal or changes of control. In addition, as is customary in such cases, as a result of this appointment as managing director, the existing employment contract has been suspended. For this purpose, his tenure at the Company on the date he was appointed managing director (14 years) would be taken into consideration, in accordance with prevailing employment legislation.

Annual variable remuneration is set by the Appointments and Remuneration Committee of the Parent at the start of each year, using predetermined quantifiable and objective criteria. The targets are in line with the strategies and actions established in the Company's strategic plan and the degree of compliance is assessed by the Committee.

The board of directors, at the proposal of the Appointments and Remuneration Committee, in its meeting of 22 February 2017, approved the inclusion of the managing director in a defined contribution benefit scheme effective from 1 January 2017. The contingencies covered by this system are retirement, death and permanent disability. Red Eléctrica's obligation is confined to making an annual contribution equivalent to 20% of the annual fixed remuneration of the managing director, accrued since 1 January 2017. In 2017, the rest of components of the managing director's remuneration remain in the same terms as were approved by shareholders in 2016.

With regard to the board of directors, their remuneration includes fixed annual remuneration, allowances for attending board meetings, remuneration for work on the board of directors' committees and specific annual remuneration both for the chairs of the committees and the



coordinating independent director. The items and amounts of this remuneration remained unchanged in 2017.

The total amounts accrued by the members of the parent Company's board of directors in 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Remuneration to Board of Directors for all concepts	2,448	2,341
Remuneration to Directors for their executive status <sup>(1)</sup>	838	802
	-----	-----
Total	3,286	3,143
	=====	=====

(1) Includes annual fixed and variable remuneration due for the year.

The increase compared with the previous year in “All items of remuneration to members of the board of directors” is due mainly to the inclusion of remuneration to the chairman in 2017, since from 1 January to 14 April 2016, when the managing director assumed all executive duties, the chairman's remuneration was included in “Remuneration to directors for the performance of executive duties”.

A breakdown of this remuneration by type of director at 31 December 2017 and 2016, in thousands of Euros, is as follows:

	<u>2017</u>	<u>2016</u>
<b>Type of director:</b>		
Executive directors	986	992 (1)
External proprietary directors	519	524
External independent directors	1,235	1,238
Other external directors	546	389 (2)
	-----	-----
Total remuneration	3,286	3,143
	=====	=====

(1) This includes the total remuneration of the managing director in 2016 and the total remuneration of the chairman as chief executive up to 15 April 2016.

(2) This includes the chairman's total remuneration from 15 April 2016 onwards.



The remuneration accrued by individual members of the Company's board of directors in 2017, in thousands of Euros, by components and directors, is as follows:

	Fixed remuneration	Variable remuneration	Allowances for attending board meetings	Remuneration for work on board of directors' committees	Chairman of Board of Directors' Committee and LID	Other remuneration <sup>(8)</sup>	Total 2017	Total 2016
Mr José Folgado Blanco	530	-	16	-	-	-	546	575
Mr Juan Lasala Bernad	530	299	16	-	-	141	986	806
Mrs María de los Ángeles Amador Millán <sup>(1)</sup>	33	-	4	7	-	-	44	175
Mr Fernando Fernández Méndez de Andés	131	-	16	28	-	-	175	175
Mrs Carmen Gómez de Barreda Tous de Monsalve	131	-	16	28	15	-	190	190
Mrs María José García Beato	131	-	16	28	-	-	175	175
Mrs Socorro Fernández Larrea	131	-	16	28	-	-	175	175
Mr Antonio Gómez Ciria	131	-	16	28	2	-	177	175
Mr Santiago Lanzuela Marina	131	-	16	28	-	-	175	175
Mr José Luís Feito Higuera	131	-	16	28	14	-	189	190
Mr Arsenio Fernández de Mesa Díaz del Rio <sup>(2)</sup>	121	-	16	19	-	-	156	-
Mr Alberto Carbajo Josa <sup>(3)</sup>	98	-	12	19	-	-	129	-
Mr José Ángel Partearroyo Martín <sup>(4) (6)</sup>	103	-	12	22	-	-	137	173
Mrs Mercedes Real Rodrigálvarez <sup>(5) (6)</sup>	22	-	5	5	-	-	32	-
Other members of the board <sup>(7)</sup>	-	-	-	-	-	-	-	159
Total remuneration accrued	2.354	299	193	268	31	141	3.286	3.143

<sup>(1)</sup> Left the Group at the General Shareholders' Meeting of 31 March 2017.

<sup>(2)</sup> New Director since the board of directors' meeting of 31 January 2017. Appointment ratified at the General Shareholders' Meeting of 31 March 2017.

<sup>(3)</sup> New Director since the General Shareholders' Meeting of 31 March 2017.

<sup>(4)</sup> Left the Company on 16 October 2017.

<sup>(5)</sup> New Director since the board of directors' meeting of 31 October 2017.

<sup>(6)</sup> Amounts received by Sociedad Estatal de Participaciones Industriales (SEPI).

<sup>(7)</sup> FY2016 board members who have left.

<sup>(8)</sup> Includes costs deriving from social benefits as part of the Chief Executive Officer's remuneration package.

In 2016, the chairman and managing director were beneficiaries of a life insurance policy with an aggregate annual premium of Euros 12 thousand and expiry date of 31 December 2016. In 2017, the Company did not pay the cost of the life insurance premium. The managing director covers the cost of the aforementioned life insurance from his remuneration (as part of Other remuneration).

As a result of the work of the Company's Appointments and Remuneration Committee on various long-term incentive plans to be used as a management tool and mechanism for compliance with the new Strategic Plan, in 2015 the Committee approved a directors' remuneration scheme for 2014-2019. This scheme includes the chairman and managing director, although in the case of the chairman the remuneration is only applicable up to 28 July 2015, the date on which the managing director was appointed. As the chairman was no longer included in this scheme, in 2016 he was paid Euros 188 thousand for the period it was applicable and no further amounts were accrued in this respect from the aforementioned date onwards.

Fulfilment of this remuneration scheme, which forms part of the remuneration policy, will be based on achieving the targets set out in the Group's Strategic Plan for this period and on meeting certain conditions. A minimum limit of 70% and maximum limit of 110% is established for evaluation of this scheme. Depending on the targets met, the total amount for the six-year period with 100% compliance would be 1.8 times the annual fixed remuneration. As in the case of annual targets, this scheme takes into account predetermined quantifiable and objective criteria, in line with the



medium- and long-term outlook of the Group's strategic plan. These targets are set and assessed by the Appointments and Remuneration Committee. The Company's financial statements include a provision for accrual of this plan in 2017.

At 31 December 2017 and 2016 no loans or advances have been granted to the members of the board of directors, nor have any guarantees been pledged on their behalf. The Company has no pension or life insurance obligations with the members of the board of directors at those dates, other than those previously mentioned, nor have any loans or advances been extended to board members.

At 31 December 2017 and 2016 the Group has taken out civil liability insurance to cover claims from third parties in respect of possible damage or loss caused by actions or omissions in performing duties as Group directors. These policies cover the Company's directors and senior management and the premiums amount to Euros 146 thousand, inclusive of tax, in 2017 (Euros 144 thousand at 31 December 2016). These premiums are calculated based on the nature of the Company's activity and its financial indicators, thus they cannot be broken down individually or allocated to directors and senior management separately.

In 2017 and 2016 the members of the board of directors did not engage in transactions with the Company or Group companies, either directly or through intermediaries, other than ordinary operations under market conditions.

## 24. MANAGEMENT REMUNERATION

In 2017 total remuneration accrued by senior management personnel amounted to Euros 649 thousand (Euros 731 thousand in 2016) and is recognised as personnel expenses in the consolidated income statement. These amounts include the variable annual remuneration accrued on a straight-line basis, on the assumption that the objectives set each year were met. After the fulfilment of these objectives has been assessed, the variable remuneration, adjusted to the actual fulfilment rate, is paid in the opening months of the following year.

The senior management personnel who have rendered services for the Group during 2017 and 2016 are as follows:

Name	Position
Carlos Collantes Pérez - Ardá	General Manager of Transmission <sup>(1)</sup>
Eva Pagán Díaz	General Manager of Transmission
Miguel Duvison García	General Manager of Operations

(1) Position held until 26 November 2015. He held the position of Assistant General Manager from that date until 31 March 2016, whereupon he left the Group.



Euros 14 thousand of the total remuneration accrued by these senior managers consisted of contributions to life insurance and pension plans (Euros 16 thousand in 2016).

No advances or loans have been extended to these senior managers at 31 December 2017 and 2016.

As a result of the work of the Parent's Appointments and Remuneration Committee on various long-term incentive plans to be used as a management tool and mechanism for compliance with the new Strategic Plan, in 2015 the Committee approved a directors' remuneration scheme for 2014-2019, which includes the senior management personnel.

Fulfilment of this remuneration scheme will be based on achieving the targets set out in the Group's Strategic Plan for this period and on meeting certain conditions. A minimum limit of 70% and maximum limit of 110% is established for evaluation of this scheme. Depending on the targets met, the total amount for the six-year period with 100% compliance would be 1.8 times the annual fixed remuneration. As in the case of annual targets, this scheme takes into account predetermined quantifiable and objective criteria, in line with the medium- and long-term outlook of the Group's strategic plan. These targets are set and assessed by the Appointments and Remuneration Committee. The Group's financial statements include a provision for accrual of this plan in 2017.

The contracts in place with serving senior management personnel do not include guarantee or golden parachute clauses, in the event of dismissal. In the event the employment relationship were terminated, the indemnity to which senior management personnel would be entitled would be calculated in accordance with applicable legislation. The contracts for these executives have been approved by the Appointments and Remuneration Committee and the board of directors has received notice thereof.

Senior management personnel who rendered services in the Group as at 31 December 2017 are included in the Structural Management Plan implemented in 2015.

At 31 December 2017 and 2016 the Group has taken out civil liability insurance to cover claims from third parties in respect of possible damage or loss caused by actions or omissions in performing duties as Group directors. These policies cover all the Group's directors and senior management and the premiums amount to Euros 146 thousand, inclusive of tax, in 2017 (Euros 144 thousand in 2016). These premiums are calculated based on the nature of the Group's activity and its financial indicators, thus they cannot be broken down individually or allocated to the sole director and senior management separately.

In 2016 expenses of Euros 823 thousand were recognised in relation to a senior manager leaving the Group.

## 25. SEGMENT REPORTING

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The principal activity of the Red Eléctrica Group is electricity transmission and operation of the electricity system in Spain, carried out through REE, which represents 93% of consolidated revenue and 88% of the Group's total assets (92% and 92%, respectively, in 2016). Other activities account for the remaining 7% of revenue and 12% of total assets (8% and 8%, respectively, in 2016). Consequently, the Group did not consider it necessary to provide information by activity or geographical segment.



## 26. INVESTMENTS IN JOINT ARRANGEMENTS

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REE and the French TSO Réseau de Transport d'Électricité (RTE) each hold a 50% investment in the INELFE joint arrangement, which has its registered office in Paris. Its statutory activity is the study and execution of interconnections between Spain and France that will increase the electricity exchange capacity between the two countries. Decisions are taken with the unanimous consent of the parties. RTE and REE both have rights to the assets and obligations for the liabilities of INELFE. The joint arrangement has therefore been classified as a joint operation.

The Group recognises the assets, including its interest in the jointly controlled assets, and the liabilities, including its share of the liabilities that have been incurred jointly in INELFE, in its consolidated annual accounts (see note 2.d).

Due to the existence of contractual agreements under which decisions on relevant activities require the unanimous consent of both parties, the Group also has joint control of a temporary joint venture. The Group has classified the investments as joint operations because the parties have rights to the assets and obligations for the liabilities. The temporary joint venture has been formed to provide a dark fibre link, with an availability guarantee, between the Balearic Islands and the Mediterranean Coast of the Spanish mainland.

## 27. GUARANTEES AND OTHER COMMITMENTS WITH THIRD PARTIES AND OTHER CONTINGENT ASSETS AND LIABILITIES

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At 31 December 2017 and 2016, the Company, together with REE, had jointly and severally guaranteed both the private bond issue in the United States and REF's Eurobonds programme for an amount of up to Euros 4,500 million.

Furthermore, at 31 December 2017 and 2016 the Company and REE have jointly and severally guaranteed the Euro Commercial Paper Programme (ECP Programme) carried out by REF for an amount of up to Euros 1,000 million.

On 19 February 2015, REDESUR, TESUR and Scotia Sociedad Titulizadora S.A. created a securitisation trust to hold the REDESUR-TESUR trust assets, in order to back the obligations arising from the US Dollar 110 million bond issue.

At 31 December 2015 the Group has extended bank guarantees to third parties in relation to its normal business operations, amounting to Euros 116,157 thousand (Euros 127,956 thousand in 2016).

## 28. ENVIRONMENTAL INFORMATION

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During 2017 Group companies incurred ordinary expenses of Euros 21,621 thousand in protecting and improving the environment (Euros 19,804 thousand in 2016), essentially due to the implementation of environmental initiatives aimed at protecting biodiversity, fire prevention, slowing climate change, minimising pollution and safeguarding the countryside.





In 2017 the Parent also carried out environmental impact and monitoring studies in relation to its new electricity facilities. The costs incurred in these studies amounted to Euros 3,387 thousand (Euros 4,469 thousand in 2016).

The Group companies are not involved in any litigation relating to environmental protection or improvement that could give rise to significant contingencies. The Group companies received no environment-related grants in 2017 or 2016.

## 29. OTHER INFORMATION

KPMG is the main auditor of the annual accounts of the Group companies, except in the case of INELFE, which is audited by PricewaterhouseCoopers.

The total fees accrued for the audit services rendered to the Group companies in 2017 were Euros 272,5 thousand (Euros 250 6 thousand in 2016).

Grupo Red Eléctrica arranged to pay audit fees to the audit firm KPMG Auditores S.L., in the years ended 31 December 2017 and 2016 as follows:

	Thousands of Euros	
	2017	2016
For audit services	181.3	176.9
For other accounting verification services	72.2	46.5
For tax advisory services	-	-
Other services		
	<u>253.5</u>	<u>223.4</u>

The above amount includes all fees relating to services provided in 2017 and 2016, regardless of when they were invoiced.

The item "Other audit-related services" in 2017 includes mainly underwriting services relating to the issuance of comfort letters, the reasonable assurance audit service on the effectiveness of the Group's ICSFR under ISAE 3000 and the procedures carried out for Group company Red Eléctrica Infraestructuras de Telecomunicación

Moreover, other affiliates of KPMG International invoiced the group in the years ended on 31 December 2017 and 2016 for fees and expenses relating to professional services, as follows:



	Thousands of Euros	
	2017	2016
For audit services	87.5	70.2
Other services	55.0	72.5
	<u>142.5</u>	<u>142.7</u>

Other auditors also invoiced the group in the years ended on 31 December 2017 and 2016 for fees and expenses relating to professional services, as follows:

	Thousands of Euros	
	2017	2016
For audit services	3.7	3.5
	<u>3.7</u>	<u>3.5</u>

Furthermore, the auditor of TEN, a company consolidated using the equity method, is Deloitte.

### 30. EARNINGS PER SHARE

Details of earnings per share in 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Net profit (thousands of euros)	669,836	636,920
Number of shares (shares)	541,080,000	541,080,000
Average number of own shares held in the portfolio (shares)	1,824,488	1,945,242
Basic earnings per share (euros)	1.24	1.18
Diluted earnings per share (euros)	1.24	1.18

At 31 December 2017 and 2016 the Group has not conducted any operations that would result in any difference between basic earnings per share and diluted earnings per share.

### 31. SHARE-BASED PAYMENTS

Details of share-based payments to management and employees at 31 December 2017 and 2016 are as follows:



RED ELÉCTRICA GROUP  
Share-based payments  
At 31 December 2017 and 2016

	2017			2016		
	<u>Number of shares</u>	<u>Average price (euros)</u>	<u>Amounts in thousands of euros</u>	<u>Number of shares</u>	<u>Average price (euros)</u>	<u>Amounts in thousands of euros</u>
Senior executives	1,332	18.00	24	1,368	17.54	24
Rest of employees	166,831	18.00	3,003	129,360	17.54	2,268
	=====	=====	=====	=====	=====	=====
TOTAL	168,163	18.00	3,027	130,728	17.54	2,292

These shares have been valued at the listed price on the delivery date. All shares delivered were approved by the Parent's shareholders at the general meeting, and the related costs incurred have been recognised under personnel expenses in the consolidated income statement.

### 32. EVENTS AFTER 31 DECEMBER 2017

No significant events have occurred between the reporting date and the date on which these annual accounts were authorised for issue.



## APPENDIX I

RED ELÉCTRICA GROUP Details of investees at 31 December 2017 and 2016 (expressed in thousands of Euros)				
Company - Registered address - Main business	2017 Percentage shareholding (1)		2016 Percentage shareholding (1)	
	Direct	Indirect	Direct	Indirect
Red Eléctrica Corporación S.A, the parent company, was incorporated in 1985. - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - Management of the business group, providing assistance and support services to the investee companies and operating the properties belonging to the Company.				
<b>A) Fully-consolidated investees</b>				
Red Eléctrica de España, S.A.U. (REE) - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - Transmission and operation of the Spanish electricity grid system and management of the transmission grid.				
Red Eléctrica Internacional, S.A.U. (REI) - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - International holdings. Provision of consultancy, engineering and construction services. - Provision of electric utilities outside the Spanish grid system.				
Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. (REINTEL) - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - Provision of consultancy, engineering, construction and telecommunications services.				
Red Eléctrica Infraestructuras en Canarias, S.A.U. (REINCAN) - Calle Juan de Quesada, 9. Las Palmas de Gran Canaria. (Spain). - Construction of power storage facilities in island and far-flung systems.				
Red Eléctrica de España Finance, B.V. (RBV) - Hoogoorddreef 15. Amsterdam (Holland). - Financing activities. - Incorporated in the Netherlands in 2003 to conduct debt issues in order to finance Grupo Red Eléctrica.				
Red Eléctrica Finanzaciones, S.A.U. (REF) - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - Financing activities.				
Redoor Reaseguros, S.A. (REDCOR) - 26, Rue Louvigny (Luxembourg). - Reinsurance activities. - Incorporated in Luxembourg in 2010 so as to reinsure the risks of the Group's various companies, guaranteeing better access to international reinsurance markets.				
Red Eléctrica Andina, S.A. (REA) - Av. Albino Ugarte N°536 Cercado. Arequipa (Peru). - Provision of line and sub-station maintenance services.				
Red Eléctrica del Sur, S.A. (REDESUR) - Juan de la Fuente, 453. Lima (Peru). - Electric power transmission and operation and maintenance of electric power grids.				
Transmisora Eléctrica del Sur, S.A. (TESUR) - Juan de la Fuente, 453. Lima (Peru). - Electric power transmission and operation and maintenance of electric power grids.				
Transmisora Eléctrica del Sur 2, S.A. (TESUR 2) - Juan de la Fuente, 453. Lima (Peru). - Electric power transmission and operation and maintenance of electric power grids.				
Transmisora Eléctrica del Sur 3, S.A. (TESUR 3) - Juan de la Fuente, 453. Lima (Peru). - Electric power transmission and operation and maintenance of electric power grids.				
Red Eléctrica Chile SpA (RECH) - Avenida El Golfín 40, piso 20. Comuna de Las Condes, Santiago (Chile). - Acquisition, holding, administration and management of securities.				
Red Eléctrica del Norte S.A. (REDENOR) - Avenida El Golfín 40, piso 20. Comuna de Las Condes, Santiago (Chile). - Electric power transmission and operation and maintenance of electric power grids.				
<b>B) Proportionately-consolidated investees</b>				
Interconexión Eléctrica Francia-España, S.A.S. (INELFE) - Tour Initiale, 1 Terrasse Bellini - 92919 Paris La Défense Cedex Paris (France). - Study and execution of electricity interconnections between Spain and France.				
<b>C) Equity-accounted investees</b>				
Transmisora Eléctrica del Norte S.A. (TEN) - Avenida Apoquindo N°3721, piso 6, Las Condes, Santiago (Chile). - Electric power transmission and operation and maintenance of electric power grids.				
(1) Equivalent to voting rights.				
(a) Shareholding through Red Eléctrica Internacional S.A.U.				
(b) Shareholding through Red Eléctrica de España S.A.U.				
(c) Shareholding through Red Eléctrica Internacional in a 25% and Red Eléctrica del Sur, S.A. in a 75%				
(d) Shareholding through Red Eléctrica del Sur S.A.U.				
(e) Shareholding through Red Eléctrica Chile SpA				



**RED**  
**ELÉCTRICA**  
CORPORACIÓN

# **RED ELÉCTRICA GROUP** **Consolidated Directors'** **Report**

**2017**

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish language version prevails.)



## Contents

<b>1. COMPANY POSITION.....</b>	<b>4</b>
<b>1.1. ORGANISATIONAL STRUCTURE .....</b>	<b>4</b>
<b>1.2. ACTIVITIES AND BUSINESS PERFORMANCE .....</b>	<b>7</b>
<b>2. BUSINESS PERFORMANCE .....</b>	<b>12</b>
<b>2.1. KEY FINANCIAL INDICATORS .....</b>	<b>12</b>
<b>3. PERSONNEL .....</b>	<b>14</b>
<b>4. LIQUIDITY AND CAPITAL.....</b>	<b>16</b>
<b>5. RISK MANAGEMENT .....</b>	<b>17</b>
<b>6. AVERAGE PAYMENT PERIODS TO SUPPLIERS. “REPORTING REQUIREMENT”, THIRD ADDITIONAL PROVISION OF LAW 15/2010 OF 5 JULY 2010.....</b>	<b>18</b>
<b>7. SIGNIFICANT EVENTS OCCURRING AFTER THE REPORTING PERIOD.....</b>	<b>18</b>
<b>8. OUTLOOK .....</b>	<b>18</b>
<b>9. INNOVATION .....</b>	<b>19</b>
<b>10. OWN SHARES.....</b>	<b>21</b>
<b>11. OTHER RELEVANT INFORMATION .....</b>	<b>22</b>
<b>11.1. STOCK MARKET PERFORMANCE AND SHAREHOLDER RETURNS .....</b>	<b>22</b>
<b>11.2. DIVIDEND POLICY .....</b>	<b>23</b>
<b>11.3. CREDIT RATING.....</b>	<b>24</b>
<b>11.4. EXCELLENCE.....</b>	<b>24</b>
<b>12. STATEMENT OF NON-FINANCIAL INFORMATION, IN ACCORDANCE WITH ROYAL DECREE–LAW 18/2017, OF 24 NOVEMBER, WHEREBY DIRECTIVE 2014/95/EU FROM THE EUROPEAN PARLIAMENT AND THE COUNCIL IS TRANSPOSED INTO SPANISH LAW.....</b>	<b>25</b>
<b>12.1. DESCRIPTION OF THE GROUP'S BUSINESS MODEL AND MAIN SUSTAINABILITY EVENTS .....</b>	<b>25</b>



---

<b>12.2.</b>	<b>PROTECTION AND CONSERVATION OF THE ENVIRONMENT .....</b>	<b>26</b>
<b>12.3.</b>	<b>CONTRIBUTION TO SOCIETY.....</b>	<b>27</b>
<b>12.4.</b>	<b>RESPECT FOR HUMAN RIGHTS AND COMBATING CORRUPTION AND BRIBERY .....</b>	<b>29</b>
<b>12.5.</b>	<b>REPOSIBLE MANAGEMENT OF THE SUPPLY CHAIN ..</b>	<b>31</b>
<b>12.6.</b>	<b>MAIN INDICATORS RELATING TO NON-FINANCIAL DISCLOSURES (summary table) .....</b>	<b>33</b>
<b>13.</b>	<b>ANNUAL CORPORATE GOVERNANCE REPORT.....</b>	<b>34</b>



## 1. COMPANY POSITION

### 1.1. ORGANISATIONAL STRUCTURE

#### Corporate bodies

The board of directors and the shareholders are responsible for governing and managing the Red Eléctrica Group and its Parent, Red Eléctrica Corporación, S.A. (hereinafter REC).

The shareholders' general meeting is governed by the articles of association and the general meeting regulations, in accordance with the Spanish Companies Act. The ownership structure at the date of the 2017 shareholders' ordinary general meeting was as follows:



The board of directors has formed two permanent committees: the Audit Committee and the Appointments and Remuneration Committee, which are regulated by the articles of association and the regulations of the board of directors, as well as by all applicable corporate governance legislation.

At 31 December 2017, REC's board of directors comprised 12 members.

The general shareholders' meeting of 31 March 2017 approved the re-election of María José García Beato as an independent director, and agreed the ratification and appointment of Arsenio Fernández de Mesa and Díaz del Río as independent directors, and the appointment of Alberto Francisco Carbajo Josa as an independent director.

At its meeting of 25 April 2017, the board of directors appointed Arsenio Fernández de Mesa as an independent director, and Díaz del Río as a member of the Audit Committee, to cover the vacancy left by the proprietary director Santiago Lanzuela Marina, and it also appointed the proprietary directors Alberto Francisco Carbajo Josa and Santiago Lanzuela Marina as members of the Appointments and Remuneration Committee, in order to cover the two vacancies on said Committee.

In a meeting held on 31 October 2017, the board of directors appointed Mercedes Real Rodríguez i) as a proprietary director of REC, in representation of Sociedad Estatal de Participaciones Industriales (SEPI), until the next General Shareholders' Meeting, so as to cover the vacancy on the board following the resignation of José Ángel Partearroyo Martín, and ii) as a member of the Appointments and Remuneration Committee; the board also appointed José Luis Feito Higuera to the Appointments and Remuneration Committee; it appointed Socorro Fernández Larrea to the Audit Committee, to cover the vacancy left by José Luis Feito





Higueruela; and it re-elected Antonio Gómez Ciria, independent director, as a member of the Audit Committee.

In the meeting held on 20 November 2017, the Audit Committee elected Antonio Gómez Ciria as its chairman.

In its meeting of 27 November 2017, the Appointments and Remuneration Committee appointed José Luis Feito Higueruela as its chairman.

The composition and powers of the board of directors and the various committees are as follows:

<b>BOARD OF DIRECTORS</b>	
<p>58.33% independent 33.33% women (36.36% external directors) Removal from office of the Chairman of the Board of Directors and the Managing Director Independent coordinating director</p>	<p style="text-align: center;"><b>MAIN COMPETENCES</b></p> <p>Approval of the general policies and strategies of the Company and the Group. Risk Monitoring for the Company and the Group. Drawing up annual accounts and submitting them to the General Meeting. Annual evaluation of the quality and efficiency of the Board and the functioning of its Committees.</p>
<b>AUDIT COMMITTEE</b>	
<p><b>80% independent</b>  <b>40% proprietary</b>  <b>40% women</b>  <b>Chairman: Independent director</b></p>	<p><b>Powers relating to:</b> The procedure for preparing the economic and financial information of the Company. The effectiveness of the internal monitoring and risk management systems. The independency of the external auditor. Compliance of legal provisions and internal regulations on the matters within its scope of action. The Company shareholders.</p>
<b>APPOINTMENTS AND REMUNERATION COMMITTEE</b>	
<p><b>60% independent</b>  <b>40% proprietary</b>  <b>40% women</b>  <b>Chairman: Independent director</b></p>	<p><b>Powers relating to:</b> Appointment and removal of directors and some members of senior management. The policy of directors' remuneration. Directors fulfilment of their duties. Directing the process for evaluating the Board and its Committees. The annual report on diversity and equality. Corporate liability and sustainability.</p>

In response to the commitment undertaken by the company chairman at the general shareholders meeting held in April 2012, and considering international best practice in the field of corporate governance, at the extraordinary meeting held on 17 July 2015, called specifically for that purpose, the board of directors of Red Eléctrica asked shareholders to approve a proposal to separate the positions of chairman of the board of directors and chief executive of the company, and to appoint Juan Lasala Bernad as chief executive officer. The two motions were passed, with votes in favour from 99% of the shareholders, compared to the required quorum of 58%. At its meeting of 28 July 2015, the board of directors appointed the new executive director as chief executive of the company.

For the process of separating powers, a transition period was established which ended when the ordinary general shareholders' meeting of 2016 was held, with the complete separation of



duties between the chairman of the board of directors and the chief executive. Since that meeting, the Chairman of the board of directors has only had the responsibilities inherent in that position.

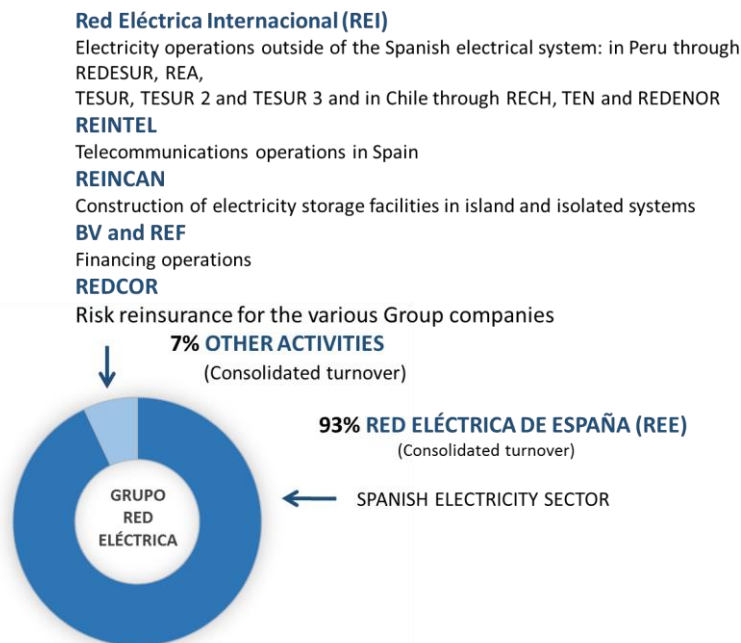
Until the ordinary general shareholders meeting of 2016, the chairman retained his executive functions, focusing on managing, supporting and sponsoring the transfer of executive powers to the new chief executive officer to ensure a rational and orderly transition.

The figure of lead independent director, created in 2013, was maintained, since, based on the responsibilities attributed to the post, it is an efficient corporate governance practice, as acknowledged by shareholders and proxy advisors alike.

The Annual Corporate Governance Report, which is attached hereto, contains detailed information regarding the composition and operation of the governing bodies of the Parent.

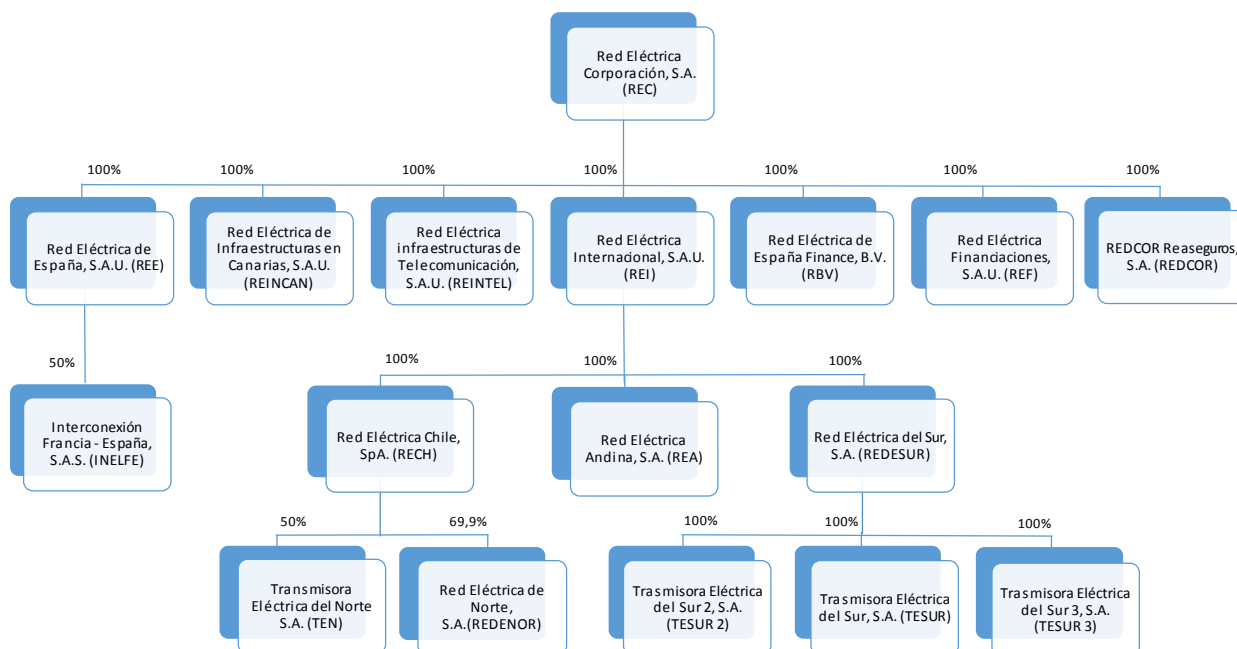
**Composition of the RED ELÉCTRICA Group**

The RED ELÉCTRICA Group's principal activity is electricity transmission and system operation in Spain via Red Eléctrica de España S.A.U. (hereinafter, REE), which generates 93% of consolidated revenues and represents 88% of the Group's total assets (92% and 92%, respectively, in 2016). Other activities account for the remaining 7% of revenue and 12% of total assets (8% and 8%, respectively, in 2016). The Group is present in six countries: Spain, Peru, Chile, the Netherlands, Luxembourg and France.





In 2017, there were changes in the consolidated Group, as described in note 2g to the consolidated annual financial statements. At 31 December 2017, the composition of the Group was as follows (for more information on the activity of each company, see Appendix I of the consolidated annual accounts):



## 1.2. ACTIVITIES AND BUSINESS PERFORMANCE

The Group carries out the aforementioned activities in Spain and abroad, most notably electricity transmission in Spain, Peru and Chile, and rendering telecommunications services to third parties.

### Role of transmission agent and system operator for the Spanish electricity system

The mission of REE, as carrier and operator of the Spanish electricity system, is to guarantee at all times the safety and continuity of the electricity supply and manage the transmission of high voltage energy. To this end, it oversees and coordinates the generation and transmission system and manages the development of the transmission network. The Company seeks to fulfil its mission while adhering to the principles of neutrality, transparency, independence and economic efficiency, so as to offer a secure, efficient and high quality electricity service to society as a whole.

Approval of the 2015-2020 Plan injected the necessary certainty so as to execute the Investment Plan which the Company is implementing and will continue to execute in the next few years.



2017 is the second year in which the remuneration for the transmission activity has been set pursuant to the new remuneration model approved in 2013.

Investments in new facilities in the transmission network in 2017 totalled Euros 411.8 million and were basically to address technical restrictions, extend the network mesh, execute specific projects for international interconnections and inter-island underwater connections, and to ensure supply security and network.

This year, around 150 kilometres of transmission network entered into service, bringing REE's total transmission network to approximately 43,800 kilometres at the end of the year. Meanwhile, transformation capacity was increased by 1,210 MVA, bringing the nationwide total up to 86,654 MVA.

The most significant initiatives in terms of development of the transmission network, by major works or axes, were as follows:

- Lanzarote - Fuerteventura axis: this axis is aimed at carrying out the necessary actions to build the grid mesh on both islands, enabling power to be harnessed and strengthening the connection between the two islands. In 2017, the first facilities of this axis came on stream, and these will be completed, with the rest of installations, in the coming years.
- Olmedo - Zamora axis: this axis is aimed at providing power to the Olmedo - Orense section of the Madrid - Galicia high-speed railway. The Tábara substation entered into service in 2017 and the Arbillera substation is scheduled to follow suit in 2018.
- Gerona Norte: this axis is linked to the interconnection with France which entered into service in 2014. Works continued on this axis in 2017, and it is expected to be completed in 2018.
- Venta de Baños - Burgos - Vitoria: these facilities relate to the need to provide power to the Burgos - Vitoria high-speed railway link. In 2017, some of the facilities entered into service, and work will be ongoing in the next few years.
- Campanario - Ayora - Cofrentes: aimed at building the grid mesh to consolidate mutual support between the regions of Castilla La Mancha and Valencia, and to strengthen the provision of power to the Madrid - Levante high-speed railway. Part of this axis is already in service. In 2017, new facilities came on stream, and work is scheduled to continue in the next few years.
- Arkale phase-shifting transformer: this consisted of installing a 550 MVA machine in the 220 kV interconnection line between the substation of Arkale (Guipuzcoa) and Argia (France), to act as a power limiter enabling part of the power to be routed through a less congested route. This will be key to increasing the interchange capacity with Europe and ensuring supply security.
- Western interconnection with France: triggered by the need to continue increasing the interconnection capacity with France, to achieve the European energy goals that will



enable access to sustainable, competitive and safe energy, in 2017, the preliminary studies continued on the laying of underwater cables in continuous current in the Gulf of Biscay.

Moreover, in 2017, the key events in regard to the operation of the electricity grid system were as follows:

- Mainland energy demand closed the year at 252,752 GWh, up 1.1% on 2016. Adjusting for labour and seasonal factors, attributable demand, mainly to economic activity, points to a growth rate of 1.6%, in contrast to the previous year, when it was 0%.
- Maximum instantaneous power was recorded on Wednesday 18 January at 19:50 hours, at a rate of 41,381 MW, i.e. 2.2% higher than the previous year's maximum and 9.0% lower than the record of 45,450 MW posted on 17 December 2007. Peak demand in terms of time was also posted on 18 January (between 20:00 and 21:00 hours) at 41,015 MWh, 8.6% below the all-time high obtained in 2007.
- Installed capacity on the mainland has fallen compared to the prior year, ending 2017 at 99,311 MW, which is 573 MW (0.6%) less than at December 2016. The biggest variation was seen in nuclear output, where power slid 455 MW as a result of the closure of the Santa María de Garoña plant. The capacity of other technologies either did not vary or changed only insignificantly.
- The auctions for the rendering of the interruptibility service in 2017 were successfully conducted between 1 January and 31 May 2018. Specifically, the country's electricity-intensive industry competed for the allocation of interruptibility in auctions resulting in the adjudication of 2,600 MW of interruptible resources.
- In 2017, renewable energy's percentage contribution to total energy generation in the electricity system shrank to 33.8% (40.8% in 2016).
- Electricity exchanges through the mainland-Balearic Islands link resulted in a net balance of exports to the islands of 1,179 GWh (-5.7% compared with 2016), covering 19.5% of their demand.
- Annual demand for electric power across all non-mainland systems ended in 2017 with a variation of 2.6% compared with the previous year. By grid, demand increased by 3.5% in the Balearics, by 2.1% in the Canaries and by 1.2% in Melilla, while it decreased by 3.5% in Ceuta.
- International electricity exchanges resulted in a net import balance for the second consecutive year after a long period of exporting since 2004, and totalled 9,160 GWh in 2017.

In accordance with Law 17/2013, REE has been commissioned to develop the Pump-Storage Hydroelectric Plants in the Canary Islands, so as to guarantee supply, system security and the integration of non-manageable renewable energies.



In July 2016, the Project Reform and the extension of the Environmental Impact Study at the Soria-Chira plant in Gran Canaria commenced. The Public Disclosure process commenced in October and ended in December 2016. In May 2017, the Company renewed the concession for reservoir and basin of the Chira Dam for hydro-electric purposes. In September 2017, the Environmental Assessment began and in the November issue of the Official Journal of the European Union (OJEU) they advertised the need to recruit the services of an Engineer – Architect to prepare the project in detail, manage the works and provide technical assistance for the Reform.

With respect to the potential reversible pump in Tenerife, in 2017 the preliminary studies were conducted. More than 60 implementation alternatives were identified depending on the terrain, of which, having analysed the minimum power and energy requirements, those that are technically feasible were selected. In a second, more detailed study, these options were analysed based on economic, technical, environmental and social parameters. This work allowed the preferred locations to be chosen. Next year, the basic projects for the two top options are expected to be completed, so that the best can be chosen and the next measures implemented.

### **Telecommunications business**

The Red Eléctrica Group's telecommunications business primarily operates in Spain, doing so through the subsidiary Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. (hereinafter REINTEL).

REINTEL is the Red Eléctrica Group company responsible for operating telecommunications networks and rendering telecommunications services to third parties.

REINTEL is a neutral provider of telecommunications infrastructure. Its principal activity is leasing dark fibre and associated infrastructure. REINTEL operates a fibre network of more than 33,000 km deployed above the electric transmission grid and railway network, guaranteeing transparent access and equal conditions to its clients and players within the telecommunications sector.

No significant events were recorded in 2017 that could influence the performance of the business.

REINTEL won a 20-year concession for the rights to use and operate the fibre optic network not used for the railway business and other associated elements, owned by high-speed rail provider Adif - Alta Velocidad.

### **International business**

The Group's international business is implemented through its subsidiary Red Eléctrica Internacional, S.A.U. (hereinafter, REI), which holds a direct 100% interest in the capital of Peruvian companies REA and REDESUR after acquiring, in January 2017, a 45% stake in the capital of REDESUR from Peruvian investment fund AC Capitales. In turn, REDESUR owns 100% of TESUR, TESUR 2 and TESUR 3. Furthermore, REI holds interests in the Chilean company



RECH (100%) and, through it, a 69.9% stake in REDENOR and 50% of Transportadora Eléctrica del Norte, S.A (hereinafter, TEN).

In 2017, the management excellence of REDESUR and TESUR (the companies that manage transmission infrastructure in Peru) allowed them to offer a transmission service with maximum availability, while supporting development in their operating environment.

For REDESUR, consolidation of the Integrated Management System (IMS) has allowed the company to continue delivering excellent operating standards, with a network availability factor of 99.85% in 2017, above the average for the last five years (99.82%).

TESUR, meanwhile, is currently at the initial stages of operating the concession for the facilities, following its entry into commercial service in mid-2014. The availability factor for TESUR's network was 99.85% in 2017.

REA renders maintenance services for the REDESUR and TESUR facilities. Moreover, in 2017, REA carried out all the work to develop and implement the special projects undertaken by REDESUR, pending at TESUR's facilities, as well as the management services for the construction projects of TESUR 2 and TESUR 3.

REA also carries out facilities maintenance and supervises works for other clients, consolidating its position in southern Peru as a leading provider of such services.

The new projects awarded to TESUR 2 and TESUR 3 are at the construction stage, and are in different phases of completion.

The design and construction activities adjudicated to the facilities of TESUR 2 and TESUR 3 under concession are still in process. The projects have an earmarked investment of USD 110 million. The work will be completed and they will enter into operation in the next few years.

The main activity of RECH, a company incorporated by REI in November 2015, is to acquire, hold, administer and manage the Group's shareholdings in Chile. REI owns 100% of the company's share capital, which amounted to USD 110 million. RECH also holds 50% of TEN, and the other 50% is owned by Chilean company Engie Energía Chile, a subsidiary of the ENGIE Group. It also owns a 69.9% stake in REDENOR.

At the end of 2017 the 500 kV power line began operating commercially, 600 km in length and connecting the Central Interconnected System (SIC in Spanish) with the Greater North Interconnected System (SING), developed by the Group company TEN.

In June 2017, the Red Eléctrica Chile-Cobra Instalaciones y Servicios consortium (69.9%- and 30.1%-owned, respectively) was awarded one of the projects included in the Plan to Expand Chile's Backbone system, involving more than 258 km power lines in the SING. This project amounts approximately to USD 55 million.

In November, the Group, through its subsidiary REDESUR, won the concession of a new project in Peru. The Group will be responsible for the design, construction, financing, operation and



maintenance, for a period of 30 years plus the construction period, of 128 km of 220 kV lines in the south of the country. The benchmark value of the investment amounts to USD 55 million.

These adjudications signal a new step forward in the Group's internationalisation strategy, after commencing its activity in Chile in 2016 and having strengthened its position in both Chile and Peru thanks to the latest adjudications. With the addition of those assets to the Group's portfolio, the company will manage more than 1,300 km of transmission network in Peru and nearly 1,500 km in Chile, obtaining a preferential position for the future interconnection between Chile and Peru.

## 2. BUSINESS PERFORMANCE

### 2.1. KEY FINANCIAL INDICATORS

**Revenue** for 2017 amounted to Euros 1,941.2 million, compared with Euros 1,932.3 million in the previous year. This figure includes the remuneration from the Transmission business in Spain, including the facilities entering into service in 2016. Furthermore, it includes the revenues associated to the provision of telecommunications services, which amounted to Euros 86.5 million, regulated revenues relating to the system operation, which amounted to Euros 56.0 million, and the revenues deriving from the foreign transmission activity, which amounted to Euros 19.6 million.

**Gross Operating Profit (EBITDA)<sup>(1)</sup>** amounted to Euros 1,519.5 million, climbing 2.3% year-on-year.

With regard to operating expenses:

- **Supplies and other operating expenses** increased by 1.8% compared with the previous year, due mainly to the inclusion of this item of the investment made in construction projects in Peru, in application of IFRIC 12, and expenses associated with accidents. If both of these effects are removed, this item would have decreased by 1.8% compared to the level of expense in 2016, evidencing the Group's efforts to improve efficiency.
- **Personnel expenses** increased by 2.4% compared to the previous year. More than half of this increase was due to the difference in wages and salaries, as a result of the larger workforce. The remainder is a result of the rise in employee benefits and similar expenses.

The **headcount** was 1,815 at 31 December 2017, while the average workforce was 1,801 employees, up 2.0% on 2016.

**Net Operating Profit (EBIT)<sup>(2)</sup>** totalled Euros 1,031.4 million, i.e. 2.8% higher than in the previous year.

<sup>1</sup>The gross operating profit or EBITDA is calculated as the sum of the net turnover plus the work carried out by the company on its fixed assets and other operating income, less expenses for personnel, supplies and other operating costs.

<sup>2</sup>The net operating profit or EBIT is calculated as the EBITDA plus the allocation of grants for non-financial assets and the gains or losses or impairment on disposals of fixed assets less provisions for amortization/depreciation.





**Net finance costs** were Euros -142.6 million, compared with Euros -151.3 million in the previous year. This improvement was due mainly to lower interest on the back of decreased finance expenses managed.

Lastly, **Profit for the year** totalled Euros 669.8 million, up 5.2% on the previous year. The effective tax rate was 24.8%, in line with the 25% defined in the Corporate Income Tax Act 27/2014.

The **Investment** carried out by the Group in 2017 amounted to Euros 510.2 million, down 20.7% on the previous year's figure, which included Euros 199.8 million relating to the 50% stake in Chilean company TEN<sup>(3)</sup>. Investment in developing the national transmission network amounted to Euros 411.8 million, a 3.3% increase on 2016.

**Dividends paid** against the previous year's profit totalled Euros 463.2 million, equivalent to Euros 0.8587 per share, an increase of 7% on the previous year as envisaged in the 2014-20 Strategic Plan.

At the end of 2017, 100% of the Group's financial debt is non-current. In terms of interest, 89% is fixed-rate and the remaining 11% is floating-rate.

In 2017, the average cost of the Group's financial debt was 2.78%, compared to 2.94% in the prior year. The average balance of gross debt was Euros 5,346.5 million, compared with Euros 5,462.1 million in the previous year.

Finally, the Group's **Net profit** amounted to Euros 3,093.4 million, i.e. 5.9% higher than at 2016 year-end. This growth was due mainly to profit in the period less dividends paid.

<b>This growth is primarily due to profit for the period.</b>	<b>2016</b>	<b>2017</b>	<b>Δ%</b>
Revenue	1,932.3	1,941.2	0.5%
EBITDA	1,486.0	1,519.5	2.3%
EBIT	1,003.3	1,031.4	2.8%
Net profit	636.9	669.8	5.2%
ROE (post-tax profit/Equity)	21.8%	21.7%	-0.5%
Cash flows from operating activities	1,007.1	1,153.3	14.5%
Dividend policy	432.8	463.2	7.0%
Equity	2,920.5	3,093.4	5.9%
Gearing	62.9%	60.8%	-3.4%
Investments	643.1	510.2	-20.7%
Total assets	10,550.4	10,917.9	3.5%
Debt service coverage ratio (Net debt/EBITDA)	3.33	3.15	-5.3%

<sup>3</sup>Company that is consolidated in the Group's financial statements by the equity method.



### 3. PERSONNEL

In 2017, the Group updated and rolled out the human resources plan, linked to the Company's strategic plan. This plan establishes actions and projects to foster a quality working environment, based on personal and professional development, diversity and equality, commitment and a healthy social climate.

In 2017 several key actions were carried out, such as organisational review, publication of the new functions manual, completion of the Campus project of the RE Group and unfolding the new internal mobility plan; opting for employment and career development.

#### A stable, committed and highly-qualified team

At the end of 2017, the Group's workforce comprised 1,815 professionals, a 2.4% increase on 2016. The commitment to employment stability is reflected in the high percentage (almost 100%) of employees on permanent contracts and the fostering of internal promotions (100% of appointments to senior management positions were covered through internal promotion).

Average headcounts in 2016 and 2017 were as follows:

	2016	2017	Δ%
<b>Average headcount</b>	<b>1,765</b>	<b>1,801</b>	<b>2.0%</b>
% men	76.6%	76.0%	-0.6%
% women	23.4%	24.0%	2.6%

#### Diversity and integration

For the Group, it is essential to foster a quality working environment, based on ethical behaviour, respect, diversity and equality. To realise the Company's commitment to these principles, various initiatives are in place aimed at guaranteeing a workplace free of discrimination that promotes diversity and overcomes gender, age and disability barriers.

Regarding the percentage of women in the workforce at the end of the year was 24.2%. While women accounted for 23.8% of management at 31 December.

Regarding disability, in 2017, the Company attained a 2.6% equivalent employment rate of people with disabilities. Of this percentage, 0.8% correspond to employees on the payroll.

#### Talent management

The global talent management model is aimed at attracting, uncovering, developing, training, transforming and retaining talent and pooling knowledge, through a systemic approach of the various action lines: employment, training, development, knowledge management and leadership, and performance assessment.



In 2017, the Campus Red Eléctrica project, the Group's corporate university, was culminated, and the facilities located in Parque Tecnológico de Madrid (PTM), in Tres Cantos, were launched, equipped with modern infrastructure, cutting-edge technology and innovative methodology.

In 2017, more than 100 hours of training per employee were provided and the average investment was Euros 4,4 thousands.

All employees are assessed continuously in terms of skills, commitment and contribution. In 2017, the current model was analysed and reviewed, with the involvement of various transversal internal working groups, with a view to nurturing a culture of development and recognition.

In 2017, an internal mobility plan integrated into the Talent Management Model was put in place, including a tool to which 100% of employees have access to share their experience and interests with respect to the areas of development and mobility—Linkred.

Also during 2017, the age management model was put into operation with the aim of stimulating inter-generational knowledge management and optimising the skills of our professionals.

### **Dialogue and transparency**

In 2017, work was carried out to design the action plans resulting from the internal survey conducted in 2016.

In addition a new climate survey was carried out using methods and an approach focused on analysing “Sustainable Commitment” which includes individual wellbeing (physical, interpersonal and emotional) in the workplace as an essential aspect, rational and emotional commitment, and organisational support. Participation was 86%, with a satisfaction score of 8.9 out of 10.

### **Health and safety**

The prevention plan associated to the results of the psychosocial risk assessment conducted in 2016 was launched in 2017. Initiated with a specific communication plan and actions to develop competencies, leadership, team cohesion, integration plans, with a direct impact on emotional/psychosocial welfare.

With regard to risk prevention, the continuous monitoring of the higher risk work and activities through safety inspection programmes is key. In this regard, in 2017 more than 13,000 safety inspections were conducted at facilities.

To raise awareness amongst employees with regard to occupational risk prevention, in 2017 REE provided more than 15,000 hours of health and safety training. Specific training on electricity-related risk made up approximately 40% of these hours.



This last year, there was an improvement in the main accident indicators. Accident frequency and seriousness fell by 29.6% and 44.4%, respectively, to rates of 1.71 (frequency) and 0.05 (seriousness).

### **Work-life balance**

The more than 60 work-life balance measures, actions and initiatives implemented by the Group and applied evenly throughout its workforce regardless of their contract type, are among the fundamental threads of the management model.

Periodically, an assessment is made of both the management model and the measures implemented through the surveys, in which people's knowledge and use of and degree of satisfaction with the entire work-life balance management system are measured. The 2017 survey, with participation of over 60%, yielded highly satisfactory results, attaining an average score of 7 out of 10, which is considered a strong score on the scale used. The survey will enable new needs and aspects for improvement to be identified.

## **4. LIQUIDITY AND CAPITAL**

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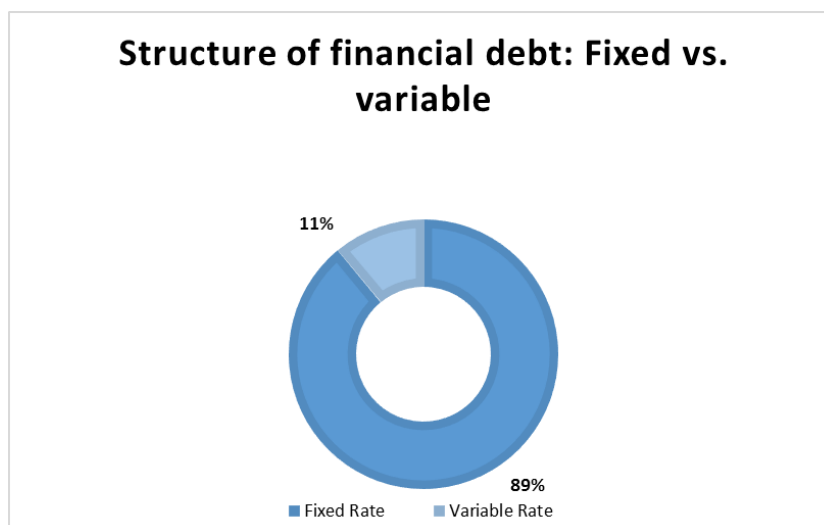
The RED ELÉCTRICA Group's liquidity policy has been designed to ensure payment obligations are met, by diversifying how financing requirements are covered and when debt matures.

The Group's liquidity position is essentially based on robust cash flow generation, primarily through regulated activities. Coupled with appropriate management of collection and payment periods and current financial capacity through short- and long-term credit facilities, this allows the Group to prudently manage its liquidity risk.

The undrawn balance on credit facilities at 31 December 2017 amounts to Euros 1,658 million.

The average maturity of the debt drawn down at the end of the year is 5.3 years.

The Group's financial strategy has aimed to reflect the nature of its businesses, at all times adhering to legislation in force. The activities conducted by the Group are very capital-intensive, wherein investments mature over long periods. In addition, these assets are remunerated over long periods of time, meaning that financial debt is primarily long-term and fixed-rate.



The Group's capital structure policy ensures a financial structure that optimises the cost of capital through a sound financial position, which balances the generation of value for shareholders with competitive costs of financing. Capital is periodically monitored through the gearing ratio, which in 2016 stood at 62.9%, compared to 60.8% in 2017. This ratio is calculated as net financial debt divided by equity plus net financial debt.

To maintain and adjust the capital structure, the Company can adjust the amount of dividends payable to shareholders, reimburse capital or issue shares.

## 5. RISK MANAGEMENT

The Group has implemented a Comprehensive Risk Management System, which aims to ensure that any risks that might affect its strategies and objectives are systematically identified, analysed, assessed, managed and controlled, according to uniform criteria and within the established risk levels, in order to facilitate compliance with the strategies and objectives of the Group. The Comprehensive Risk Management Policy was approved by the board of directors. This Comprehensive Risk Management System, the Policy and the General Procedure are based on the COSO II (Committee of Sponsoring Organizations of the Treadway Commission) Enterprise Risk Management Integrated Framework.

The main risks to which the Group is exposed, and which might affect the achieving its objectives, are regulatory risks—inasmuch as the Group's main businesses are regulated—operating risks, mainly from the activities for the electric grid system service, and financial and environmental risks.

The Integrated Risk Management Policy also includes financial risk, detailed in note 15 of the Consolidated Annual Financial Statements.



## 6. AVERAGE PAYMENT PERIODS TO SUPPLIERS. “REPORTING REQUIREMENT”, THIRD ADDITIONAL PROVISION OF LAW 15/2010 OF 5 JULY 2010

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In accordance with the Spanish Accounting and Auditing Institute (ICAC) resolution of 29 January 2016 regarding the information that must be disclosed in the notes to annual accounts on average payment periods to suppliers in commercial transactions, the average supplier payment period in the case of Spanish Group companies was 47.2 days at the 2017 year end.

The disclosures required by this Resolution are outlined in note 19 to the Group's consolidated financial statements for 2017.

## 7. SIGNIFICANT EVENTS OCCURRING AFTER THE REPORTING PERIOD

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No significant events have occurred between the reporting date and the date on which these consolidated annual accounts were authorised for issue.

## 8. OUTLOOK

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The Group will keep working towards achieving the objectives laid out in the Strategic Plan. To this end, it will continue in its role of Spanish TSO, while also reinforcing its efficiency criteria so as to adapt to the new, more stringent regulatory and remuneration environment, and placing greater emphasis on widening its business base as an alternative means of growth.

Implementation of the strategy, based on excellence, innovation and personal development, will allow the Group to maintain its current leadership in terms of the reliability and security of the electricity systems it operates and the excellent standards in other activities.

The Group will uphold its commitment to maximise value for its shareholders, offering an attractive return in the form of dividends and generating value through efficient management of its activities, analysing alternatives for expanding its business base, maintaining a robust capital structure and working to guarantee supply with a maximum level of quality.

The Group will therefore continue to seek the generation of long-term value, creating lasting, competitive advantages and improving our corporate reputation, whilst focusing on providing optimum service to society – the differentiating feature of the Group's management.

### **Outlook for regulated activities in Spain**

Regulated activities primarily observe the following lines of action:

- Market integration and the sustainability of the electricity system, which justify maintaining the level of investment in the transmission network in coming years, in accordance with the new remuneration framework. The investment plan will focus on bolstering the process of reinforcing the structure and mesh of the grid and developing interconnections, both internationally and, especially, in non-mainland systems.



- A goal of efficiency, enabling the Group to maintain its position as an international benchmark. Accordingly, the Company has reviewed its main operating processes, promoting a streamlined and flexible organisation that optimises the Company's returns and the efficiency of the mainland and non-mainland electricity systems.
- Implementation of new regulated activities, such as storage of energy in the island systems as a tool to guarantee the security of the non-mainland and isolated electricity systems.

The Group will apply a financial policy adapted to the new remuneration model for the transmission activity, ensuring that financial debt is diversified and its liquidity position can comfortably cover upcoming maturities, aiming for the most flexible financial structure possible.

#### **Outlook for telecommunication activities**

The telecommunications activities carried out by REINTEL, as telecommunications infrastructure supplier, will focus on the backbone fibre network market, specifically the lease of dark fibre optic infrastructure associated with agents in the telecommunications sector. To this end, REINTEL will continue to implement its commercial plan and undertake the investments requested by customers, in order to generate greater revenues.

Furthermore, REINTEL will continue to make progress on interconnecting rail and electrical fibre networks with the aim of offering new solutions to its customers, such as new redundant sources and access points, whilst continuing to uphold the high standard of service quality offered to its customers.

#### **Outlook for the international business**

The Group will continue to focus on strengthening its performance in the countries where it operates, specifically in Peru and Chile.

Furthermore, as a means of broadening the business base, the Company will seek to execute projects or acquisitions which, fulfilling a series of geographic, strategic and financial criteria, boost the Company's international presence.

## **9. INNOVATION**

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In 2017, work continued to implement and roll out the new Innovation Strategy to leverage innovation as a driver for growth, cultural change and sustainability within the Group. This initiative aims to bring innovation to all corners of the business activity, focusing primarily on four key angles: In the international arena, innovation activity undertaken as part of ENTSO-E projects is particularly noteworthy.

One of the milestones was the second edition of the innovation awards, whose aim is to detect potentially interesting ideas and foster a culture of innovation. 28 proposals were submitted



this time around, and the winning idea was ANTILUS — an unmanned vessel to inspect and monitor undersea power lines.

At the end of 2017, in cooperation with InnoEnergy, the GRID2030 programme was launched, a European initiative to uncover potentially disruptive ideas for the Group and finance their transition to solutions closer to being incorporated into the Group's activities. The deadline for presenting proposals for this first edition is February 2018.

Abroad, we highlight the dedication to the Research, Development and Innovation Committee of ENTSO-E, the European association of transmission system operators, and its working groups. We also highlight the collaboration with the European Technology & Innovation Platform (ETIP) for electricity networks is ongoing as part of the EU's SET Plan. REE sits on the steering committee as a representative of the European TSOs.

With regard to projects financed by European programmes, in 2017 work is ongoing in BEST PATHS (*Beyond the State-of-the-art Technologies for re-Powering Ac corridors & multi-Terminal HVDC Systems*), coordinated by REE and involving 39 partners, including universities, technological centres, industry, electric utilities and TSOs; and in MIGRATE, in which REE is a partner leading a working package aimed at improving the understanding of the electric power grid system with a high level of penetration of power electronics devices (generators, loads, HVDC, FACTS...). The OSMOSE project was also approved and will commence shortly. This project will research the scope (mainly based on storage) to improve the electric grid system's operation and the integration of renewables.

As regards projects implemented under domestic innovation programmes, work continues on AMCOS-Stability FACTS to design a prototype to improve the stability of frequency and voltage in small isolated systems.

Throughout 2017, work was ongoing on our own RDi projects, including the CECOVEL and ALMACENA projects.

The CECOVEL (Electric Vehicle Control Centre – Centro de Control del Vehículo Eléctrico) project is a Group initiative to support electric mobility in the current scenario of energy transition. In operation since 2017, CECOVEL monitors demand for energy to recharge electric vehicles, raising the visibility of these new consumers of electricity. This is a collaboration involving the main charging station managers in Spain which currently monitors more than 900 charging stations. The project received an enerTIC Award in 2017, in the *Smart Vehicle* category.

The ALMACENA project has enabled a more in-depth investigation into new storage technologies in the sphere of integrating renewables and improving system operating services thanks to an electrochemical storage unit installed in Carmona (Seville). In 2017, research was ongoing into operation and maintenance, compiling information to feed into the models developed. Similarly, optimisation models were developed to determine the best possible functioning of the storage equipment in isolated electric grid systems, devising a methodology to estimate the size of the storage equipment in such systems and the construction of the model to optimise the annual operating costs of that equipment in isolated systems.



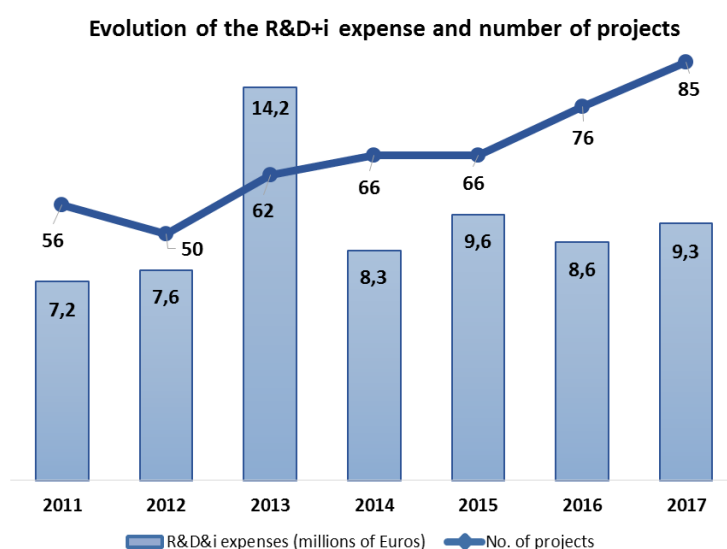


Geared towards environmental conservation, including the development and validation of a ground-breaking technique, the first in the world, to recover underwater meadows formed by *Posidonia Oceanica* seagrass – a highly-protected aquatic plant native to the Mediterranean – using laboratory-germinated seeds and bundles originating from natural fragmentation. Notably, the RGI (*Renewables Grid Initiative*), an association of various TSOs and environmental NGOs in the European Union, aimed at fostering renewable energy, granted this project the ‘*Good Practice of the year 2017*’ award.

The VEGETA project was also successfully completed. This was an algorithm methodology to globally optimise the entire cycle of vegetation treatment under power lines with the aim of achieving efficient and socially responsible forestry management.

Overall, the Group worked on 85 innovation projects in 2017, at a total cost of Euros 9.3 million.

It is important to say that in 2017 a significant number of projects in the construction, operation and maintenance of electric power transmission facilities were completed, as well as in the environmental sphere.



## 10. OWN SHARES

In order to provide investors with adequate levels of liquidity the Company acquired 1,781,515 shares with a total par value of Euros 0.9 million and a cash value of Euros 32.4 million in 2017. A total of 2,134,154 shares were sold, with an overall par value of Euros 1.1 million and a cash value of Euros 39.9 million.

At 31 December 2017 the Company held 1,613,693 own shares, representing 0.30% of its share capital. These shares had a par value of Euros 0.50 each, and an overall par value of Euros 0.8 million and an acquisition price of Euros 18.45 (see note 11 to the annual financial statements) and their market value totalled Euros 29.8 million.



The Parent has complied with the requirements of article 509 of the Spanish Companies Act, which provides that the par value of acquired shares listed on official secondary markets, together with those already held by the Parent and its subsidiaries, must not exceed 10% of the share capital. The Group subsidiaries do not hold own shares or shares in the Parent.

## 11. OTHER RELEVANT INFORMATION

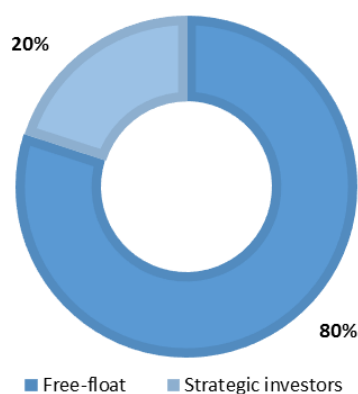
### 11.1. STOCK MARKET PERFORMANCE AND SHAREHOLDER RETURNS

All of the shares in REC, the Group's listed company, are quoted on the four Spanish stock exchanges and are traded through the Spanish automated quotation system. REC also forms part of the IBEX 35 index, of which it represented 1.9% at the end of 2017.

At 31 December 2017, the share capital of REC amounted to Euros 270.5 million and was represented by 541,080,000 shares with a par value of Euros 0.50 each, subscribed and fully paid.

During the year REC's free float was 80%.

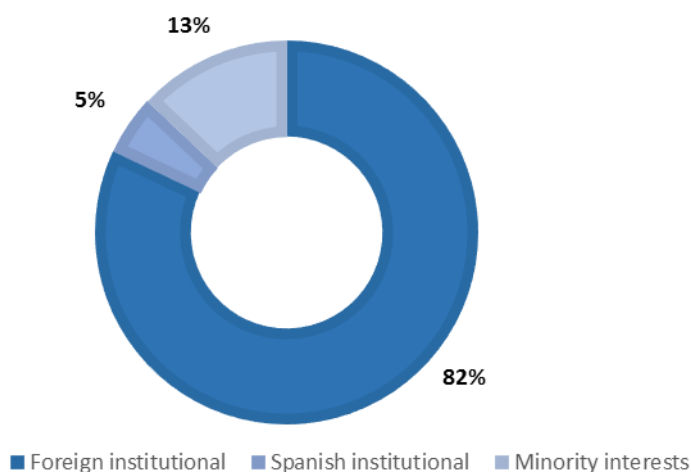
#### Shareholder structure



At the date of the last shareholders' meeting – 31 March 2017 – the free float comprised 432,864,000 shares, of which an estimated 13% is held by non-controlling shareholders, 5% by Spanish institutional investors and 82% by foreign institutional investors, primarily in the United Kingdom and the United States.



## Distribution of the free float



With regard to share performance, 2017 was a good year. Wall Street surprised investors with another robust performance, with its main indices logging gains in some cases in excess of 20%, and setting an impressive array of records in the year (almost 70 records in the Dow Jones). Moreover, the US tax reform approved at the end of 2017 was another driver of healthy growth in the New York Stock Exchange.

Bourses elsewhere in the world logged a more moderate performance. In Europe, however, in 2017 we have also seen Germany's DAX and the UK's FTSE beat their previous records. Nevertheless, the revaluations in the main European equity markets were more modest, with Milan and Frankfurt the outperformers, both logging gains of more than 12%.

Shares in REC gained 4.4% in 2017, outperforming most regulated European energy companies. The company's efforts to improve efficiency, its shareholders' remuneration policy and its diversification strategy were applauded by the markets, in what was a tough context for companies like ours.

The market capitalisation of the Company at the end of 2017 was Euros 10,124 million.

In total, 596 million shares were traded in 2017, which is 1.1 times the Company's share capital. In cash terms, Euros 10,958 million was traded, down 25% on the Euros 13,432 million traded in the prior year.

### 11.2. DIVIDEND POLICY

The dividends paid in 2017 amounted to Euros 463.2 million, 7% more than in 2016.



The dividend against 2017 results, proposed by the Board of Directors and pending approval at the General Shareholders' Meeting, is Euros 0.9188 per share, an increase of 7% on the previous year.

Based on the projections and estimates contained in the Group's 2014-2019 Strategic Plan, the dividend could grow at a rate of approximately 7%. This increase is considered as the average annual rate for the period covered by the Strategic Plan, on the basis of the total dividend approved with a charge to 2014. This forecast is subject to fulfilment of the Plan.

The dividend will be paid in two instalments – an interim dividend in January and a supplementary dividend half way through the year following approval of the annual accounts by the shareholders at their general meeting.

### 11.3. CREDIT RATING

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On 4 July 2017, the rating agency Standard & Poor's issued a new report on Red Eléctrica, maintaining its rating and outlook. Following this announcement, the Company and its subsidiary REE maintain long-term ratings of A- and short-term ratings of A-2, with a stable outlook.

On 18 September 2017, the rating agency Fitch Ratings granted the Company a long-term rating of 'A', with a stable outlook. Following this announcement, REC and REE maintain long-term ratings of 'A' and short-term ratings of 'F1', with a stable outlook.

### 11.4. EXCELLENCE

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In 1999, the Company adopted the EFQM (*European Foundation for Quality Management*) model as a tool for ongoing improvement in its management and results, and since 2001 it has commissioned external assessments every two years in order to identify areas for improvement, which are articulated through excellence plans, and to achieve progress in management excellence. In 2017, as a result of this external assessment, the Company renewed its Recognised for Excellence 500+ certification, with a RADAR score of more than 700 points, consolidating its position among leading companies in Spain and Europe.

Since 2000, the Company has also had a certified quality system encompassing all the organisation's processes. In 2017, this system was adapted to the latest version of international standard UNE-EN-ISO9001 and it received certification through an external audit which, since 2012, has been conducted integrally on all the certified corporate management systems.

The excellence and quality management system is in turn based on a process management approach. In 2017, the process manual was reviewed to ensure it is fully aligned with the Company's functions manual. This year a project to improve "the voice of external customers" was implemented, to speed up the process of compiling and processing information on customer satisfaction, as well as facilitating the introduction of improvements as a result of analysing the requirements and expectations of external customers.



## 12. STATEMENT OF NON-FINANCIAL INFORMATION, IN ACCORDANCE WITH ROYAL DECREE–LAW 18/2017, OF 24 NOVEMBER, WHEREBY DIRECTIVE 2014/95/EU FROM THE EUROPEAN PARLIAMENT AND THE COUNCIL IS TRANSPOSED INTO SPANISH LAW

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### 12.1. DESCRIPTION OF THE GROUP'S BUSINESS MODEL AND MAIN SUSTAINABILITY EVENTS

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In 2002, the Group defined its Corporate Social Responsibility Policy and implemented a system enabling the adequate management of the economic, social and environmental impacts of its activity on its stakeholders.

As a key line of action for the Group, the 2014-2019 Strategic Plan lays down a management process based on corporate responsibility best practice. In implementing this strategy, the Group acts in a responsible, ethical and committed manner vis-à-vis its stakeholders and society in general.

In 2016, the Group decided to further enhance its management by designing the **Group's 2030 Sustainability Commitment**, approved by the board of directors' Appointments and Remuneration Committee on 24 May 2017. The Commitment defines four sustainability priorities, identified as the drivers for responding to the challenges facing the Group and for materialising existing opportunities.

- **Decarbonisation of the economy.** The Group undertakes to be a proactive agent in the energy transition towards an emissions-free model, based on the electrification of the economy and the efficient integration of renewable energies through a robust and better-connected network and the development and operation of energy storage systems.
- **Responsible value chain.** The Group undertakes to extend its responsibility commitment to all the links of the value chain, from its employees to its suppliers and customers, by forging alliances and underpinned by the model of good governance and integrity.
- **Contribution to the development of the surrounding community.** The Group undertakes to contribute to economic, environmental and social progress in the surrounding area, by providing an essential service in a secure and efficient way, fostering environmental conservation, enhancing people's quality of life and social welfare and involving communities in the development of our activities so as to generate mutual rewards that are tangible to that community.
- **Anticipation and action for change.** The Group undertakes to foster a corporate culture of innovation and flexibility that enables it to identify growth opportunities and tackle future challenges, by staying ahead of—and adapting to—global trends and to the regulatory environment emerging from the new energy model.



The Group belongs to the most reputable sustainability indices, in recognition of its excellent track record in this connection, and its firm commitment to transparency in its reporting to third parties. In 2017, the Group was recognised as a global leader in the Electric Utilities sector and the Utilities super-sector, which encompasses the sectors of electricity, gas and water, by the Dow Jones Sustainability Index (DJSI). The Company is also listed in the FTSE4Good, Climate Disclosure Project, Euronext Vigeo-Eiris, Ethibel, MSCI and ECPI.

## **12.2. PROTECTION AND CONSERVATION OF THE ENVIRONMENT**

The Group's commitment to the environment originates from Company management, and is based on the environmental policy (reviewed and approved in October 2014) and implemented by means of an Environmental Management System that is certified under ISO 14.001 and EMAS regulations. The involvement of all of the organisational units and the commitment of all of the Group's employees are essential to the implementation of this system.

The main environmental challenges facing the Company are as follows:

- Ensuring that facilities are compatible with the environment, selecting layouts and locations to minimise environmental impact. Application of preventative and corrective measures and strict environmental criteria in all stages of activity means that the potential impact on the environment is immaterial.
- Ensure the protection and conservation of biodiversity. The Group has a specific commitment to the management of biodiversity (reviewed in 2017) and a multi-year Action Plan including the related goals and specific actions to achieve those goals. We highlight the actions relating to the following areas:
  - Protection of birds, the main idea being to minimise the risk of birds' colliding with earth wires in power lines. A plan has been devised to use bird-saving devices in sections with the greatest potential impact on birds (more than 700 km of lines) and is scheduled for completion in 2023. In 2017, 45% of critical priority areas were equipped with deterrents.
  - Prevention of forest fires, through the proper design and maintenance of fire breakers and the joint efforts of all the administrations with competencies in this area. There are currently 12 fire prevention agreements in place, with a related budget of more than Euros 1.2 million every 5 years *earmarked for cleaning up public land, acquiring fire prevention and fire-fighting equipment, training and awareness.*
  - Implementation of conservation projects in partnership with the government, NGOs and other bodies, including those relating to the conservation of birds and those aimed at restoring degraded areas. The latter include the "REE Marine Wilderness" project to restore *posidonia oceanica seagrass* and the "Red Eléctrica Forest", with more than 778 hectares restored (from 2009 to 2017) and an investment of Euros 1,843,941.
- Helping to fight climate change, leading the Group to undertake a formal commitment (reviewed in 2017) and implement a Climate Change Action Plan defining the main goals for



2020 and 2030. The plan includes actions relating to the Company's transmission and grid system operating activities and its contribution to European emissions targets. Action lines and tasks are also outlined to reduce the Company's carbon footprint. These include actions aimed at improving the management of SF6 gas and at energy savings and efficiency, especially linked to sustainable mobility and the reduction of electricity consumption. The plan also tackles the adaptation to climate change as one of the main areas for work in this matter.

Note that, in 2017, the Company's ordinary expenses to protect and improve the environment amounted to Euros 21.6 million and the amount earmarked for environmental aspects linked to investment projects was Euros 3.4 million.

### **12.3. CONTRIBUTION TO SOCIETY**

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The Group focuses its socio-environmental commitment towards unlocking shared value with society, fostering actions and investments aligned with its business goals which, as they generate value for the Group, also have a positive impact on society, the territory and its inhabitants. Likewise, it contributes to the attainment of various challenges, such as the UN's Sustainable Development Goals or those envisaged as part of the European 2020 energy strategy.

Shared value is created by the Group both in the way it develops and builds infrastructure and in its manner of operating and providing services to the effective systems in which it operates and to its customers. This activity generates opportunities to unlock shared value throughout the life cycle of infrastructure.

In addition, the Group accompanies its projects on the ground with collaboration projects to nurture institutional and social relationships, transparently seeking partnership agreements, disseminating information about the electricity network and fostering involvement in projects and initiatives that boost socio-economic development, and the conservation, protection and valuing of natural heritage in the territories where it operates.

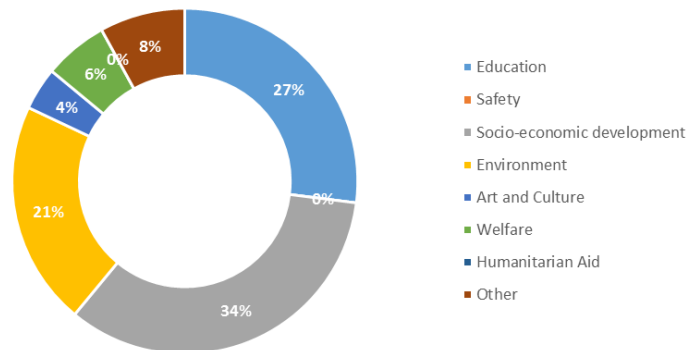
In this regard, in 2017 REE contributed Euros 6.5 million<sup>4</sup> to developing or promoting social initiatives.

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<sup>4</sup> This amount was obtained by applying LBG (London Benchmarking Group) methodology.



## Acting Area



In 2017, the Company signed around 100 agreements with public and social entities to cooperate in socio-economic, environmental, educational and cultural development projects, primarily.

More than 50% of the 480-plus social initiatives undertaken focused on the **socio-economic development of the territory**: construction projects or municipal infrastructure improvements, efforts to nurture cultural wealth in territories, restoration of emblematic and socially significant buildings with an impact on tourism, among others.

With regard to the **dissemination of knowledge**, the Group takes an active role in disseminating and raising awareness about the electricity network as a whole, since a better informed society has greater capacity to develop and maintain a sustainable energy model.

In this connection, in 2017, more than 1,700 people visited REE facilities and control centres, more than 560,000 visitors assisted to the itinerant exhibition "A Highway behind the Wall Socket" ("*Una autopista detrás del enchufe*") explaining the electricity supply process from generation to consumption, and more than 8,370 school children took part in activities under the framework of the educational game "**entreREDEs**", aimed at teaching kids to be efficient and environmentally-friendly consumers in the future.

15 cooperation agreements were also signed with universities and training centres.

In Spain, training for the State Police and Security Forces was ongoing. In 2017, training on the prevention of forest fires was provided in 10 provinces of 6 regions, involving 1,556 trainees.

### Corporate volunteering

Since 2005, promoting corporate volunteering has been a pivotal part of the Group's action, as a result of its firm commitment to improving society, enabling it to channel the solidarity and social concerns of our employees.





In 2017, a new model of corporate volunteering was designed in order to respond to the social and environmental needs and aspects in the general interest in those territories where the Group has a presence, via the employees' voluntary involvement in actions aligned with the Group's Sustainability Commitment.

## 12.4. RESPECT FOR HUMAN RIGHTS AND COMBATING CORRUPTION AND BRIBERY

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### Respect for human rights

The Group has an explicit public commitment to respecting and safeguarding human rights in all the territories in which it operates as it conducts its business, with a particular emphasis on vulnerable groups. This commitment is enshrined in the guidelines and conduct outlined in the **Code of Ethics** and the **Corporate Social Responsibility Policy**, and applies throughout the supply chain thanks to the Group's **Code of Conduct for Suppliers**. Lastly, as a member of the Spanish network of the UN Global Compact, REE underpins its commitment to human rights by adhering to the ten principles of the Global Compact.

In order to continue making headway in human rights management and strengthening the Group's commitment in this sphere, in 2017 the Company devised a **human rights management model**, approved by the Sustainability Committee, encompassing all the Group's activities and based on the United Nations' guiding principles for companies and human rights.

The Group's approach is one of ongoing control and improvement by implementing actions to prevent potential breaches of human rights, and to find solutions and address cases in which such breaches have occurred. Consequently, the Group is subject to internal and external audits in connection with human rights and it conducts social audits at its suppliers to ensure the efficiency of the management model.

In 2017, the Group carried out due diligence regarding human rights in connection with all its activities, and found there was a low risk in all the areas analysed, evidencing that the Group implements proper controls.

All the Group's stakeholders can access the Ethical Channel, as a formal response mechanism for queries and complaints in connection with human rights. In addition, the company has the DIGAME (Let's talk) Attention Centre and ASA (Supplier Helpdesk) services, where stakeholders can express their concerns regarding any suspected breach of human rights. In 2017, these channels received a total of three complaints in relation to human rights issues. All of those complaints were resolved.

### Ethics and Compliance at the RED ELÉCTRICA Group

Ethics and Compliance are fundamental pillars for the proper course of business at the Group. This means acting with the utmost integrity in discharging the Group's obligations and commitments, and in relations and cooperation with its stakeholders.



The Group has a series of corporate rules of conduct establishing the values and standards of behaviour that must be subscribed by all persons in the Group in the performance of their professional activities.

### **Code of Ethics**

The Group's Code of Ethics applies to the Group's directors and employees, and establishes the values and commitments that must govern their behaviour. The latest edition of the Group's Code of Ethics was approved by the Board of Directors on 28 May 2013.

### **Ethical channel**

The Group has an Ethical Channel, available through its corporate website, to convey queries, complaints or suggestions relating to the Code of Ethics. The Group has an 'Ethics Manager' for fielding queries and compiling, analysing and resolving complaints relating to the Code of Ethics. This figure, in direct contact with the Chairman and the board of directors, acts independently, and undertakes to maintain the utmost confidentiality in performing his duties.

In 2017, 26 queries were filed with the Ethics Manager, with a maximum resolution time of 10 days. The queries related to the following patterns of behaviour:

- Integrity, responsibility and transparency.
- Respect, dignity and non-discrimination.
- Responsible monitoring of the supplier management.
- Restriction of the acceptance of gifts, loans or invitations.
- Suitable safeguards for the information systems.

In 2017, 7 complaints were received in connection with compliance with the Code of Ethics, 5 of these were resolved in the year and 2 are in the implementation phase of the action plan proposed by the Ethics Manager.

### **Compliance system**

The Group's Compliance System is fully aligned with the best practices in this sphere, so as to support the organisation in fulfilling its obligations and commitments.

The main goals of the compliance system are:

- To nurture a corporate culture based on ethics and compliance
- To attain a global vision of compliance at the organisation
- To have a transversal and homogeneous approach to compliance
- To strengthen the preventive aspects of compliance

In accordance with the Group's commitment to responsible and sustainable management, and with best management practices, the organisation has a Compliance Unit within the Risk Control, Compliance and Quality Department (part of Internal Audit and Risk Control)



integrating compliance functions with those of risk control and quality management, based on the synergies between these various functions.

### **Prevention of criminal risks**

The Group has a Criminal Risk Prevention Programme aimed at identifying the rules, procedures and tools it has established to prevent non-compliance with criminal legislation applicable to the Group and its staff and adapting it to the current regulatory framework. Thus, the prevention of criminal risks potentially affecting the Group based on its activities and business sectors, in accordance with the Criminal Code, are incorporated in its due control processes.

This Programme, approved by the board of directors, has a control body which supervises its compliance and carries out the specific measures to ensure that it is properly updated and executed. Moreover, it periodically reports to the Audit Committee concerning the actions implemented, improvements proposed, updates introduced, measures agreed and any other aspect deemed relevant in discharging its duties.

As the body in charge of monitoring, supervising and updating the Programme, the Control and Supervisory Body of the Criminal Risk Prevention Programme include periodically reporting to the Audit Committee concerning the actions implemented, the improvements agreed and any other aspect deemed relevant in discharging its duties.

In 2017, the Control and Supervisory Body did not receive any complaints regarding non-compliances in connection with the Criminal Risk Prevention Programme and none of the Group's companies were investigated or found guilty of non-compliances linked to the organisation's criminal risks. Likewise, no complaints were filed in connection with potential cases of corruption, and no Group company was investigated or found guilty by any court in connection with non-compliances linked to corruption cases.

## **12.5. RESPONSIBLE MANAGEMENT OF THE SUPPLY CHAIN**

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The globalisation of markets has increased the limits of companies' responsibilities and triggered a change in the sole of suppliers, which have become a pivotal element. In this regard, the Group focuses on broadening its responsibility over the supply chain and is guided by a responsible management model. The Group's management model is based on the principles of non-discrimination, mutual recognition, proportionality, equal treatment and transparency, as well as a framework of legislation and internal Group codes, policies and rules.

In 2017, REE carried out work (including receiving materials and equipment and executing services and projects) through more than one thousand suppliers, for an amount exceeding six hundred million euros.



With regard to the risks and impacts identified in the supply chain, the identification and ranking of risks and impacts on the supply chain by priority have enabled the company to establish adequate controls to minimise them.

In 2017, a supplier sustainability assessment model was devised. This model has 29 questions, grouped into 3 blocks: ethics and labour conditions, environment and workplace health and safety. Based on this knowledge, the aim is to foster sustainable development at suppliers to steadily increase the maturity of the supply chain in terms of sustainability.

In order to verify compliance with the Code of Conduct among the Group's suppliers, audits were conducted at 75 suppliers in 2017. These audits, whose aim is to assess suppliers' compliance with the Code of Conduct, focuses on those supplies with a high potential or real impact on labour conditions and ethical behaviour or suppliers where some kind of ethical incident has been detected.

As a result of the audits, improvements or action plans were agreed at more than 60% of suppliers, the monitoring of which allows their performance and the impact of the improvement implemented to be measured.



## 12.6. MAIN INDICATORS RELATING TO NON-FINANCIAL DISCLOSURES (summary table)

Non-financial indicators	2016	2017	Δ%
Direct emissions of greenhouse gases (scope 1) (tCO <sub>2</sub> eq.) <sup>(5)(8)</sup>	31,500	28,765	-8.7
Direct emissions of greenhouse gases (scope 2) (tCO <sub>2</sub> eq.) <sup>(5)(8)</sup>	848,793	956,967	12.7
Electricity consumption (MWh) <sup>(8)</sup>	15,541	15,177	-2.3
Lines incorporating bird deterrents in critical priority areas (kilometres accumulated at year end) <sup>(8)</sup>	218 (29.5% of the total to be equipped with deterrents)	332 (45% of the total to be equipped with deterrents)	52.3
Women on the board of directors (%) or figure <sup>(6)</sup>	4 (36.4%)	4 (33.3%)	-
Women on the payroll Group (final) (%) <sup>(6)</sup>	23.5	24.2	3.0
Women in executive positions Group (final) (%) <sup>(6)</sup>	20.1	23.8	1.8
People with disabilities on the payroll (%) <sup>(7)</sup>	0.8	0.8	-
Average hours of training per employee <sup>(7)</sup>	82	108	31.7
Investment in training per employee (euros) <sup>(7)</sup>	3,431	4,398	28.2
Accident frequency rate <sup>(7)</sup>	2.43	1.71	-29.6
Serious accident rate <sup>(7)</sup>	0.09	0.05	-44.4
Social audits to suppliers (number) <sup>(7)</sup>	40	75	87.5
Number of complaints relating to human rights <sup>(6)</sup>	-	3	-
Number of cases of corruption <sup>(6)</sup>	-	-	-
Investment in the community (millions of euros) <sup>(7)</sup>	6.4	6.5	1.6

<sup>5</sup> The increase in scope 2 emissions is due to the increase in emissions linked to the losses in the transmission network, calculated using the emission factor corresponding to the annual generation mix. The factor calculated for 2017 is considerably higher than in 2016 due mainly to the sharp downturn in hydro-electric generation (associated with low water availability due to weather conditions), which it supplemented with generation from non-renewable sources.

<sup>6</sup> Group

<sup>7</sup> Spain: REE + REC + REINCAN + REI + REINTEL

<sup>8</sup> REE



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### 13. ANNUAL CORPORATE GOVERNANCE REPORT

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The Annual Corporate Governance Report forms an integral part of the Directors' Report and can be viewed at the following address:

<http://www.cnmv.es/Portal/consultas/EE/InformacionGobCorp.aspx?nif=A-78003662>

The various sections of this consolidated director's report contain certain prospective information that reflects projections and estimates based on underlying assumptions, statements referring to plans, objectives and expectations associated with future transactions, investments, synergies, products and services, as well as statements concerning results or future dividends, or estimates calculated by the directors and based on assumptions that those directors consider reasonable.

While the Group considers the expectations reflected in those statements to be reasonable, investors and holders of shares in the Parent are advised that the information and statements containing future projections are subject to risks and uncertainties, many of which are difficult to foresee and generally beyond the Group's control. As a result of such risks, actual results and developments could differ substantially from those expressed, implied or forecast in the information and statements containing future projections.

The affirmations and statements containing future projections do not provide any guarantee as to future results and have not been reviewed by auditors outside the Group or by other independent third parties. It is recommended that no decisions be made on the basis of the affirmations and statements containing future projections that refer exclusively to the information available at the date of this report. All of the affirmations and statements containing future projections that are reflected in this report are expressly subject to the warnings given. The affirmations and statements containing future projections included in this document are based on the information available at the date of this directors' report. Except as required by applicable legislation, the Group is not obligated to publicly update its statements or review the information containing future projections, even where new data is published or new events arise.