GAS NATURAL SDG, S.A.

Audit Report independent,
Annual Accounts as at 31 December 2016 and
Directors' Report for 2016

Gas Natural SDG, S.A.
Annual Report 2016

ANNUAL ACCOUNTS

Gas Natural SDG, S.A.
Balance sheet **(Million euros)**

	31.12.16	31.12.15
NON-CURRENT ASSETS	**29,993**	**29,907**
Intangible assets (Note 7)	195	272
Goodwill	190	272
Other intangible assets	5	--
Property, plant and equipment (Note 8)	153	179
Land and buildings	140	167
Plant and other property, plant and equipment	13	12
Long-term investments in Group companies and associates (Note 9)	29,443	29,308
Equity instruments	13,688	14,613
Loans to companies	15,755	14,695
Long-term investments (Note 10)	74	15
Equity instruments	5	5
Derivatives	59	1
Other financial assets	10	9
Deferred income tax assets (Note 19)	128	133
CURRENT ASSETS	**2,084**	**2,739**
Trade and other receivables (Note 11)	670	701
Trade receivables	145	95
Group companies and associates	368	400
Sundry receivables	153	192
Current income tax assets	--	10
Public Administrations	4	4
Short-term investments in Group companies and associates (Note 9)	883	730
Loans to companies	816	727
Other financial assets	67	3
Short-term investments (Note 10)	27	63
Other financial assets	27	63
Short-term prepayments and accrued expenses	2	1
Cash and cash equivalents (Note 12)	502	1,244
Cash at banks and in hand	502	1,089
Other cash equivalents	-	155
TOTAL ASSETS	**32,077**	**32,646**

Notes 1 to 32 form an integral part of these Annual accounts.

Gas Natural SDG, S.A.
Balance sheet

	(Million euros)	
	31.12.16	**31.12.15**
NET EQUITY (Note 13)	**13,444**	**13,285**
SHAREHOLDERS' EQUITY	**13,431**	**13,298**
Capital	1,001	1,001
Authorised capital	1,001	1,001
Share premium	3,808	3,808
Reserves	7,898	7,873
Legal and statutory	300	300
Other reserves	7,598	7,573
Treasury shares	(13)	--
Profit for the year	1,067	1,024
Interim dividend	(330)	(408)
ADJUSTMENTS FOR CHANGES IN VALUE	**13**	**(13)**
Hedging operations	13	(13)
NON-CURRENT LIABILITIES	**14,626**	**15,114**
Long-term provisions (Note 14)	467	481
Long-term post-employment obligations	285	283
Other provisions	182	198
Long-term borrowings (Note 15)	3,300	3,159
Borrowings from financial institutions	3,190	2,983
Derivatives	93	161
Other financial liabilities	17	15
Amounts owing to group companies and associates falling due in more than one year (Note 17)	10,627	11,239
Deferred income tax liabilities (Note 19)	231	234
Long-term accruals	1	1
CURRENT LIABILITIES	**4,007**	**4,247**
Short-term borrowings (Note 15)	297	621
Borrowings from financial institutions	270	187
Derivatives	15	14
Other financial liabilities	12	420
Amounts owing to group companies and associates falling due in less than one year (Note 17)	3,000	2,891
Trade and other payables (Note 18)	710	735
Trade payables	242	247
Payables with group companies and associates	311	254
Sundry payables	93	196
Personnel (outstanding remuneration)	23	22
Current tax liabilities	24	--
Other amounts payable to Public Administrations	17	16
TOTAL NET EQUITY AND LIABILITIES	**32,077**	**32,646**

Notes 1 to 32 form an integral part of these Annual accounts.

Gas Natural SDG, S.A.

Income statement

	(Million Euros)	
	2016	**2015**
Net turnover (Note 20)	5,062	5,640
Sales	3,088	3,640
Income from equity instruments of Group companies and associates (Note 9)	1,560	1,542
Income from marketable securities and other financial instruments of Group companies and associates	414	458
Supplies (Note 21)	(3,118)	(3,647)
Consumption of goods	(3,113)	(3,641)
Raw materials and other consumables	(5)	(6)
Other operating income (Note 24)	444	361
Supplementary income and other operating income	443	359
Operating grants released to the income statement	1	2
Personnel costs (Note 22)	(201)	(191)
Wages, salaries and related expenses	(152)	(143)
Social Security	(34)	(33)
Provisions	(15)	(15)
Other operating expenses (Note 23)	(337)	(365)
External services	(330)	(326)
Taxes	(2)	(2)
Impairment loss and variation in trade provisions	(5)	(8)
Other current operating expenses	--	(29)
Amortisation expense (Notes 7 and 8)	(94)	(92)
Impairment and results on disposals of fixed assets	(139)	(109)
Gain/(loss) on disposals of tangible fixed assets *(Note 8)*	36	--
Impairment and losses from equity instruments of Group companies and associates	(206)	(106)
Gain/(loss) on disposals of equity interests in Group companies and associates (Note 9)	31	(3)
OPERATING PROFIT	**1,617**	**1,597**
Financial income	30	29
Negotiable securities and other financial instruments	30	29
- In third parties	30	29
Financial expenses	(664)	(698)
Borrowings from group companies and associates	(569)	(580)
Borrowings from third parties	(95)	(118)
Variation in fair value of financial instruments	(1)	2
Investments	(1)	2
Net exchange gains / losses	1	(13)
NET FINANCIAL INCOME (Note 25)	**(634)**	**(680)**
PROFIT BEFORE TAX	**983**	**917**
Income tax (Note 19)	84	107
PROFIT FOR THE YEAR	**1,067**	**1,024**
Basic and diluted earnings per share in Euros	1.07	1.02

Notes 1 to 32 form an integral part of these Annual accounts.

Gas Natural SDG, S.A.
Statement of changes in net equity

A) STATEMENT OF INCOME AND EXPENSE RECOGNISED	**(Million Euros)**	
	2016	**2015**
PROFIT FOR THE YEAR	**1,067**	**1,024**
INCOME AND EXPENSE RECOGNISED DIRECTLY IN NET EQUITY	**20**	**(4)**
Cash flow hedges	24	(9)
Actuarial gains and losses and other adjustments (Note 14)	3	4
Tax effect (Note 19)	(7)	1
RELEASES TO INCOME STATEMENT	**8**	**8**
Cash flow hedges	10	11
Tax effect (Note 19)	(2)	(3)
TOTAL INCOME AND EXPENSE RECOGNISED IN NET EQUITY	**1,095**	**1,028**

Notes 1 to 32 form an integral part of these Annual accounts.

Gas Natural SDG, S.A.
Statement of changes in Net equity

B) STATEMENT OF TOTAL CHANGES IN NET EQUITY **(Million Euros)**

	Share capital	Share premium	Reserves	Treasury shares	Profit or loss brought forward	Profit for the year	Interim dividend	Adjustments for changes in value	Grants, donations and bequests received	Total
Balance at 01/01/2015	**1,001**	**3,808**	**8,145**	**--**	**--**	**1,083**	**(397)**	**(14)**	**3**	**13,629**
Adjustments for changes in accounting policy (Note 4)	--	--	(451)		--	--	--	--	--	(451)
Adjusted balance at 01/01/2015	**1,001**	**3,808**	**7,694**	**--**	**--**	**1,083**	**(397)**	**(14)**	**3**	**13,178**
Total recognised revenues and expenses	--	--	3	--	--	1,024	--	1	--	1,028
Operations with partners or owners										
- Dividend distribution (Note 14)	--	--	--	--	(512)	--	(408)	--	--	(920)
- Trading in treasury shares	--	--	2	--	--	--	--	--	--	2
- Reductions due to business combinations	--	--	--	--	--	--	--	--	(3)	(3)
Other variations in net equity (Note 4)	--	--	174	--	512	(1,083)	397	--	--	--
Balance at 31/12/2015	**1,001**	**3,808**	**7,873**	**--**	**--**	**1,024**	**(408)**	**(13)**	**--**	**13,285**
Total recognised revenues and expenses	--	--	2	--	--	1,067	--	26	--	1,095
Operations with partners or owners										
- Dividend distribution (Note 14)	--	--	--	--	(593)	--	(330)	--	--	(923)
- Trading in treasury shares (Note 14)	--	--	--	(13)	--	--	--	--	--	(13)
Other variations in net equity (Note 14)	--	--	23	--	593	(1024)	408	--	--	--
Balance at 31/12/2016	**1,001**	**3,808**	**7,898**	**(13)**	**--**	**1,067**	**(330)**	**13**	**--**	**13,444**

Notes 1 to 32 form an integral part of these Annual accounts.

Gas Natural SDG, S.A.
Statement of cash flow **(Million Euros)**

	2016	2015
Profit/(loss) for the year before tax	**983**	**917**
Adjustments to results	**(1,112)**	**(1,163)**
Fixed asset depreciation (Notes 7 and 8)	94	92
Impairment adjustments	211	114
Change in provisions	6	39
Profit/(loss) on write-offs and disposals of fixed assets	(36)	--
Profit/(loss) on write-offs and disposals of financial instruments	(31)	3
Financial income	(2,004)	(2,029)
Financial expenses	664	698
Gains/(losses) on exchange	(1)	13
Change in fair value of financial instruments	1	(2)
Other income and expenses	(16)	(91)
Changes in working capital	**28**	**(463)**
Inventories	--	--
Debtors and other receivables	10	(128)
Other current assets	(1)	1
Creditors and other payables	19	(336)
Other cash flows from operating activities	**1,529**	**1,662**
Interest paid	(640)	(669)
Dividends received	1,560	1,542
Interest collected	447	493
Income tax collections/(payments)	162	296
Cash flows from operating activities	**1,428**	**953**
Amounts paid on investments	**(2,071)**	**(1,634)**
Group companies and associates	(2,047)	(1,623)
Property, plant and equipment	(16)	(10)
Other financial assets	(8)	(1)
Amounts collected from divestments	**1,639**	**866**
Group companies and associates	1,571	865
Property, plant and equipment	66	--
Other financial assets	2	1
Cash flows from investing activities	**(432)**	**(768)**
Collections and payments equity instruments	**(13)**	**--**
Acquisition of own equity instruments	(13)	--
Collections and payments financial liability instruments	**(394)**	**(838)**
Issued	6,347	4,873
Bank borrowings	801	287
Payables to Group companies and associates	5,546	4,583
Other payables		3
Repayment/redemption of	(6,741)	(5,711)
Bank borrowings	(531)	(1,165)
Payables to Group companies and associates	(6,187)	(4,514)
Other payables	(23)	(32)
Dividend payments	**(1,331)**	**(909)**
Cash flow from financing activities	**(1,738)**	**(1,747)**
NET INCREASE/DECREASE IN CASH OR CASH EQUIVALENTS	**(742)**	**(1,562)**
Cash and cash equivalents at the beginning of the year	1,244	2,806
Cash and cash equivalents at the year end	502	1,244

Notes 1 to 32 form an integral part of these Annual accounts.

Gas Natural SDG, S.A.

Contents of the notes to the annual accounts for 2016

Notes to the annual accounts of Gas Natural SDG, S.A. for the year ended 31 December 2016

Note 1. General information

Gas Natural SDG, S.A. (hereon, the Company), parent company of Gas Natural Fenosa group (hereon, Gas Natural Fenosa), was incorporated as a public limited company in 1843 and its registered office for corporate purposes is in Plaça del Gas, number 1, Barcelona.

The company's corporate purposes, as per its articles of association, comprise the following activities:

a) All types of activities related to the gas and electricity business and any other type of existing energy source, the production and selling of electrical, electro-mechanical and electronic equipment and components, management of architectural projects, civil engineering works, public services and gas and hydro-carbon distribution in general; management of communications and telecommunications networks and maintenance of electro- and gas-related appliances; as well as consulting, business and energy planning services and the rationalisation of energy use, research, development and exploitation of new technologies, communications, computer and industrial security systems; training and selection of human resources and real estate management and development.

b) The activity as a holding company, incorporating companies or holding shares as a stakeholder or shareholder in other companies no matter what their corporate purposes or nature, by subscribing, acquiring or holding shares, stakes or any other securities deriving from the same, subject to compliance with the legal requirements in each and every case.

The Company's most relevant ordinary activity is the holding of shares in subsidiaries through which the Company pursues its corporate objects.

The shares of Gas Natural SDG, S.A. are listed on the four Spanish stock exchanges, the continuous market and form part of the Ibex 35 stock index.

Note 2. Regulatory framework

2.1. Regulation of the natural gas industry in Spain

<u>Main characteristics of the natural gas industry in Spain</u>

The Spanish gas sector is regulated by Law 34/1998, October 7, on the hydrocarbons sector, as amended by Law 12/2007, July 2, Royal Decree-law 13/2012 and Law 18/2015, May 21, as well as Law 18/2014, and by its enabling regulations, the most relevant being Royal Decree 1434/2002, December 27, Royal Decree 949/2001, August 3 and Royal Decree 984/2015, 30 October.

The Ministry of Energy, Tourism and the Digital Agenda (MINETAD) is the competent organisation in the regulation of the gas and electricity industries, while the National Markets and Competition Commission (CNMC) is the regulatory authority in charge of maintaining and ensuring effective competition and transparent functioning of the Spanish energy industries. Prior to the publication of Law 3/2013 of June 4, these functions were performed by the National Energy Commission (CNE), which has been integrated into the CNMC. The relevant Ministries of the Regional Governments have competencies in legislative, enforcement and legislation.

Furthermore, the Technical Manager of the System, Enagás, S.A., is responsible for the appropriate functioning and coordination of the gas system. It should therefore be borne in mind that Law 12/2007 limits the shareholding in Enagás, S.A. to a maximum of 5% of its share capital, and voting rights to 3% in general, and the voting rights of participants in gas activities to 1%, and, in any case, the sum of the interest of the shareholders undertaking activities in the gas sector cannot exceed 40%.

In general, the Spanish gas sector has the following main characteristics:

- It is an industry in which regulated and unregulated activities coexist. The regulated activities consist of transport, regasification, storage and distribution of natural gas. The non-regulated activities comprise generation, supply and retailing of natural gas.

- The natural gas sector is almost entirely dependent on foreign supplies of natural gas, which represent almost 99.9% of the natural gas supply in Spain.

- Under EU legislation (Directives 2003/55/CE of June 26, and 2009/73/EU), the supply of natural gas in Spain is totally non-regulated, and all Spanish consumers can freely choose their natural gas provider as from 1 January 2003. The deregulation procedure for the industry has been reinforced substantially by the disappearance as from 1 July 2008 of the bundled tariff of distribution companies and the subsequent right of consumers to participate in the deregulated market (although as indicated further below a tariff of last resort has been maintained for consumers of lower consumption).

The Company supplies gas that is subsequently sold mainly to other Gas Natural Fenosa companies. This activity is treated as described below:

Natural gas is supplied in Spain mainly by gas operators such as Gas Natural Fenosa under long-term contracts with gas producers. Although such supplies are not regulated, they are subject to two types of limit, basically to assure supply diversification and competition in the market: 1) no country may be source of more than 60% of the natural gas brought to Spain; and 2) no party or business group may bring natural gas to Spain for consumption in a volume exceeding 70% of domestic consumption, excluding self-consumption.

2.2. Regulation of the electricity sector in Spain

<u>Main characteristics of the electricity sector in Spain</u>

The regulation of the electricity industry in Spain has undergone a major reform process during the year 2013 which led to the publication of Law 24/2013, of 26 December, of the Electricity Sector, which adapts the previous law (Law 54/1997, of 27 November) to the circumstances of both the economy and the power and energy sector in Spain.

The Ministry of Industry, Energy and Tourism is the body responsible for regulating the gas and electricity sectors, while the CNMC is the regulatory authority that is entrusted with the task of maintaining and ensuring effective competition and transparent functioning of Spanish energy sectors. The relevant Ministries of the Regional Governments have competencies in legislative, enforcement and legislation. The Nuclear Safety Council exercises specific competencies over the facilities using this technology.

Furthermore, the Technical System Manager, Red Eléctrica de España, S.A. (REE), has the main function of guaranteeing the continuity and safety of the electricity supply and the proper coordination of the production and transport system. Thus, please bear in mind that law provides a strict legal separation between the system operator and the activities of generation or sale of electric power.

Generally, the electricity sector has the following main features:

- It is a sector in which regulated and non-regulated activities coexist. The regulated activities consist of transport and electricity distribution (as well as system and market operation).

  Following the directives of EU legislation (Directives 2009/72/CE), all Spanish consumers can freely choose their electricity provider. A system of regulated tariff applies to consumers with contracted capacity of less than 10 kW. This regulated tariff has been referred to as the Small Consumer Voluntary Price (PVPC), and it also exists the last-resort tariff (TUR) having become the regulated price applicable to consumers classed as vulnerable and to consumers that do not meet requirements to apply the PVPC but are temporarily without a supply company in the free market. The last-resort tariff (TUR) for vulnerable consumers is funded by the social bond which will be assumed by the parent companies of electricity supply groups or by individual electricity supply companies if they do not form part of a group.

- The electricity consumed in Spain is mostly generated domestically, since the international connections with France and Portugal have a very small capacity.

- Since July 1, 2007 the Iberian Electricity Market (MIBEL) has begun to operate effectively between Spain and Portugal, which has involved the integration of the electricity systems of both countries (although this integration is still not perfect).

- During the period 2000-2013, the electricity system was not self-sufficient in terms of price, an annual deficit having been generated and financed by the conventional electricity companies, including Gas Natural Fenosa.

  With the aim of eliminating the sector deficit, a number of provisions introduced in recent years have brought in important measures and adjustments to electricity sector activities to correct departures caused by mismatches between costs and revenue, culminating in the regulatory package known as the July 2013 electricity reform and the approval in December 2013 of Electricity Sector Law 24/2014, which established the basic principle of the sector's economic and financial sustainability.

Finally, on 27 December, Law 24/2013 (26 December) on the electricity sector was published, being the main developments as follows:

- With respect to the principle of the system's economic and financial sustainability:

  - The remuneration calculation parameters will have a six-year term and will be reviewed prior to the start of the regulatory period taking into account the economic cycle, demand for electricity and an adequate return from these activities.

- A distinction is made between transport and distribution network access tolls and the charges that are necessary to cover other costs of the relevant system activities, which will be determined using methodology to be established by the Government; in general, tolls and charges will be reviewed annually or in the event of circumstances that have a material impact on regulated costs or on the calculation parameters employed.

- Small consumer voluntary prices (PVPC) are regulated and will be the same throughout Spain. These prices are defined in line with the prices previously referred to as last-resort tariffs, as the maximum prices that the reference supply companies may charge consumers that avail themselves of the prices. The last-resort tariff (TUR) has become the regulated price applicable to consumers classed as vulnerable and to consumers that do not meet requirements to apply the voluntary price for small consumers but are temporarily without a supply company in the free market.

- Mismatches due to a revenue deficit are limited to the extent that they may not exceed 2% of revenues estimated for the reference period and cumulative liabilities due to mismatches may not exceed 5% of those revenues. Should these limits not be observed, the relevant tolls or charges will be reviewed. The portion of the mismatch that is not offset by a rise in tolls and charges shall be financed by the parties subject to the settlement system in proportion to their debt claims arising from the activities performed. The amounts contributed in this way will be reimbursed in the settlements for the following five years, plus applicable interest. Any surplus revenues generated will be used to offset prior-year mismatches; while there are outstanding prior-year liabilities, the access tolls or charges may not be reduced.

- For year 2013, an income deficit for liquidations of the electrical system for a maximum amount of Euros 3,600 million is recognised. This deficit will generate receivables consisting in the right to receive an amount of the monthly billing for fifteen successive years beginning on January 1, 2014 until its complete satisfaction.

- The obligation to keep separate accounting records is extended, applying not only to the separation of electricity activities from non-electricity activities, but also to the separation of production with regulated remuneration activity from non-regulated. This obligation extends to all producers receiving regulated remuneration.

- Electricity generation:

  - The temporary closure of generation facilities is contemplated and will be subject to prior administrative authorisation.

  - Hydraulic resources that must be used to generate electricity are regulated as well as the daily market system of offers, with the particularity that all production units must offer its energy in the market, including those operating under the former special regime.

  - Electricity demand and contracting, rights and obligations of electricity generators, and specific remuneration regime records are all regulated.

- System's economic and technical management:

    - System operator and market operator functions are regulated, as are the procedures for the certification of the system operator by the National Markets and Competition Commission, and for authorisation and designation as a transmission grid manager by the Ministry of Industry, Energy and Tourism, which must be notified to the European Commission, and certification relating to non-European Union countries.

    - Grid access and connection is regulated, clearly defining the access right and connection right concepts, as well as access and connection permits, the related grant procedure and requirements, and parties responsible for granting permits subject to technical and economic criteria to be stipulated in enabling regulations.

- Electricity transmission:

    - A specific requirement is provided whereby remuneration for new facilities must be included in the planning phase.

    - The functions that must be performed by the transmission company are provided, having previously been included in different laws or enabling regulations.

- Electricity distribution:

    - A definition of distribution facilities is provided.

    - The obligations and functions of electricity distribution companies are stipulated, distinguishing between distribution performed as the owners of distribution grids and distribution performed as grid management companies.

- Regime for inspections, infringements and penalties:

    - The classification of infringements is revised and new infringements are included, certain conduct having been identified that had not been envisaged in Law 54/1997 (27 November) but has a negative impact on the electricity system's economic sustainability and functioning.

    - The amount of penalties is revised, existing incidental penalties are extended and powers to impose penalties are modified.

Note 3. Basis of presentation

Gas Natural SDG, S.A. Annual accounts for 2015 were approved by the Annual General Meeting on 4 May 2016.

The Annual accounts for 2016, which were issued by the Board of Directors of Gas Natural SDG, S.A. on 7 February 2017, will be submitted to the General Meeting for approval; they are expected to be approved without any changes.

The accompanying Annual accounts have been prepared on the basis of the Company's accounting records and are presented in accordance with prevailing commercial legislation and the provisions of the Chart of Accounts introduced under Royal Decree 1514/2007 (16 November), as amended by Royal Decree 1159/2010 (17 September) and Royal Decree 602/2016 (2 December), so as to present fairly the Company's equity and financial position at 31 December 2016, and the results, changes in equity and cash flows of Gas Natural SDG, S.A. for the year then ended.

The figures set out these Annual accounts are expressed in million euros, unless otherwise stated.

At 31 December 2016, the Company records negative working capital, in the amount of Euros 1,923 million, covered by dividends expected in the following year and the amount drawable on long-term credit lines (Note 16).

The consolidated Annual accounts of Gas Natural Fenosa for 2016 have been prepared in accordance with the International Financial Reporting Standards adopted by the European Union (IFRS-EU), in accordance with Regulation (EU) 1606/2002 of the European Parliament and the Council. The main figures disclosed in the consolidated Annual accounts, which have been audited, are as follows:

Total assets	47,114
Equity attributed to the parent Company	15,225
Minority interests	3,780
Net turnover	23,184
Net income after tax attributed to the parent Company	1,347

Note 4. Comparability

Pursuant to paragraph 2 of the Single Transitional Provision and Additional Provision Two of Royal Decree 602/2016, the Company has opted to calculate the effect of the change in the amortisation of goodwill from the acquisition date of the assets concerned against the goodwill reserve, adjusting the comparative information so that for each item in the balance sheet, income statement, statement of changes in equity, cash-flow statement and notes to the accounts, the figures for the previous year have been included as well as the figures for 2016. The figures for 2015 were calculated by applying the alternative option provided for in Royal Decree 602/2016. As a result, the figures for the previous year relating to these items differ from the figures included in the approved annual accounts for 2015, which were drawn up in accordance with the accounting principle and standards in force in said year.

The changes to the comparative figures are summarised below:

	31.12.2015	Adjustments	Adapted to RD 602/2016
NON-CURRENT ASSETS	**30,440**	**(533)**	**29,907**
Intangible assets	815	(543)	272
Property, plant and equipment	179	--	179
Long-term investments in Group companies and associates	29,308	--	29,308
Long-term investments	15	--	15
Deferred income tax assets	123	10	133
CURRENT ASSETS	**2,739**	**--**	**2,739**
TOTAL ASSETS	**33,179**	**(533)**	**32,646**

NET EQUITY	**13,815**	**(530)**	**13,285**
SHAREHOLDERS' EQUITY	**13,828**	**(530)**	**13,298**
Capital	1,001	--	1,001
Share premium	3,808	--	3,808
Reserves	8,324	(451)	7,873
Profit for the year	1,103	(79)	1,024
Interim dividend	(408)	--	(408)
ADJUSTMENTS FOR CHANGES IN VALUE	**(13)**	**--**	**(13)**
NON-CURRENT LIABILITIES	**15,117**	**(3)**	**15,114**
Long-term provisions	481	--	481
Long-term borrowings	3,159	--	3,159
Amounts owing to group companies and associates falling due in more than one year	11,239	--	11,239
Deferred income tax liabilities	237	(3)	234
Long-term accruals and deferred income	1	--	1
CURRENT LIABILITIES	**4,247**	**--**	**4,247**
TOTAL NET EQUITY AND LIABILITIES	**33,179**	**(533)**	**32,646**

	31.12.2015	Adjustments	Adapted to RD 602/2016
Net turnover	5,640	--	5,640
Supplies	(3,647)	--	(3,647)
Other operating income	361	--	361
Personnel costs	(191)	--	(191)
Other operating expenses	(365)	--	(365)
Amortisation expenses	(11)	(81)	(92)
Impairment and results on disposals of financial instruments	(109)	--	(109)
OPERATING PROFIT	**1,678**	**(81)**	**1,597**
NET FINANCIAL INCOME	**(680)**	**--**	**(680)**
PROFIT BEFORE TAXES	**998**	**(81)**	**917**
Income tax	105	2	107
PROFIT FOR THE YEAR	**1,103**	**(79)**	**1,024**

Note 5. Demerger of Gas Natural SDG, S.A. in favour of Gas Natural Fenosa Generación, S.L.U. in 2015

On 30 January 2015, the Board of Directors of Gas Natural SDG, S.A. and the Sole Administrator of Gas Natural Fenosa Generación, S.L.U. signed the Plan for the Demerger of Gas Natural SDG S.A.'s nuclear generating business in favour of the wholly-owned company Gas Natural Fenosa Generación, S.L.U. The operation was approved by Gas Natural SDG, S.A.'s General Shareholders' Meeting and by Gas Natural Fenosa Generación, S.L.U.'s Single Shareholder on 11 April 2015 and entered in the Barcelona Mercantile Register on 1 July 2015, once the legally stipulated periods had elapsed and the necessary authorisations had been obtained, with retroactive effects to 1 January 2015 for accounting purposes. Pursuant to Article 89 of Corporate Income Tax Law 27/2014, the demerger was specifically completed under the special scheme provided by Title VII, Chapter VII of that law.

As this contribution was made to a Group company, over which there is control, it was recognised, pursuant to Rule 21 of the Chart of Accounts introduced under Royal Decree 1514/2007 (16 November), as amended by Royal Decree 1159/2010 (17 September), by which consolidation rules are approved, at the carrying amount of the assets and liabilities handed over, in the Group's consolidated Annual accounts on the operation date.

Set out below is a breakdown of the assets and liabilities demerged from the Company at 1 January 2015 in favour of Gas Natural Fenosa Generación, S.L.U.:

Intangible assets	247
Property, plant and equipment	876
Long-term investments	2
Deferred income tax assets	9
NON-CURRENT ASSETS	**1,134**
Inventories	64
Other current assets	33
CURRENT ASSETS	**97**
TOTAL ASSETS	**1,231**
GRANTS	**3**
Long-term provisions	147
Long -erm payables to group companies and associates	543
Deferred income tax liabilities	95
NON-CURRENT LIABILITIES	**785**
Short-term borrowings	12
Trade and other payables	69
CURRENT LIABILITIES	**81**
TOTAL LIABILITIES	**869**
TOTAL NET ASSETS	**362**

In exchange for the demerged net assets, Gas Natural SDG, S.A. received the shares involved in the capital increase carried out by Gas Natural Fenosa Generación, S.L.U. amounting to Euros 362 million.

Note 6. Accounting policies

The main accounting principles applied by the Company to prepare these annual accounts are described below.

6.1. Intangible assets

Intangible assets are carried at acquisition price or production cost, or at fair value in the case of assets acquired through a business combination, less accumulated amortisation and any recognised impairment losses.

a) Goodwill

Goodwill represents the excess, on the date of acquisition, of the cost of a business combination over the fair value of the net identifiable assets acquired at the date of the operation. Consequently, goodwill is only recognised when it has been acquired for valuable consideration and relates to the future economic profits from assets that have not been identified individually and recognised separately.

Goodwill is amortised in ten years and it is to be recovered on a straight-line basis. Goodwill is tested annually to analyse possible impairment losses. It is recognised in the consolidated balance sheet at cost value less amortisation and any cumulative impairment adjustments.

The impairment of goodwill cannot be reversed.

b) Other intangible assets

Research expenditure is recognised in the income statement when incurred.

Costs associated directly with the production of computer software programs that are likely to generate economic profits greater than the costs related to their production are recognised as intangible assets. The direct costs include the personnel costs that has developed the computer programs.

Computer software development costs recognized as assets are amortised on a straight–line basis in four to five years as from the time the assets are prepared to be brought into use.

The Company does not have intangible asset with an indefinite useful life.

6.2. Property, plant and equipment

a) Cost

Property, plant and equipment are carried at acquisition price or production cost, or at the value attributed to the asset if it is acquired as part of a business combination.

Financial costs relating to financing for plant projects during the plant construction period to the date the asset is ready for use form part of property, plant and equipment.

Renewal, extension or improvement costs are capitalised as an increase in the asset's value only when its capacity, productivity or useful life increases.

Major maintenance expenditures are capitalised and amortised over the estimated useful life of the asset (generally 2 to 6 years) while minor maintenance is expensed as incurred.

Own work capitalised under Property, plant and equipment relates to the direct cost of production.

Expenses arising from actions designed to protect and improve the environment are expensed in the year they are incurred.

When such costs entail additions to property, plant and equipment the purpose of which is to minimise the environmental impact and to protect and improve the environment, they are accounted for as an increase in the value of property, plant and equipment.

Gains and losses on disposals are determined by comparing proceeds with carrying amounts. These are included in the Income statement.

b) Depreciation

The assets are depreciated on a straight-line basis over their useful lives or the concession term, if shorter. Estimated useful lives are as follows:

	Estimated useful life years
Buildings	33 – 50
Computer hardware	4
Vehicles	6
Other	3 - 20

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each Balance sheet date.

When the carrying value of an asset is greater than its estimated recoverable amount or when it is no longer useful, its value is written down immediately to its recoverable amount (Note 6.3).

6.3. Impairment of assets

Assets are tested for impairment provided that an event or change in circumstances indicates that their carrying amount might not be recoverable. Additionally, investments in group companies and associates, long-term investments, goodwill and intangible assets that are not in use are tested annually for impairment.

When the recoverable amount is less than the asset's carrying amount, an impairment loss is recognised through profit and loss for the amount of the difference between the two. The recoverable amount is calculated at the higher of an asset's fair value less costs of sale and value in use calculated by applying the discount cash flow method. In general, Gas Natural SDG, S.A. is considering recoverable amount to be value in use, which is calculated using the methodology described below.

For the purposes of assessing impairment losses, assets are grouped together at the lowest level for which there are separately identifiable cash flows. Assets and goodwill are assigned to these cash-generating units (CGUs).

In the case of investments in group companies, barring investments the recoverable amount of which is determined based on the investee's equity (Note 6.4) and goodwill, the cash flows employed are based on the Strategic Plan approved by Gas Natural SDG, S.A., extended to five years on the basis of regulations and expected market evolution, drawing on available industry forecasts and historical experience of price trends and volumes produced.

The cash flows after the projected period are extrapolated using the growth rates estimated for each CGU or group of CGUs, and in no case exceed the average long-term growth rate for the business in which they operate. In all cases, they are lower than the growth rates stated in the strategic plan. Additionally, in order to estimate future cash flows in the calculation of residual values, all maintenance investments have been considered and, if applicable, renewal investments necessary to maintain the CGUs' production capacity.

The nominal growth rates used for the CGU and financial assets in Spain fluctuate between 1.2% and 2.2% (0.8% and 1.8% in 2015). Specifically, a growth rate of 1.8% has been applied to the shareholding in Unión Fenosa Gas, S.A. (1.4% in 2015). For the businesses in which Gas Natural Distribución Latinoamérica, S.A., Global Power Generation, S.A.U. and Gas Natural Fenosa Internacional, S.A. hold interests, the growth rates used vary between 1.0% and 4.6% (1.0% and 4.9% in 2015).

The cash flows have been discounted using the average costs of funds before tax. For the CGU and financial assets in Spain this cost fluctuates between 5.2% and 6.1% (5.6% and 6.8% in 2015). In the particular case of Unión Fenosa Gas, S.A. the discount rate has been 11.9% (11.0% in 2015). For the businesses in which Gas Natural Distribución Latinoamérica, S.A., Global Power Generation, S.A.U. and Gas Natural Fenosa Internacional, S.A. hold interests, rates are between 5.8% and 17.0% (6.3% and 16.0% in 2015).

The parameters used in the breakdown of the above discount rates have been:

- Risk free bond: 10-year Bond reference market for the CGU.
- Market risk premium: Estimate of the variable interest of each country at 10 years.
- Deleveraged Beta: According to average of each sector in each case.
- Local current interest rate swaps: 10-year swap.
- Net Equity-debt ratio: Sector average.

Apart from the discount rates, the most sensitive aspects that are included in the projections used and are based on industry forecasts and historical experience are as follows:

In the case of the investment in Gas Natural Fenosa Generación, S.L.U. and Gas Natural Fenosa Renovables, S.L.U.:

- Electricity generated. Market demand evolution has been estimated based on the consensus expressed by several international bodies. The share has been estimated based on Gas Natural Fenosa's market share in each technology and on the expected evolution of each technology's share of the total market. It has been considered the impacts of Royal Decree-Law 2/2013, Royal Decree-Law 9/2013, Law 24/2013 and Royal Decree-Law 413/2014.

- Electricity price. Market electricity prices used have been calculated using models that cross expected demand with supply forecasts, taking into account the foreseeable evolution of generation capacity in Spain, based on sector forecasts.

- Fuel costs. Estimated by reference to long-term supply contracts concluded by Gas Natural Fenosa, the forecast evolution of price curves and market experience.

- Operation and maintenance costs. Estimated from historical costs of managed park.

- The effect of taxes established by Law 15/2012.

For the investment in Unión Fenosa Gas, S.A.:

- Gas supply costs In accordance with the prices of the long-term contracts entered into by Unión Fenosa, S.A. and expected price fluctuations in spot markets.

- Gas volumes to be obtained from each supply source.

- Selling price of natural gas. Valued using predictive modelling based on the forecast performance of price curves and experience in the markets where Union Fenosa Gas, S.A. operates.

As a result of the above process, in 2016 the recoverable values of the CGUs' assets, calculated using the methodology described, have been, except for the interest in Union Fenosa Gas, S.A., which an impairment have been recognised on such interest (Note 9) higher than the carrying amounts recognised in these annual accounts.

In 2015, impairment analyses did not reveal the need to post impairment losses, except for the shares in Unión Fenosa Gas, S.A. (Note 9).

Gas Natural SDG, S.A. has carried out a sensitivity analysis of the unfavourable variations which, drawing on historical experience, may reasonably affect the above-mentioned sensitive variables used as a basis for the recoverable amount of the CGUs. Specifically, the most relevant sensitivity analyses performed are as follows:

	Increase	Decrease
Discount rate	50 basis points	-
Electricity generated	-	5%
Electricity price	-	5%
Fuel and gas supply costs	5%	-
Operating and maintenance costs	5%	-

These sensitivity analyses performed separately for each basic assumption would not affect the conclusions drawn to the effect that the recoverable amount exceeds the carrying amount, except for Unión Fenosa Gas, S.A., the recoverable value of which is equivalent to its carrying amount.

6.4. Financial assets and liabilities

Investments in the equity of group and multi-group companies and associates

These are stated at the lower of cost of acquisition or fair value, if the investments are acquired through a business combination, and the recoverable value. The recoverable value is determined as the larger of fair value minus cost of sale and the current value of the cash flows generated by the investment. If there is no better evidence of recoverable value, recoverable value will be the equity of the investee company adjusted by any tacit capital gains subsisting at the valuation date. The value adjustment, and as the case may be, its reversal, is recorded on the income statement in which it takes place.

In non-cash contributions of a business to a group company, the investment is measured at the carrying amount of the assets and liabilities contributed, as per the consolidated Annual accounts on the transaction date. The consolidated Annual accounts of the largest group or subgroup into which the assets and liabilities are integrated, where the parent is a Spanish company, are used.

In mergers and spin-offs between group companies that involve the group's parent, directly or indirectly, the assets and liabilities acquired are measured at the amount that would be reflected in the group's Consolidated Annual accounts following the transaction. The difference between the cost of the shares handed over and the carrying amount of the assets and liabilities acquired, in the group's Consolidated annual accounts, is recognised under “Reserves” in the balance sheet.

Investments

Purchases and sales of investments are recognised on trade-date, which is the date on which Gas Natural SDG, S.A. commits to purchase or sell the asset, and are classified under the following categories:

a) Loans and receivables

These are non-derivative financial assets, with fixed or determinable pay outs, that are not listed on an active market, and for which there is no plan to trade in the short-term. They include current assets, except for those maturing after twelve months as from the balance sheet date that are classified as non-current assets.

They are initially recorded at their fair value and then at their amortised cost using the effective interest rate method.

A provision is set up for impairment of receivables when there is objective proof that all the outstanding amounts will not be paid. The provision is the difference between the book value of the asset and the present value of the estimated future cash flows discounted at the effective interest rate.

b) Held-to-maturity financial assets

These are assets representing debt with fixed or determinable pay outs and fixed maturity which the Company plans to and can hold until maturity. The valuation criteria for these investments are the same as those for loans and financial receivables.

c) Fair value financial assets through profit or loss

These are assets acquired for short-term sale. Derivatives form part of this category unless they are designated as hedges. These financial assets are stated, both initially and in later valuations, at their fair value, and the changes in their value are taken to the income statement for the year.

d) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative debt or equity instruments that are not designated in either category.

They are recognised at fair value. The changes are recorded directly in equity until the asset is sold or impaired, at which time the accumulated gains and losses in equity are taken to the Income statement.

The fair values of quoted investments are based on current bid prices. In the case of shareholdings in unlisted companies, fair value is determined using valuation techniques that include the use of recent transactions between willing and knowledgeable parties, references to other instruments that are substantially the same and the analysis of discounted future cash flows. If none of these techniques can be used to determine fair value, investments are carried at cost less any impairment loss.

Financial assets are written off when the contractual rights to the asset's cash flows have expired or they have been transferred; in the latter case, the risks and rewards of ownership must have been substantially transferred. Financial assets are not written off, and a liability is recognised in the same amount as the payment received, in asset assignments where the risks and rewards of ownership are retained.

Cash and cash equivalents

Cash and cash equivalents include cash at hand, time deposits with financial entities and other short-term investments noted for their great liquidity with an original maturity no longer than three months as from the acquisition date.

Borrowings

Borrowings are initially recognised at their fair value, net of the transaction costs that they may have incurred. Any difference between the amount received and the repayment value is recognised in the income statement during the period of repayment using the effective interest rate method.

Borrowings are classified as current liabilities unless they mature in more than twelve months as from the balance sheet date, or include tacit one-year prorogation clauses that can be exercised by Gas Natural SDG, S.A.

Trade and other payables

Trade and other current payables are financial liabilities that fall due in less than twelve months that are stated at their fair value and do not accrue explicit interest. They are accounted for at their nominal value. Those maturing in more than twelve months are considered non-current payables.

6.5. Financial derivatives and other financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative in designated as a hedging instrument, and if so, the nature of the asset being hedged.

For each hedging transaction, Gas Natural SDG, S.A. documents at the inception of the transaction and periodically, the relationship between hedging instruments and hedged items, as well as its risk management objective. Additionally, the aims of risk management and hedging strategies are periodically reviewed.

A hedge is considered to be highly effective when the changes in the fair value or the cash flows of the assets hedged are offset by the change in the fair value or cash flows of the hedging instrument, with an effectiveness ranging from 80% to 125%.

The market value of the different financial instruments is calculated using the following procedures:

– Derivatives listed on an official market are calculated on the basis of their year-end quotation.

– Derivatives that are not traded on official markets are calculated on the basis of the discounting of cash flows based on year end market conditions, based on market conditions as at Consolidated balance sheet date or, for some non-financial items, on best estimation on forward curves of said non-financial item.

Fair values obtained in absence of risk are adjusted by the expected impact of the risk of counterparty credit observable in positive valuation scenarios and the impact of own credit risk in observable negative valuation scenarios.

The embedded derivatives in other non-financial instruments are booked separately as derivatives only when their economic characteristics and tacit risks are not closely related to the instruments in which they are embedded and when the whole is not being booked at fair value through profit and loss.

For accounting purposes, the operations are classified as follows:

1. Derivatives eligible for hedge accountings

a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedges are recognised in the Income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

b) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the Income statement.

Amounts accumulated in equity are reclassified to the Income statement in the periods when the hedged item will affect profit or loss.

c) Hedges of net foreign investments

Fair value hedge accounting is applied to the differences arising from the exchange rates on loans in foreign currency for financing foreign investments in group and multi-group companies and associates made in the same functional currency.

2. Derivatives that do not qualify for hedge accounting

Certain derivative instruments do not qualify for hedge accounting. Such derivatives are classified as at fair value through profit or loss, and changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the Income statement.

3. Energy purchase and sale agreements

During the normal course of its business Gas Natural SDG, S.A. enters into energy purchase and sale agreements which in most cases include “take or pay” clauses, by virtue of which the buyer takes on the obligation to pay the value of the energy contracted independently of whether he receives it or not. These agreements are executed and maintained in order to meet the needs of receipt of physical delivery of energy projected by Gas Natural SDG, S.A. in accordance with the energy purchase and sale estimates made periodically, which are monitored systematically and adjusted as the case may be by physical delivery.

Consequently, these are negotiated contracts for “own use”, and, accordingly, lie beyond the standards on valuation of financial instruments.

6.6. Non-current assets held for sale and discontinued activities

Gas Natural SDG, S.A. classifies as held-for-sale assets those assets for which, at the year end, active initiatives have been initiated for their sale, which is estimated to take place within the next twelve months.

These assets are stated at the lower of their carrying value and fair value minus the costs necessary for their sale and are not subject to depreciation, since the date they are classified as non-current assets held for sale.

Additionally, Gas Natural SDG, S.A. treats components (cash-generating units or groups of CGUs) representing a business line or geographic area of operations that is significant and may be analysed separately from the rest, and has been sold or otherwise disposed of, or meets the conditions to be classed as held for sale, as discontinued operations. Entities acquired solely for resale are also classed as discontinued operations.

6.7. Share capital

Share capital is represented by ordinary shares.

Incremental costs directly attributable to the issue of new shares or options, net of taxes, are deducted from equity as a deduction from Reserves or share premium in the case of issues of capital with premiums.

Dividends on ordinary shares are recognised as a deduction from equity in the period they are approved.

Acquisitions of treasury shares are recorded at acquisition cost, deducted from equity until disposal. The gains and losses on disposal of treasury shares are recognised under "Reserves" in the Balance sheet.

6.8. Earnings per share

Basic earnings per share are calculated as a quotient between profit or loss for and the average weighted number of ordinary shares in circulation during this period excluding the average number of treasury stock held by Gas Natural SDG, S.A.

Diluted earnings per share are calculated as a quotient between profit or loss for attributable to the ordinary shareholders adjusted by the effect attributable to the potential ordinary shares having a dilutive effect and the average weighted number of ordinary shares in circulation during this period, adjusted by the average weighted number of ordinary shares that would be issued if all the potential ordinary shares were converted into ordinary shares of the Company. Accordingly, the conversion is considered to take place at the beginning of the period or at the time of issue of the potential ordinary shares, if these have been placed in circulation during the period itself.

6.9. Provisions for employee obligations

a) Post-employment pension obligations and the like

- Defined contribution plans

Gas Natural SDG, S.A., together with other group companies, is the promoter of a joint occupational pension plan, which is defined contribution plan for retirement and a defined benefit plan for the so-called risk contingencies, which are assured.

Additionally, there is a defined contribution plan for a group of executives, for which Gas Natural SDG, S.A. undertakes to make certain contributions to an insurance policy. Gas Natural SDG, S.A. guarantees this group a yield of 125% of the CPI of the contributions made to the insurance policy. All the risks have been transferred to the insurance company, since it insures the guarantee indicated above.

The contributions made have been recognised in “Staff costs” in the Income statement.

- Defined benefit plans

For certain groups of employees there are commitments for defined benefit schemes in relation to the payment of supplements on retirement, death and disability pensions, in accordance with the benefits agreed by the entity, which have been transferred out of the company in the form of single premium insurance policies under Royal Decree 1588/1999, 15 October, which adopted the Regulations on the instrumentation of pension commitments.

The liability recognised on the Balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the Balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial losses and gains arising from changes in actuarial assumptions or from differences between assumptions and reality are recognised entirely in the period in which they arise, directly in equity reserves.

Past service costs are recognised immediately in the Income statement, in "Staff costs".

b) Other post-employment benefit obligations

Gas Natural SDG, S.A. provides for post-employment benefits to their retirees. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment using an accounting methodology similar to that used for defined benefit pension plans. Actuarial gains and losses arising from changes in actuarial assumptions, are charged or credited to income in “Reserves”.

c) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. Gas Natural SDG, S.A. recognises a liability when current employees are laid off based on a detailed formal plan that cannot be withdrawn; or providing termination benefits. In the event that mutual agreement is required, the provision is only recorded in those situations in which Gas Natural SDG, S.A. has decided to give its consent to voluntary redundancies once they have been requested by the employees.

6.10. Provisions

Provisions are recognised when Gas Natural SDG, S.A. has a present legal or implicit obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the Company's best estimate of expenditure required to settle the present obligation at the Balance sheet date.

When it is expected that part of the disbursement needed to settle the provision is paid by a third party, the payment is recognised as a separate asset, provided that its receipt is practically assured.

In the contracts in which the obligations borne include inevitable costs greater than the economic profit expected to be received from them, the expenses and respective provisions are recognised in the amount of the current value of the existing difference.

6.11. Leases

a) Finance leases

Leases of property, plant and equipment where the lessee substantially bears all the risks and rewards of ownership are classified as finance leases.

These leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the lease payments, including the purchase option. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other long-term liabilities except for those falling due more than twelve months. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases are depreciated over the asset's useful life.

b) Operating leases

Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases.

Operating lease payments are charged to the income statement on a straight-line basis over the lease term.

6.12. Income tax

Corporate income tax expense includes the deferred tax expense and the current tax expense, which is the amount payable (or refundable) on the tax profit for the year.

Deferred taxes are recorded by comparing the temporary differences that arise between the taxable income on assets and liabilities and their respective accounting figures in the Annual accounts used the tax rates that are expected to be in force when the assets and liabilities are realized.

Deferred tax arising from direct charges or credits to equity accounts are also charged or credited to equity.

Deferred tax assets and tax credits are recognised only to the extent that it is probable that future taxable income will be available against which to offset temporary differences and apply tax credits.

When tax rates change, deferred tax assets and liabilities are reestimated. These amounts are charged or credited to losses or profits, or to reserves, depending on the account to which the original amount was charged or credited.

6.13. Revenue recognition and payments for regulated activities

a) General

Sales are recognised when products are delivered to the customer and have been accepted by the customer, even if they have not been invoiced, or if applicable, services are rendered, and it is probable that the economic benefits associated with the transaction will flow to the entity. Net turnover for the year includes the estimate of the energy supplied that has not yet been invoiced

The expenses are recognised on an accruals basis, immediately in the case of disbursements that are not going to generate future economic profits or when the requirements for recording them as assets are not met.

Sales are stated net of tax and discounts.

b) Income from the gas business

Note 2.1. describes the basic aspects of the applicable gas sector regulations.

c) Income from electricity activities

Note 2.2. describes the basic aspects of the applicable electricity sector regulations.

From 2006 to 2013, given that the income collected by the companies in the Spanish electricity industry has not been sufficient to remunerate the different activities and costs of the system, The companies themselves, including the Company, were forced to finance this income deficit until its definite funding. Following successive auctions and assignments of the outstanding debt claims, on 15 December 2014 the electricity system deficit securitisation process was completed.

Following the publication of Electricity Sector Law 24/2013, December 26 (Note 2.2), temporary mismatches between electricity system revenues and costs are funded by the companies subject to the settlement system, including Gas Natural Fenosa, generating the right to recover the relevant amount over the following five years, including interest at a market rate. Consequently, the financing for the electricity system revenue deficit is recognised as a financial asset since, on the basis of this regulation, Gas Natural Fenosa is entitled to a reimbursement and there are no future contingent factors. From 2014 to 2016, following the reforms undertaken, there has been no revenue shortfall in the sector, according to the provisional settlements of these years.

d) Other income and expenses

In accounting for revenues from the service provision agreements is used the percentage realisation method in which, when the income can be reliably estimated, it is recorded on the basis of the degree of progress in the completion of the contract at the year end, calculated as a proportion of the costs incurred at that date of the estimated costs required to fulfil the contract.

If the income from the contract cannot be estimated reliably, the costs (and respective income) are recorded in the period in which they are incurred, provided that the former can be recovered. The contract margin is not recorded until there is certainty of its materialisation, based on cost and income planning.

In the event that the total costs exceed the contract revenues, this loss is recognised immediately in the Income statement for the year.

Interest incomes and expenses are recognised using the effective interest method.

Dividend income is recognised when the right to collect the dividend is established.

The holding of shares in Group companies and associates is deemed to be the Company's most relevant ordinary activity from which periodic revenue is obtained. In accordance with the stance adopted by the Spanish Institute of Accounting and Auditing ("ICAC") in connection with the calculation of net revenue in holding companies (Reply number 2 in ICAC Official Gazette number 79), dividends from Group companies and associates, and interest received on loans granted to Group companies and associates, are recognised as “Revenue”. Additionally, the item “Impairment and results on disposal of equity instruments of Group companies and associates” is included in “Operating profit/(loss)”.

6.14. Foreign currency transactions

Foreign currency transactions are translated to euro using the exchange rates in force at the transaction dates. Gains and losses resulting from the settlement of these transactions and translation at the year-end exchange rates of monetary assets and liabilities denominated in foreign currency are recognised in the income statement.

6.15. Transactions between related parties

In general, transactions between related parties are recorded initially at their fair value. If the agreed price differs from its fair value, the difference is recorded taking into account the economic reality of the operation. The later valuation is made in accordance with the provisions of the respective legislation.

Notwithstanding the above, in merger, de-merger or non-cash contribution operations of a business, the assets that make up the acquired business are stated at the amount corresponding to the same once the operation takes place in the Consolidated Annual accounts of Gas Natural Fenosa.

In these cases, the difference that could arise between the net value of the assets and liabilities of the acquired company, adjusted by the balance of the groupings of grants, donations and bequests received, or any value adjustments or capital or share premiums, as the case may be, issued by the merging company, is recorded under “Reserves” in the balance sheet.

6.16. Business combinations

Business combinations are recorded using the acquisition method. The cost of an acquisition is calculated using the fair value of the assets given, the equity instruments issued and the liabilities incurred or borne on the transaction date plus the costs directly attributable to the acquisition. The valuation process required in order to use the acquisition method is completed within the period of one year as from the acquisition date.

The identifiable assets acquired and the liabilities or contingent liabilities incurred or borne as a result of the transaction, are initially stated at their fair value at the date of acquisition, provided that this can be reliably measured.

The surplus cost of the acquisition in relation to the fair value of the shareholding of Gas Natural SDG, S.A. in the net identifiable assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets acquired, the difference is recognised directly in the Income statement.

6.17. Cash flow statement

The cash flow statements has been prepared using the indirect method and contain the use of the following expressions and their respective meanings:

a) Operating activities: activities that constitute ordinary Gas Natural SDG, S.A. revenues, as well as other activities that cannot be qualified as investment or financing.

b) Investing activities: acquisition, sale or disposal band other means of assets in the long-term and other investments not included in cash and cash equivalents.

c) Financing activities: activities that generate changes in the size and composition of equity and liabilities that do not form part of operating activities.

6.18. Significant accounting estimates and judgments

The preparation of Annual accounts requires the formulation of estimates and judgments. The valuation standards that require a large number of estimates are set out below:

a) Intangible assets and Property, plant and equipment (Notes 6.1 and 6.2)

The determination of useful life of intangible assets and property, plant and equipment requires estimates of their degree of use, as well as expected technological evolution. The assumptions regarding the degree of use, technological framework and future development involve a significant degree of judgement, insofar as the timing and nature of future events are difficult to foresee.

b) Impairment of assets (Note 6.3)

The estimated recoverable value of the CGU applied to the impairment tests has been determined using the discounted cash flows based on the projections approved by Gas Natural SDG, S.A., which have historically been substantially met.

c) Derivatives or other financial instruments (Note 6.5)

The fair value of financial instruments traded in active markets is based on quoted market prices at the Balance sheet date. The quoted market price used for financial assets is the current bid price.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. Gas Natural SDG, S.A. uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using quoted forward exchange rates at the Balance sheet date. The fair value of commodity derivatives is calculated by using forward prices curves. The recoverable value of the investments in the equity of group and multi-group companies and associates is determined as the greater of their fair value less costs of sale and the current value of the cash flows from the investment.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to Gas Natural SDG, S.A. for similar financial instruments.

d) Provisions for employee benefits (Note 6.9)

A number of assumptions must be used to calculate pension costs, other costs of post-retirement benefits and other post-retirement liabilities. Gas Natural SDG, S.A. estimates at the year end the provision required to cover pension commitments and similar obligations, based on advice from independent actuaries. The changes affecting such assumptions may result in the recording of different amounts and liabilities. The most significant assumptions for the measurement of pension or post-retirement benefit liabilities are energy consumption by beneficiaries during retirement, retirement age, inflation and the discount rate employed. Social security coverage assumptions are also essential to determine other post-retirement benefits. Future changes to these assumptions will have an impact on future pension costs and liabilities.

e) Provisions (Note 6.10)

Gas Natural SDG, S.A. makes an estimate of the amounts to be settled in the future, including amounts relating to contractual obligations, outstanding litigation, restoration of land or other liabilities. These estimates are subject to the interpretation of current events and circumstances, projections of future events and estimates of their financial effects.

f) Income tax (Note 6.12)

The calculation of the income tax expense requires interpretations of tax legislation in the jurisdictions in which Gas Natural SDG, S.A. operates. The determination of expected outcomes of outstanding disputes and litigation requires the preparation of significant estimates and judgment. Gas Natural SDG, S.A. evaluates the recoverability of the deferred income tax assets based on estimates of future taxable income. The recoverability of the deferred tax assets depends ultimately on the capacity of Gas Natural SDG, S.A. to generate sufficient tax profits during the periods in which these deferred taxes are deductible. Deferred tax liabilities are recognised based on estimates of the net assets that will not be tax deductible in the future.

Note 7. Intangible assets

Set out below there is an analysis of movements in intangible assets:

	Computer software	Other intangible assets	Subtotal	Goodwill	Total
Cost	2	--	2	1,062	1,064
Accumulated amortisation	(2)	--	(2)	(462)	(464)
Net carrying value at a 01/01/2015	**--**	**--**	**--**	**600**	**600**
Amortisation charge	--	--	--	(81)	(81)
Demerger scope (Note 5)	--	--	--	(247)	(247)
Net carrying value at 31/12/2015	**--**	**--**	**--**	**272**	**272**
Cost	2	--	2	815	817
Accumulated amortisation	(2)	--	(2)	(543)	(545)
Net carrying value at a 01/01/2016	**--**	**--**	**--**	**272**	**272**
Investment	4	1	5	--	5
Amortisation charge	--	--	--	(82)	(82)
Net carrying value at 31/12/2016	**4**	**1**	**5**	**190**	**195**
Cost	6	1	7	815	822
Accumulated amortisation	(2)	--	(2)	(625)	(627)
Net carrying value at 31/12/2016	**4**	**1**	**5**	**190**	**195**

Goodwill derives from the vertical merger of Unión Fenosa, S.A. completed in 2009 and is attributable to the benefits and synergies arising from the integration with the Gas Natural Fenosa Group. In 2016, following changes in accounting legislation, this goodwill has started to be amortised, adjusting the comparative information (Note 4).

Intangible assets include, at 31 December 2016, fully amortised assets still in use totalling Euros 2 million (Euros 2 million at 31 December 2015).

Note 8. Property, plant and equipment

Set out below is an analysis showing movements in Property, plant and equipment during 2016 and 2015:

	Land and buildings	Plant and other property, plant and equipment	Property, plant and equipment Under construction	Total
Cost	237	2,316	5	2,558
Accumulated depreciation	(76)	(1,433)	--	(1,509)
Net carrying value at a 01/01/2015	**161**	**883**	**5**	**1,049**
Investment	15	2	--	17
Depreciation charge	(9)	(2)	--	(11)
Demerger scope (Note 5)	--	(871)	(5)	(876)
Net carrying value at 31/12/2015	**167**	**12**	**--**	**179**
Cost	248	34	--	282
Accumulated depreciation	(81)	(22)	--	(103)
Net carrying value at a 01/01/2016	**167**	**12**	**--**	**179**
Investment	12	3	--	15
Divestments	(23)	--	--	(23)
Depreciation charge	(10)	(2)	--	(12)
Reclassifications and transfers	(6)	--	--	(6)
Net carrying value at 31/12/2016	**140**	**13**	**--**	**153**
Cost	201	33	--	234
Accumulated depreciation	(61)	(20)	--	(81)
Net carrying value at 31/12/2016	**140**	**13**	**--**	**153**

At 1 January 2015, as indicated in Note 5, “Plant and other PPE” basically included nuclear power plants, which were transferred to Gas Natural Fenosa Generación, S.L.U. in the demerger operation.

In December 2016, Gas Natural SDG, S.A., General de Edificios y Solares, S.L. and Unión Fenosa Distribución S.A., 100% companies of Gas Natural Fenosa completed the sale of four properties in Madrid (Avenida San Luis 77, Antonio Lopez 193, A Canto 11-13 and Avenida América 38). For Gas Natural SDG, S.A., it has sold the Avenida América 38 building, for Euros 64 million and recognised a gain before income tax of Euros 36 million. Additionally, the company has signed 10-year operating lease contracts, without a purchase option, with the buyers of each of those properties, which are renewable, except for Avenida América 38, for five years more (Note 29). At the transaction date, the remaining useful life of all the sold properties was far higher than the maximum lease term.

In 2016 there have been disposals of fully-depreciated assets totalling Euros 7 million (Euros 14 million at 31 December 2015).

Property, plant and equipment include fully-depreciated assets still in use totalling Euros 16 million at 31 December 2016 (Euros 20 million in 2015).

It is Gas Natural SDG, S.A.'s policy to take out insurance where deemed necessary to cover risks that could affect its property, plant and equipment.

At 31 December 2016 and 31 December 2015, Gas Natural SDG, S.A. has no investment commitments.

Note 9. Investments in group companies and associates

A breakdown of the investments in group companies and associates is as follows:

	At 31.12.16	At 31.12.15
Equity instruments	13,688	14,613
Loans	15,755	14,695
Non-current	**29,443**	**29,308**
Loans	816	727
Other financial assets	67	3
Current	**883**	**730**
TOTAL	**30,326**	**30,038**

Movements during the year in non-current investments in group companies and associates are as follows:

	Shareholdings in group companies	Loans to group companies	Shareholdings in associates	Total
Balance at 01/01/2015	**13,833**	**13,935**	**11**	**27,779**
Additions	912	789	--	1,701
Divestments	(399)	(713)	--	(1,112)
Demerger scope (Note 5)	362	--	--	362
Reclassification	--	627	--	627
Charge/reversal provisions	(106)	--	--	(106)
Net exchange gains / losses	--	57	--	57
Balance at 31/12/2015	**14,602**	**14,695**	**11**	**29,308**
Additions	40	1,584	--	1,624
Divestments	(759)	(259)	--	(1,018)
Reclassification	--	(266)	--	(266)
Charge/reversal provisions	(206)	--	--	(206)
Net exchange gains / losses	--	1	--	1
Balance at 31/12/2016	**13,677**	**15,755**	**11**	**29,443**

Year 2016

The most significant movements in the item “Shareholdings in Group companies and associates” in 2016 relate to:

- Capital contribution to offset losses posted by the company Gas Natural Exploración, S.L. in the amount of Euros 30 million.

- Capital contribution to offset losses in Gas Natural S.U.R. SDG, S.A. in the amount of Euros 10 million.

- Capital reduction through the reimbursement of contributions from Clover Financial and Treasury Services, Ltd in the amount of USD 825 million. The reduction in the shareholding has generated a Euros 33 million profit due to the effect of the exchange rate.

- Sale of the 50% shareholding in Nueva Generadora del Sur, S.A. to Gas Natural Generación, S.L.U. at its carrying amount of Euros 1 million.

- Capital reduction in Natural Re, S.A. in the amount of Euros 4 million.

- The distributions of reserves by Global Power Generation, S.A.U. and Gasifica, S.A. amounting to Euros 64 million and Euros 1 million, respectively, has been recorded as a decrease in the carrying value of shareholdings.

- During the year Gasifica, S.A. was dissolved, leading to a reduction in the investment of Euros 3 million and a loss of Euros 2 million.

Year 2015

The most significant movements in the item “Shareholdings in Group companies and associates” in 2015 related to:

- Demerger of the nuclear power generation business, which was transferred in bloc to the company Gas Natural Fenosa Generación, S.L.U. in exchange for shares in the beneficiary company totalling Euros 362 million (Note 5).

- Spin-off of Nueva Generadora del Sur, S.A. (owned 50% by Gas Natural SDG, S.A. and 50% by Compañía Española de Petróleos, S.A. (CEPSA)) to Genroque, S.L. and Puente Mayorga Generación, S.L. in order to separate the two 400 MW units that formed the combined cycle plant operated by Nueva Generadora del Sur, S.A.

  Following the spin-off, the 50% stake in Puente Mayorga Generación, S.L. was sold to CEPSA and a 50% stake in Genroque, S.L. was purchased from CEPSA, so that each of Nueva Generadora del Sur, S.A.’s shareholders operated and managed each unit separately.

- Sale of the shareholding in the company Genroque, S.L.U. to Gas Natural Generación, S.L.U. for its carrying amount of Euros 200 million. On 30 December 2015, Gas Natural Fenosa Generación, S.L.U.’s Extraordinary General Meeting approved the vertical merger of Genroque, S.L.U. in order to fully integrate the unit into Gas Natural Fenosa's generation facilities.

- Capital reduction and reimbursement of contributions in Clover Financial and Treasury Services, Ltd. in the amount of Euros 175 million.

- Subscription for a capital increase in Nueva Generadora del Sur, S.A. in the amount of Euros 61 million.

- Gas Natural Fenosa and Kuwait Investment Authority (KIA) entered into an agreement for increase capital by USD 550 million, fully subscribed by KIA. Following this capital increase, KIA holds a 25% stake in the international generation subsidiary Global Power Generation, S.A.

  Additionally, Gas Natural SDG, S.A. fully subscribed a capital increase of USD 713 million (Euros 640 million) in Global Power Generation, S.A.

- Subscription for a capital increase in Natural Re, S.A. in the amount of Euros 4 million.

- Capital contribution to offset losses in Gas Natural S.U.R. SDG, S.A. in the amount of Euros 12 million.

The cumulative provision for the impairment of shareholdings in Group companies and associates totals Euros 1,487 million at 31 December 2016 (Euros 1,281 million at 2015), relating basically to the following companies:

- Gas Natural Exploración, S.L.: the recoverable amount has been calculated on the basis of its equity. In 2016 an impairment loss of Euros 21 million was posted. The provision at 31 December 2016 totals Euros 213 million (Euros 192 million at 31 December 2015).

- Unión Fenosa Gas, S.A.: At 31 December 2015 the fair value of Unión Fenosa Gas, S.A. was similar to its carrying value. Euros 86 million was provided for basically in relation to the change in the contribution to the consolidated figure of the shareholding in said company.

  In the previous years an impairment of the interest in Unión Fenosa Gas, S.A. amounting to Euros 1,002 million had been recognised basically due to the substantial failure of the Egyptian supplier to comply with the agreements to re-establish supplies of gas to the Damietta (Egypt) liquefaction plant and the variation of the contribution of this invested company to the consolidated group.

  In 2016 an impairment of Euros 174 million was recognised with respect to the interest in Unión Fenosa Gas, S.A. due to the need to update the assumptions concerning the supply cost in view of the forecast evolution of the energy scenario for Unión Fenosa Gas and the change in the contribution to the consolidated figures. In Note 6.3, the assumptions corresponding to the discount and growth rate are detailed. The other assumptions have not been altered. The provision at 31 December 2016 totals Euros 1,262 million (Euros 1,088 million at 31 December 2015).

Financial income for dividends received from investments in equity instruments of group companies and associates during the years 2016 and 2015, correspond to the following companies:

	2016	**2015**
Holding Negocios Regulados Gas Natural, S.A.	354	336
Gas Natural Comercializadora, S.A.	326	133
Gas Natural Aprovisionamientos SDG, S.A.	242	58
Unión Fenosa Distribución, S.A.	241	458
Sagane, S.A.	177	209
Gas Natural Servicios SDG, S.A.	62	80
Global Power Generation, S.A.U.	58	--
Clover Financial And Treasury Services, Ltd.	45	66
Unión Fenosa Preferentes, S.A.	29	42
Gas Natural Almacenamientos Andalucía, S.A.	8	--
Gas Natural Informática, S.A.	5	4
Gas Natural Fenosa Finance, B.V.	3	1
Gas Natural Fenosa Engineering, S.L.U.	3	--
General de Edificios y Solares, S.L.	2	5
Gasifica, S.A.	2	--
Gas Natural Capital Markets, S.A.	2	15
Unión Fenosa Minería, S.A.	1	1
Gas Natural Distribución Latinoamérica, S.A.	--	121
Unión Fenosa Gas, S.A.	--	13
TOTAL	**1,560**	**1,542**

Dividends pending collection at 31 December 2016 amounted to Euros 64 million, recorded under “Other current financial assets”.

The breakdown of shareholdings in group companies is set out below:

					% interest			Net equity				
Company	**Registered Office**	**Activity**	**Net carrying value 2016**	**Net carrying value 2015**	**Direct**	**Indirect**	**Total**	**Capital**	**Reserves (1)**	**Profit/(loss)**	**Interim dividend**	**Others (2)**
Gas Natural Aprovisionamientos SDG, S.A.	Spain	Gas commercialisation	18	18	100.0	--	100.0	1	19	32	--	14
Gas Natural Fenosa LNG, S.L.	Spain	Gas commercialisation	2	2	100.0	--	100.0	2	--	--	--	--
Sagane, S.A.	Spain	Gas commercialisation	42	42	100.0	--	100.0	95	22	145	--	5
Unión Fenosa Gas, S.A.	Spain	Gas commercialisation	1,179	1,353	50.0	--	50.0	33	655	15	--	52
Gas Natural Comercializadora, S.A.	Spain	Gas and electricity commercialisation	121	121	100.0	--	100.0	3	102	259	(125)	19
Gas Natural S.U.R. SDG, S.A.	Spain	Gas and electricity commercialisation	44	34	100.0	--	100.0	2	15	(14)	--	1
Gas Natural Servicios SDG, S.A.	Spain	Gas and electricity commercialisation	106	106	100.0	--	100.0	3	51	169	--	5
Unión Fenosa Distribución, S.A.	Spain	Electricity distribution	1,630	1,630	100.0	--	100.0	833	437	167	(159)	322
Gas Natural Fenosa Generación Nuclear, S.L.	Spain	Electricity generation	--	--	100.0	--	100.0	--	--	--	--	--
Gas Natural Fenosa Generación, S.L.U.	Spain	Electricity generation	3,897	3,897	100.0	--	100.0	552	1,652	(375)	--	4
Gas Natural Fenosa Renovables, S.L.U.	Spain	Electricity generation	397	397	100.0	--	100.0	90	105	9	--	--
Global Power Generation, S.A.U.	Spain	Electricity generation	1,556	1,608	75.0	--	75.0	20	1,877	(2)	--	143
Nueva Generadora del Sur, S.A.	Spain	Electricity generation	--	1	50.0	--	50.0	--	--	--	--	--
P.H. La Perla, S.A.	Costa Rica	Electricity generation	--	--	100.0	--	100.0	--	--	--	--	--
Toledo PV A.I.E.	Spain	Electricity generation	--	--	33.3	--	33.3	--	1	1	--	--
Gas Natural Almacenamientos Andalucía, S.A.	Spain	Gas infrastructures	8	8	100.0	--	100.0	--	9	1	--	--
Gas Natural Exploración, S.L.	Spain	Gas infrastructures	9	--	100.0	--	100.0	8	13	(1)	--	(11)
Petroleum Oil & Gas España, S.A.	Spain	Gas infrastructures	41	41	32.3	67.7	100.0	4	29	(8)	--	2
Natural Re, S.A.	Luxembourg	Insurance	9	9	100.0	--	100.0	4	57	8	--	--
Arte Contemporáneo y Energía, A.I.E.	Spain	Services	--	--	75.0	25.0	100.0	--	--	--	--	--
Compañía Española de Industrias Electroquímicas, S.A.	Spain	Services	4	4	98.5	--	98.5	3	12	1	--	--
General de Edificios y Solares, S.L.	Spain	Services	63	63	100.0	--	100.0	34	35	19	--	--
Clover Financial and Treasury Services, Ltd.	Ireland	Financial services	680	1,382	100.0	--	100.0	--	422	41	--	289
Gas Natural Capital Markets, S.A.	Spain	Financial services	--	--	100.0	--	100.0	--	--	8	--	--
Gas Natural Fenosa Finance, B.V.	Netherlands	Financial services	7	7	100.0	--	100.0	--	2	1	--	(1)
Unión Fenosa Financiación, S.A.	Spain	Financial services	11	11	100.0	--	100.0	1	--	--	--	--
Unión Fenosa Preferentes, S.A.U.	Spain	Financial services	--	--	100.0	--	100.0	--	1	2	(2)	110
Gas Natural Informática, S.A.	Spain	IT services	20	20	100.0	--	100.0	20	9	(1)	--	--
Gas Natural Fenosa Engineering, S.L.	Spain	Engineering services	24	24	100.0	--	100.0	--	19	1	--	--
Holding Negocios Regulados Gas Natural, S.A.	Spain	Holding company	1,981	1,981	100.0	--	100.0	300	1,682	341	(325)	--
Gas Natural Distribución Latinoamérica, S.A.	Spain	Holding company	558	558	100.0	--	100.0	402	221	91	--	--
Gasifica, S.A.	Spain	Holding company	--	3	10.0	45.0	55.0	--	--	--	--	--
La Energía, S.A.	Spain	Holding company	11	11	100.0	--	100.0	11	5	--	--	--
La Propagadora del Gas, S.A.	Spain	Holding company	10	10	100.0	--	100.0	10	1	--	--	--
Gas Natural Fenosa Internacional, S.A.	Spain	Holding company	944	945	100.0	--	100.0	250	464	(116)	--	140
Unión Fenosa Minería, S.A.	Spain	Holding company	305	316	100.0	--	100.0	11	169	--	--	--
TOTAL			**13,677**	**14,602**								

Appendix I to Gas Natural Fenosa's consolidated annual accounts provides a breakdown of other indirect shareholdings.
The Capital, Reserves, Profit/(loss) and the rest of the Net equity information is shown at a societary level.
(1) Includes the share premium, reserves, prior-year losses and retained earnings.
(2) Includes measurement adjustments, other equity instruments and grants, donations and bequests.

The non-current loans to group companies which at 31 December 2016 total Euros 15,755 million mature in 2018 (at 31 December 2015, Euros 14,695 million maturing in 2017).

Set out below are movements during 2016 and 2015 in loans and other current financial assets:

	Loans to group companies	Other financial assets	Total
Balance at 01/01/2015	**1,079**	**3**	**1,082**
Additions	1,282	--	**1,282**
Divestments	(448)	--	**(448)**
Reclassifications	(1,186)	--	**(1,186)**
Balance at 31/12/2015	**727**	**3**	**730**
Additions	424	64	**488**
Divestments	(673)	--	**(673)**
Reclassifications	338	--	**338**
Balance at 31/12/2016	**816**	**67**	**883**

There are no significant differences between carrying values and fair values in the balances under Loans to group companies and other receivables.

The item “Loans to Group companies” relates to the cash pooling balances with investees, as manager of the Group centralised cash. It also includes accrued unmatured interest of Euros 32 million (Euros 31 million in 2015).

At 31 December 2016, loans to Group companies and associates have borne interest at a rate of 2.54% (2.89% in 2015) in the case of non-current amounts, and 1% (1.03% in 2015) in the case of current amounts.

Note 10. Investments

The breakdown of investments by category is as follows:

A 31 December 2016	Available-for-sale financial assets	Loans and receivables	Assets at fair value through P&L	Hedging derivatives	Total
Equity instruments	5	--	--	--	**5**
Derivatives (Note 16)	--	--	31	28	**59**
Other financial assets	--	10	--	--	**10**
Non-current investments	**5**	**10**	**31**	**28**	**74**
Other financial assets	--	27	--	--	27
Current investments	**--**	**27**	**--**	**--**	**27**
Total	**5**	**37**	**31**	**28**	**101**

At 31 December 2015	Available-for-sale financial assets	Loans and receivables	Assets at fair value through P&L	Hedging derivatives	Total
Equity instruments	5	--	--	--	**5**
Derivatives (Note 17)	--	--	1	--	**1**
Other financial assets	--	9	--	--	**9**
Non-current investments	**5**	**9**	**1**	**--**	**15**
Other financial assets	--	63	--	--	63
Current investments	**--**	**63**	**--**	**--**	**63**
Total	**5**	**72**	**1**	**--**	**78**

Available-for-sale financial assets

The main variations in available-for-sale financial assets are as follows:

	2016	2015
At 1 January	**5**	**7**
Demerger scope (Note 5)	--	(2)
At 31 December	**5**	**5**

All available-for-sale financial assets relate to unlisted shareholdings at 31 December 2016 and 31 December 2015.

Loans and receivables

The breakdown of Loans and other receivables is as follows:

	At 31.12.16	At 31.12.15
Loans to companies	2	2
Deposits and guarantee deposits	8	7
Non-current	**10**	**9**
Deposits and guarantee deposits	27	63
Current	**27**	**63**
Total	**37**	**72**

Note 11. Trade and other receivables

The breakdown of this account is as follows:

	At 31.12.16	At 31.12.15
Trade receivables	169	116
Trade receivables, group companies and associates	368	400
Sundry receivables	77	11
Provision	(24)	(21)
Derivatives (Note 16)	76	181
Current income tax asset	--	10
Public Administration	4	4
Total	**670**	**701**

In general, amounts billed pending collection do not bear interest, being the average maturity period less than 19 days.

Movements in the bad debt provision are as follows:

	2016	2015
At 1 January	**(21)**	**(13)**
Net charge for the year (Note 23)	(5)	(8)
Other	2	--
At 31 December	**(24)**	**(21)**

Note 12. Cash and cash equivalents

Cash and cash equivalents include:

	At 31.12.16	At 31.12.15
Cash at banks and in hand	502	1,089
Other cash equivalents	--	155
Total	**502**	**1,244**

Investments in “Other Cash equivalents” in 2015 matured in less than three months at a weighted effective interest rate of 0.41%.

Note 13. Net equity

The main items of Net equity are as follows:

Share capital and share premium

The variations during the years 2016 and 2015 in the number of shares and share capital and share premium accounts have been as follows:

	Number of shares	Share capital	Share premium	Total
At 1 January 2015	**1,000,689,341**	**1,001**	**3,808**	**4,809**
Changes	--	--	--	--
A 31 December 2015	**1,000,689,341**	**1,001**	**3,808**	**4,809**
Changes	--	--	--	--
At 31 December 2016	**1,000,689,341**	**1,001**	**3,808**	**4,809**

All issued shares are fully paid up and carry equal voting and dividend rights.

The Spanish Companies Act specifically allows the use of the “Share premium balance” to increase capital and imposes no specific restrictions on its use.

The most representative holdings in the share capital of Gas Natural SDG, S.A. at 31 December 2016 and 31 December 2015, in accordance with the public information available or the communication issued by the Company itself, are as follows:

	Interest in share capital %	
	2016	**2015**
- Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona,“la Caixa”(1)	24.4	34.4
- Repsol, S.A.	20.1	30.0
- Global Infrastructure Partners III (2)	20.0	-
- Sonatrach	4.0	4.0

(1) Through Criteria Caixa, S.A.U. and Caixabank, S.A. In 2015 additionally thorugh Vida Caixa, S.A. de Seguros y Reaseguros.

(2) Global Infrastructure Partners III, whose investment manager is Global Infrastructure Management LLC, owns its stake indirectly through GIP III Canary 1, S.à.r.l.

On 21 September 2016 the shareholders of Gas Natural Fenosa, Criteria Caixa, S.A.U. (la Caixa) and Repsol, S.A. (Repsol) reported the sale to GIP III Canary 1, S.à.r.l. (GIP) of shares representing 20% (10% Criteria and 10% Repsol) of the capital of Gas Natural SDG, S.A. in accordance with the sale and purchase agreement concluded on 12 September 2016. As a result of this sale, the agreement between ‘‘la Caixa” and Repsol concerning Gas Natural of 11 January 2000, amended on 16 May 2002, 16 December 2002 and 20 June 2003, has been terminated and the composition of the Board of Directors and Board committees of Gas Natural Fenosa has changed; in addition, the Regulations of its Board of Directors envisages a majority of two thirds of Board members for the approval of certain reserved matters.

All the shares of Gas Natural SDG, S.A. are traded on the four official Spanish Stock Exchanges and the “Mercado continuo” and form part of Spain’s Ibex 35 stock index.

The share price at 31 December 2016 of Gas Natural SDG, S.A. was Euros 17.91 (Euros 18.82 at 31 December 2015).

Reserves

Reserves include the following:

	2016	**2015**
Legal reserve	200	200
Statutory reserve	100	100
RD 7/96 revaluation reserve	225	225
Goodwill reserve	496	496
Voluntary reserves	6,603	6,580
Other reserves	274	272
	7,898	**7,873**

Legal reserve

Appropriations to the legal reserve are made in compliance with the Spanish Capital Companies Act, which stipulates that 10% of the profits must be transferred to this reserve until it represents at least 20% of share capital. The legal reserve can be used to increase capital in the part that exceeds 10% of the capital increased.

Except for the use mentioned above, and as long as it does not exceed 20% of share capital, the legal reserve can only be used to offset losses in the event of no other reserves being available.

Statutory reserve

Under the articles of association of Gas Natural SDG, S.A., 2% of net profit for the year must be allocated to the statutory reserves until it reaches at least 10% of share capital.

Revaluation reserve

The revaluation reserve can be used to offset accounting losses, increase share capital, or can be allocated to freely distributable reserves, provided that that the monetary gain has been realised. The part of the gain that will be considered realised is the part relating to the amortisation recorded or when the revaluated assets have been transferred or written off the books of account.

Goodwill reserve

Law 22/2015 on Auditing has eliminated the requirement to record annually the restricted reserve for at least 5% of the goodwill figuring under assets on the balance sheet, stipulating that in periods starting as from 1 January 2016, the goodwill reserve is to be reclassified to voluntary reserves and will be available in the amount that exceeds the goodwill recognised under assets on the balance sheet.

The amortisation reserve at 1 January 2015 has been used in the calculation of accumulated goodwill amortisation at that date (Note 4).

Voluntary and other reserves

It relates basically to voluntary reserves for undistributed profits, also including the effects of the measurement of shareholdings in group companies as a result of transactions between group companies recognised in the same amounts stated in Gas Natural Fenosa's Consolidated annual accounts.

Treasury shares

Movements during 2016 and 2015 involving the treasury shares of Gas Natural SDG, S.A. are as follows:

	Number of shares	In million euro	% Capital
At 1 January 2015	-	-	-
Acquisitions	2,899,180	58	0.3%
Disposals	(2,899,180)	(58)	(0.3%)
At 31 December 2015	**-**	**-**	**-**
Acquisitions	3,049,189	53	0.3%
Disposals	(2,298,644)	(40)	(0.2%)
At 31 December 2016	**750,545**	**13**	**0.1%**

On 14 May 2015, the shareholders in General Meeting authorised the Board of Directors to purchase, within five years, in one or more operations, a maximum of 10% of share capital or the maximum figure applicable under legislation prevailing at the time of acquisition. The relevant Company shares must be fully paid in and the nominal value of the shares directly or indirectly acquired, added to those already held by the Company and its subsidiaries, may not exceed 10% of share capital or any other limit established by law.

The minimum and maximum acquisition price will be the share price on the continuous market of the Spanish stock exchanges, within an upper or lower fluctuation of 5%.

In 2016, gains made on transactions involving treasury shares by Gas Natural Fenosa has been Euros 0.4 million, which was recorded in “Other reserves” (Euros 2 million, in 2015).

Earnings per share

Basic earnings per share are calculated by dividing profit by the weighted average number of ordinary shares in issue during the year.

	At 31.12.16	At 31.12.15
Profit for the year	1,067	1,024
Weighted average number of ordinary shares in issue	1,001,468,342	1.001.689.341
Earnings per share (in Euros):		
- Basic	1.07	1.02
- Diluted	1.07	1.02

The weighted average number of ordinary shares in issue used to calculate the Earnings per share of 2016 is as follows:

	2016
Weighted average number of ordinary shares	1,001,689,341
Weighted average number of treasury shares	(220,999)
Weighted average number of ordinary shares in issue	1,001,468,342

The Company has no financial instruments that could dilute the earnings per share.

Dividends

Set out below is a breakdown of the payments of dividends made in 2016 and 2015:

	2016			2015		
	% of Nominal	**Euros per share**	**Amount**	**% of Nominal**	**Euros per share**	**Amount**
Ordinary shares	133%	1.33	1,331	91%	0.91	909
Other shares (without voting rights, redeemable, etc.)	**-**	**-**	**-**	**-**	**-**	**-**
Total dividends paid	**133%**	**1.33**	**1,331**	**91%**	**0.91**	**909**
a) Dividends charged to income statement	133%	1.33	1,331	91%	0.91	909
b) Dividends charged to reserves or share premium account	-	-	-	-	-	-
c) Dividends-in-kind	-	-	-	-	-	-

Year 2016

Includes the payment of an interim dividend of Euros 0.4078 per share out of 2015 profits, for a total amount of Euros 408 million, agreed on 30 October 2015 and paid on 8 January 2016.

The proposal for the distribution of 2015 profits approved by the Annual General Meeting held on 4 May 2016 included the payment of a supplementary dividend of Euros 0.5922 per share, for a total amount of Euros 593 million, paid on 30 June 2016.

On 30 October 2016, the Board of Directors of Gas Natural SDG, S.A. resolved to pay an interim dividend of Euros 0.330 per share out of 2016 results, for a total of Euros 330 million, which was paid on 27 September 2016.

The Company had sufficient liquidity to pay out the dividend at the approval date, with the necessary liquidity to proceed to payment pursuant to the Spanish Companies Act. The provisional liquidity statement drawn up by the Directors on 22 July 2016 as follows:

Profit/(loss) after tax		721
Reserves to be recognised		--
Maximum amount distributable		721
Forecast interim dividend payment		330
Cash resources	1,434	
Undrawn credit facilities	6,906	
Total liquidity		8,340

On 7 February 2017, the Board of Directors approved the following proposal for the distribution of Gas Natural SDG, S.A.'s net profit for 2016, for submission to the Annual General Meeting:

Available for distribution	
Profit/(loss)	1,067
Distribution	
To Voluntary reserve	66
To Dividend	1,001

This proposal for the distribution of profits prepared by the Board for approval by the Annual General Meeting includes the payment of a supplementary dividend of Euros 0.67 per qualifying share outstanding on the proposed payment date, 27 June 2017.

The economic rights inherent to treasury shares, with the exception of the right to free allocation of new shares, will be allocated proportionally to the rest of the shares.

Year 2015

Includes the payment of an interim dividend of Euros 0.397 per share out of 2014 profits, for a total amount of Euros 397 million, agreed on 28 November 2014 and paid out on 8 January 2015.

The proposal for the distribution of 2014 profits approved by the Annual General Meeting held on 14 May 2015 included the payment of a supplementary dividend of Euros 0.511 per share, for a total amount of Euros 512 million, paid on 1 July 2015.

Grants

Movements in capital grants during 2015 were as follows:

	Capital grants
At 1.01.2015	**3**
Demerger scope (Note 5)	(3)
At 31.12.2015	**--**

Movements in the above table are shown net of taxes.

Note 14. Provisions

The breakdown of provisions at 31 December 2016 and 2015 is as follows:

	At 31.12.16	At 31.12.15
Provisions for employee obligations	285	283
Other provisions	182	198
Non-current provisions	**467**	**481**

Provisions for employee obligations

A breakdown of the provisions related to employee obligations is as follows:

	2016			2015		
	Pensions and other similar obligations	Other obligations with personnel	Total	Pensions and other similar obligations	Other obligations with personnel	Total
At 1 January	**274**	**9**	**283**	**280**	**9**	**289**
Contributions charged to profits	8	7	15	8	9	17
Payments during the year	(10)	--	(10)	(15)	--	(15)
Changes recognised directly in equity	(4)	--	(4)	(4)	--	(4)
Demerger scope (Note 5)	--	--	--	(1)	--	(1)
Transfers and other applications	7	(6)	1	6	(9)	(3)
At 31 December	**275**	**10**	**285**	**274**	**9**	**283**

Pensions and other similar liabilities

Most of the post-employment obligations of Gas Natural SDG, S.A. consist of the contribution of defined amounts to occupational pension plan systems. Nevertheless, at 31 December 2016 and 31 December 2015, Gas Natural SDG, S.A. held the following defined benefit obligations for certain groups of workers:

- Pensions to retired workers, the disabled, widows, orphans and other related groups.
- Defined benefit supplement obligations with retired personnel of the legacy Unión Fenosa group who retired before November 2002 and a residual part of current personnel.
- Coverage of retirement and death for certain employees.
- Gas subsidy for current and retired personnel.
- Electricity for current and retired personnel.
- Obligations with employees that took early retirement until they reach official retirement age and early retirement plans.
- Salary supplements and contributions to social security for a group of employees taking early retirement until they can access ordinary retirement.
- Health care and other benefits.

The amounts recognised in the Balance sheet for pensions and similar obligations, as well as the movement in the current value of the obligations and the fair value of the plan assets are determined as follows:

Present value of obligations	**2016**	**2015**
At 1 January	1,057	1,112
Service cost for the year	2	2
Interest cost	20	21
Changes recognised directly in equity	65	(13)
Benefits paid	(71)	(73)
Transfers and other	7	8
At 31 December	**1,080**	**1,057**

Fair value of plan assets		
At 1 January	783	832
Expected yield	14	15
Contributions	(2)	1
Changes recognised directly in equity	69	(9)
Benefits paid	(59)	(59)
Transfers and other	--	3
At 31 December	**805**	**783**
Provisions for pensions and similar obligations	**275**	**274**

The amounts recognised in the income statement for all the above-mentioned defined benefit plans are as follows:

	2016	**2015**
Service cost for the year	2	2
Interest cost	20	21
Expected return on plan assets	(14)	(15)
Total charge to the income statement	**8**	**8**

Benefits to be paid in the coming years for the above-mentioned commitments are as follows:

	2016	2015
1 to 5 years	2	4
5 to 10 years	37	30
More than 10 years	236	240
Provisions for pensions and similar obligations	**275**	**274**

The plan assets expressed as a percentage of the total fair value of the assets are as follows:

% of total	2016	2015
Bonds	100%	100 %

Cumulative actuarial gains and losses, net of the tax effect, recognised directly in equity are negative in the amount of Euros 3 million in 2016 (negative in the amount of Euros 6 million in 2015).

The change recognised in equity relates to actuarial losses and gains derived basically from adjustments to:

	2016	2015
Financial assumptions	22	7
Experience	(26)	(11)
Limits on assets	--	--
At 31 December	**(4)**	**(4)**

Actuarial assumptions applied are as follows:

	At 31.12.16	At 31.12.15
Discount rate (p.a.)	0.0 a 1.8%	0.2 a 2.6%
Expected return on plan assets (p.a.)	0.0 a 1.8%	0.2 a 2.6%
Future salary increases (p.a.)	2.0%	2.0%
Future pension increases (p.a.)	2.0%	2.0%
Inflation rate (annual)	2.0%	2.0%
Mortality table	PERMF 2000	PERMF 2000
Life expectancy:		
Men		
Retired during the year	22.5	22.5
Retiring within 20 years	42.5	42.5
Women		
Retired during the year	27	27
Retiring within 20 years	48.4	48.4

These assumptions are applicable to all the obligations homogeneously irrespective of the origin of their collective bargaining agreements.

The interest rates used to discount post-employment commitments are applied based on the period of each commitment and the reference curve is calculated applying observable rates for high-credit-quality corporate bonds (AA) issued in the Eurozone.

The costs of health care have been measured on the basis of the expected costs of the premiums of the different medical care policies taken out. A 1% variation in the increase in the cost of these premiums would not have a significant impact on the liability booked at 31 December 2016 and 31 December 2015, nor would it cause a relevant variation in the normal and financial costs for future years in relation to those booked in 2016 and 2015.

Other obligations with personnel

The Company operates a variable multi-annual remuneration system aimed at strengthening the commitment of the management to achieving the economic objectives of the group directly related to those established in the current Strategic Plans, approved by the Board of Directors and communicated to the financial markets and the achievement of which, along with their permanence in the group, grants the right to receive a variable remuneration in cash in the first quarter of the year after their termination.

At 31 December 2016, there is a provision for the 2014-2016, 2015-2017 and 2016-2018 remuneration programmes totalling Euros 19 million (Euros 18 million at 31 December 2015), Euros 9 million of which are classed as non-current in 2016 (Euros 9 million 2015).

Other non-current provisions

The movement in other non-current provisions is as follows:

	2016	**2015**
	Non-current provisions	**Non-current provisions**
At 1 January	**198**	**328**
– Appropiations (1)	1	15
– Reversals	(10)	(2)
Payments	(7)	(17)
Transfers and others	--	20
Demerger scope (Note 5)	--	(146)
At 31 December	**182**	**198**

(1) Includes Euros 1 million and Euros 2 million in 2016 and 2015, respectively, relating to the financial update of provisions.

"Non-current provisions" mainly includes provisions posted to cover obligations deriving mainly from tax claims (Note 19), litigation and arbitration, and other liabilities.

No provision for onerous contracts was deemed necessary at 31 December 2016 or 2015.

At 31 December 2016, the estimated payment dates for these obligations are between one and five years (Euros 7 million), between five and 10 years (Euros 0 million) and more than 10 years (Euros 175 million) (2015: Euros 9 million at between one and five years, Euros 0 million at between five and 10 years and Euros 189 million at more than 10 years).

Note 15. Borrowings

The breakdown of borrowings at 31 December 2016 and 2015 is as follows:

	At 31.12.16	At 31.12.15
Borrowings from financial institutions	3,190	2,983
Derivatives (Note 16)	93	161
Other financial liabilities	17	15
Non-current borrowings	**3,300**	**3,159**
Borrowings from financial institutions	270	187
Derivatives (Note 16)	15	14
Other financial liabilities	12	420
Current borrowings	**297**	**621**
Total	**3,597**	**3,780**

The carrying amounts and fair value of the non-current borrowings are as follows:

	Carrying amount		Fair value	
	At 31.12.16	At 31.12.15	At 31.12.16	At 31.12.15
Borrowings from financial institutions and other financial liabilities	3,300	3,159	3,301	3,164

The fair value of loans with fixed interest rates is estimated on the basis of the discounted cash flows over the remaining terms of such debt. The discount rates were determined based on market rates available at 31 December 2016 and 31 December 2015 on borrowings with similar credit and maturity characteristics.

The movement in borrowings is as follows:

	2016	2015
At 1 January	**3,780**	**4,521**
Demerger scope (Note 5)	--	(12)
Increase	859	845
Decrease	(1,042)	(1,574)
At 31 December	**3,597**	**3,780**

The following tables describe borrowings and maturities at 31 December 2016 and 2015, taking into account the impact of derivative hedges.

	2017	2018	2019	2020	2021	2022 and beyond	Total
At 31 December 2016:							
Fixed	156	232	630	127	84	92	1,321
Floating	141	192	500	348	471	624	2,276
Total	**297**	**424**	**1,130**	**475**	**555**	**716**	**3,597**

	2016	2017	2018	2019	2020	2021 and beyond	Total
At 31 December 2015:							
Fixed	579	365	191	588	177	255	2,155
Floating	42	79	196	720	400	188	1,625
Total	**621**	**444**	**387**	**1,308**	**577**	**443**	**3,780**

Setting aside the impact of derivatives on borrowings, fixed-rate debt would amount to Euros 104 million of total borrowings at 31 December 2016 (Euros 630 million at 31 December 2015); variable-rate debt would amount to Euros 3,385 million at 31 December 2016 (Euros 2,975 million at 31 December 2015).

The following tables describe the gross borrowings denominated in foreign currencies at 31 December 2016 and at 31 December 2015 and their maturities, taking into account the impact of the derivative hedges:

	2017	2018	2019	2020	2021	2022 and beyond	Total
At 31 December 2016:							
Euro debt	264	409	705	475	555	716	3,124
USD debt	33	15	425	--	--	--	473
Total	**297**	**424**	**1,130**	**475**	**555**	**716**	**3,597**

	2016	2017	2018	2019	2020	2021 and beyond	Total
At 31 December 2015:							
Euro debt	589	413	373	896	577	443	3,291
USD debt	32	31	14	412	--	--	489
Total	**621**	**444**	**387**	**1,308**	**577**	**443**	**3,780**

Borrowings bore an average effective interest rate in 2016 of 1.53% (2.02% in 2015) including the derivatives assigned to each transaction.

At 31 December 2016, Euros 6 million in interest pending payment are included (Euros 7 million at 31 December 2015).

Set out below are the most relevant financial instruments:

Bank borrowings

Bank borrowings include other bilateral bank loans of Euros 1,537 million at 31 December 2016 (Euros 1,670 million at 31 December 2015), no amounts having been drawn down on credit lines.

These payables include bank borrowings totalling Euros 1,169 million (Euros 625 million at 31 December 2015) that are subject to the fulfilment of certain covenants.

At the preparation date of these Annual accounts, Gas Natural SDG, S.A. is not in breach of its financial obligations or of any type of obligation that could give rise to the early maturity of its financial commitments.

Institutional financing

The Company records balances payable to the Official Credit Institute (ICO) relating to instruments maturing in 2018 at maximum, for a total amount of Euros 112 million (Euros 185 million in 2015).

Additionally, financing granted by the European Investment Bank (EIB) to Gas Natural SDG, S.A. has been drawn down in the amount of Euros 1,811 million, the sum of Euros 300 million being drawable on a financing line granted but not utilised (Euros 1,315 million and Euros 133 million drawable in 2015).

Note 16. Risk management and derivative financial instruments

Risk management

Gas Natural Fenosa has a series of standards, procedures and systems for identifying, measuring and managing different types of risk which are made up of the following basic action principles:

- Guaranteeing that the most relevant risks are correctly identified, evaluated and managed.
- Segregation at the operating level of the risk management functions.
- Assuring that the level of risk exposure of Gas Natural Fenosa in its business is in line with the objective risk profile and achievement of its annual, strategic objectives.
- Ensuring the appropriate determination and review of the risk profile by the Risk Committee, proposing global limits by risk category, and assigning them to the Business Units.

On 23 June 2016, the United Kingdom voted to withdraw from the European Union ("Brexit"). Although the UK's withdrawal will be accompanied by a process of negotiation over a period of time that cannot be determined as yet, the decision has already had consequences in the capital and foreign exchange markets. Gas Natural Fenosa's exposure to Brexit risk is practically non-existent.

Interest rate risk

The fluctuations in interest rates modify the fair value of the assets and liabilities that accrue a fixed interest rate and the cash flows from assets and liabilities pegged to a floating interest rate, and, accordingly, affect equity and profit, respectively.

The purpose of interest rate risk management is to balance floating and fixed borrowings in order to reduce borrowing costs within the established risk parameters.

Gas Natural SDG, S.A. employs financial swaps to manage exposure to interest rate fluctuations, swapping floating rates to fixed rates.

The financial debt structure at 31 December 2016 and 2015 (Note 15), after taking into account the hedges arranged through derivatives, is as follows:

	At 31.12.16	**At 31.12.15**
Fixed interest rate	1,321	2,155
Floating interest rate	2,276	1,625
Total	**3,597**	**3,780**

The floating interest rate is mainly subject to the fluctuations of the Euribor and the Libor.

The sensitivity of results and equity (measurement adjustments) to interest rate fluctuations is as follows:

	Increase/decrease in interest rates (basis points)	Effect on profit before tax	Effect on equity before tax
2016	+50	(11)	80
	-50	11	(80)
2015	+50	(8)	10
	-50	8	(10)

Exchange rate risk

The variations in the exchange rates can affect the fair value of:

- Counter value of cash flows related to the purchase-sale of raw materials denominated in currencies other than local or functional currencies.
- Debt denominated in currencies other than local or functional currencies.
- Operations and investments in non-Euro currencies, and, accordingly, the counter value of equity contributed and results.

In order to mitigate these risks Gas Natural SDG, S.A. finances, to the extent possible, its investments in local currency. Furthermore, it tries to match, whenever possible, costs and revenues indexed in the same currency, as well as amounts and maturities of assets and liabilities arising from operations denominated in non-Euro currencies.

For open positions, the risks in investments in non-functional currencies are managed through financial swaps and foreign exchange fluctuation insurance when its marginal contribution to the risk is relevant and can exceed the risk limits established.

The non-Euro currency with which Gas Natural SDG, S.A. operates the most is the US Dollar. The sensitivity of results and equity ("Adjustments for changes in value") of the Society to a 5% variation (increase or decrease) in the US Dollar / Euro exchange rate is as follows:

		2016	**2015**
Effect on profit before tax	+5%	--	(1)
	- 5%	--	1
Effect on equity before tax	+5%	--	--
	- 5%	--	--

Commodity price risk

A portion of operating expenses of Gas Natural SDG, S.A. are linked to the purchase of gas for supplies for other group companies. Therefore, Gas Natural SDG, S.A. is exposed to the variation in commodity prices whose determination is basically subject to crude oil prices and those of its by-products.

The exposure to these risks is managed and mitigated through the monitoring of its position regarding these commodities, trying to balance purchase and supply obligations and diversification and management of supply contracts. When it is not possible to achieve a natural hedge the position is managed, within reasonable risk parameters, through derivatives to reduce exposure to price risk, generally through hedging instruments.

In electricity and CO_2 emission allowances trading by the Company, risk is insignificant due to the low volume of transactions and the established limits placed, both on the amount and maturity date.

The sensitivity of results and equity (measurement adjustments) to changes in the fair value of derivatives contracted to hedge commodity prices and for trading purposes is analysed below:

	Increase / decrease in the electricity sale price	Effect on profit before tax	Effect on equity before tax
2016	+10%	--	--
	-10%	--	--
2015	+10%	1	--
	-10%	(1)	--

As regards exposure to low commodity prices, Gas Natural Fenosa has no relevant investments in upstream businesses or commodities production, so that fluctuations in commodity prices have no significant impact on asset values.

Sensitivity to the prices of oil, gas, coal and electricity is explained below:

- Gas and electricity distribution. It is a regulated activity with revenue and profit margins linked to distribution infrastructure management services rendered, irrespective of the prices of the commodities distributed. In any event, a fall in the price of gas could increase consumption, having a favourable impact on revenue and thus contributing to the stability of Gas Natural Fenosa's results.

- Gas and electricity. Profit margins on gas and electricity supply activities are directly affected by commodity prices. In this regard, Gas Natural Fenosa has a risk policy that stipulates the tolerance range, based on applicable risk limits, among other aspects. Measures employed to keep risk within the stipulated limits include active supply management, balanced acquisitions and sales formulas, and specific hedging so as to maximise the risk-profit relationship.

Credit risk

The credit risk arising from the default of a counterparty is controlled through policies that assure that wholesale sales of products are made to customers with an appropriate credit history, for which the respective solvency studies are established and based on which respective credit limits are assigned.

Various credit quality measurement models have been designed. Based on these models, the probability of customer default on payment can be measured, and the expected commercial loss can be kept under control.

The main guarantees negotiated are bank guarantees, guarantees and deposits.

Furthermore, the outstanding trade receivables are stated on the balance sheet net of provisions for bad debts (Note 11), estimated by Gas Natural SDG, S.A. based on the age of the debt and the experience of previous years in line with the prior segregation of customer portfolios and the current economic environment.

At 31 December 2016 and 2015 Gas Natural SDG, S.A. does not have significant concentrations of credit risk.

In order to mitigate credit risk in financial positions, derivatives have been contracted and cash surpluses are placed in banks and financial institutions that are highly solvent according to credit ratings by Moody's and S&P.

Likewise, most of the accounts receivable not due nor provided for, have a high credit rating according to the valuations of Gas Natural SDG, S.A. based on an analysis of the solvency and payment habits of each customer.

The ageing analysis of financial assets concluded that there were no unimpaired, past due financial assets at 31 December 2016 and 2015.

The impaired financial assets are broken down in Note 11.

Liquidity risk

Gas Natural SDG, S.A. has liquidity policies that ensure compliance with its payment commitments, diversifying the coverage of financing needs and debt maturities. A prudent management of the liquidity risk includes maintaining sufficient cash and realisable assets and the availability of sufficient funds to cover credit obligations.

At 31 December 2016, available cash totalled Euros 7,883 million (Euros 8,187 million in 2015), including cash and cash equivalents of Euros 502 million (Euros 1,244 million in 2015), undrawn bank financing and credit lines to the amount of Euros 7,381 million (Euros 6,943 million in 2015). There is also unused capacity to issue debt on the capital markets (Note 17).

Capital management

The main purpose of capital management of Gas Natural SDG, S.A. is to ensure a financial structure to optimise capital cost and maintain a solid financial position, in order to combine the creation of added value with the access to the financial markets at a competitive cost to cover financing needs.

Gas Natural Fenosa considers the following to be objective indicators of capital management: maintaining a long-term leverage ratio of approximately 50%.

The long-term credit rating of Gas Natural SDG, S.A. is as follows:

	2016	2015
Moody's	Baa2	Baa2
Standard & Poor's	BBB	BBB
Fitch	BBB+	BBB+

Derivative financial instruments

The breakdown of derivative financial instruments by category and maturity is as follows:

	At 31.12.16		At 31.12.15	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Hedging derivative financial instruments	**28**	**61**	**--**	**160**
Fair value hedge				
- Interest rate and foreign exchange rate	--	40	--	122
Cash flow hedge				
- Interest rate	28	21	--	38
Other financial instruments	**31**	**32**	**1**	**1**
- Interest rate and foreign exchange rate	31	32	1	1
Derivative financial instruments – non current	**59**	**93**	**1**	**161**
Hedging derivative financial instruments	**--**	**15**	**--**	**14**
Fair value hedge				
- Exchange rate	--	10	--	13
Cash flow hedge				
- Interest rate	--	5	--	1
Other financial instruments	**76**	**82**	**181**	**189**
- Price of commodities	76	82	181	189
Derivative financial instruments current	**76**	**97**	**181**	**203**
Total	**135**	**190**	**182**	**364**

"Other financial instruments" include the derivatives not qualifying for hedge accounting.

The impact on the Income statement of derivative financial instruments is as follows:

	2016		2015	
	Operating results	**Financial results**	**Operating results**	**Financial results**
Cash flow hedge	--	(10)	--	(11)
Other financial instruments	(28)	(2)	(2)	15
Total	**(28)**	**(12)**	**(2)**	**4**

The breakdown of derivatives at 31 December 2016 and 2015, their fair value and maturities of their notional values is as follows:

	31.12.16							
	Fair value	**Notional value**						
		2017	**2018**	**2019**	**2020**	**2021**	**Subsequent years**	**Total**
INTEREST RATE HEDGES:								
Cash flow hedges:								
Financial swaps (EUR)	23	684	--	--	--	--	1,500	2,184
Financial swaps (USD)	--	166	259	-	--	--	--	425
Financial swaps (NOK)	(21)	--	--	--	--	--	101	101
EXCHANGE RATE HEDGES:								
Fair value hedges:								
Financial swaps (USD)	(40)	--	--	60	--	160	--	220
Foreign exchange insurance (USD)	(10)	219	--	--	--	--	--	219
OTHERS:								
Commodities price derivatives (EUR)	(6)	13	--	--	--	--	--	13
Financial swaps (MXN)	(1)	-	--	--	--	--	--	-
	(55)	**1,082**	**259**	**60**	**--**	**160**	**1,601**	**3,162**

		31.12.15						
	Fair value	Notional value						
		2016	2017	2018	2019	2020	Subsequent years	Total
INTEREST RATE HEDGES:								
Cash flow hedges:								
Financial swaps (EUR)	(13)	255	684	--	--	--	--	939
Financial swaps (USD)	(1)	--	161	251	--	--	--	412
Financial swaps (NOK)	(25)	--	--	--	--	--	101	101
EXCHANGE RATE HEDGES:								
Fair value hedges:								
Financial swaps (USD)	(122)	--	--	--	722	--	160	882
Foreign exchange insurance (USD)	(13)	675	--	--	--	--	--	675
OTHERS:								
Commodities price derivatives (EUR)	(8)	103	27	--	--	--	--	130
	(182)	**1,033**	**872**	**251**	**722**	**--**	**261**	**3,139**

Note 17. Amounts owing to group companies and associates

The breakdown by maturity of borrowings from group companies is as follows:

Maturity	At 31.12.16	At 31.12.15
2016	--	2,891
2017	3,000	1,602
2018	1,556	1,470
2019	1,199	1,196
2020	1,639	1,636
2021	1,531	1,238
2022	1,742	--
Subsequent years	2,960	4,097
Total	**13,627**	**14,130**

Payables to Group companies mainly relate to issuances by Gas Natural Capital Markets, S.A. and Gas Natural Fenosa Finance, B.V. under the European Medium-Term Notes (EMTN) programme. This programme was created in 1999; following a number of extensions, the latest in December 2016, the programme limit is Euros 14 billion (Euros 14 billion in 2015). At 31 December 2016, a total of Euros 10,205 million principal had been utilised (Euros 10,605 million in 2015), being the amount yet to be utilised at Euros 3,795 million.

Additionaly, it includes the amount payable to Gas Natural Finance, B.V. for Euro Commercial Paper (ECP) issues, Euros 100 million having been utilised (Euros 300 million in 2015), the amount available is Euros 900 million (Euros 700 million in 2015). The balances payable to Gas Natural Fenosa Finance, B.V. in respect of perpetual subordinated debentures amounting to Euros 1,500 million (Euros 1,500 million 2015) and the debt with Unión Fenosa Preferentes, S.A. relating to preferred shares totalling Euros 110 million (Euros 110 million in 2015), are also included.

Borrowings from group companies include interest accrued pending maturity of Euros 350 million (Euros 354 million in 2015).

"Cash-pooling" balances with Group companies amounting to Euros 1,163 million are also included.

Borrowings from group companies and associates accrued an average interest rate of 4.2% in 2016 (4.1% in 2015).

There are no significant differences between the carrying amounts and fair values of Payables to Group companies and associates.

Note 18. Trade and other payables

The breakdown in 2016 and 2015 is as follows:

	At 31.12.16	At 31.12.15
Trade payables	242	247
Payables with group companies and associates	311	254
Derivatives (Note 16)	82	189
Other payables	11	7
Personnel (outstanding remuneration)	23	22
Public Administrations	17	16
Current tax liabilities	24	--
Total	**710**	**735**

Most payables do not accrue interest and have contractual maturity dates of less than 30 days, in the case of gas purchases and within the legal limits, for other suppliers.

Information on average supplier payment period. Additional Provision 3 "Duty of disclosure" of Law 15/2010/5 July

The average payment period is in accordance with Law 15/2010 on measures to combat late payment in business operations.

Information disclosed under the Resolution of 29 January 2016 of the Institute of Accountants and Auditors concerning the details to be included in the notes to the annual accounts concerning the average supplier payment period is as follows:

	2016	2015
	Amount	**Amount**
Total payments (euros)	3,993,685,684	5,411,897,950
Total payments outstanding (euros)	88,041,054	99,655,311
Average supplier payment period (days) (1)	22	24
Transactions paid ratio (days) (2)	22	24
Transactions pending payment ratio (days) (3)	24	26

(1) Calculated on the basis of amounts paid and pending payment
(2) Average payment period in transactions paid during the year.
(3) Average age, suppliers pending payment balance.

In the following ratios are not included all those situations that could affect the calculation, such as payables with group companies and associates.

Note 19. Tax situation

Gas Natural SDG, S.A. is the parent of the tax consolidated group 59/93, in which are all the companies resident in Spain subsidiaries, directly or indirectly integrated in at least 75 % of the parent company and meet certain requirements, which involves joint determination of taxable income of the group and the deductions and allowances to the quota. The tax consolidated group for 2016 is analysed in Appendix I.

Corporate income tax is calculated on the basis of economic or accounting profit obtained by application of generally accepted accounting principles, which do not necessarily coincide with taxable profit, understood as taxable income for corporate income tax purposes.

The reconciliation of accounting profit for the years 2016 and 2015 to taxable income is as follows:

	At 31.12.16	At 31.12.15
Accounting profit before tax	**983**	**998**
Permanent differences	**(1,278)**	**(1,438)**
Temporary differences:		
Arising during current year	28	18
Arising in prior years	(28)	(129)
Tax base	**(295)**	**(551)**

Permanent differences in 2016 mainly relate to the application of the tax consolidation system and to the exemption for the avoidance of double taxation on dividends and income derived from the transfer of shareholdings provided for in Article 21 of Law 27/2014 on corporate income tax, which entails permanent negative differences of Euros 1,560 million resulting mainly from the negative adjustments of dividends accrued in the year and the impairment of Group company and associate shareholdings amounting to Euros 206 million.

In 2015, permanent differences relate basically to the application of the tax consolidation system and to the exemption for the avoidance of double taxation on dividends and income derived from the transfer of shareholdings provided for in Article 21 of Law 27/2014 on corporate income tax, entailing negative permanent differences of Euros 1,542 million, due mainly to downward adjustments for dividends accrued during the year and the impairment of Group company and associate shareholdings amounting to Euros 106 million.

In 2016 the Company posted a tax loss of Euros 295 million, which is recovered from the Tax Group companies due to the taxable income generated by them during the year.

Law 27/2014 keeps the non deductibility in corporate income tax of the impairment losses on shareholdings, as a result of Law 16/2013 with effect as from 1 January 2013. In 2016 and 2015 the impairment losses recognised for shareholdings were not treated as tax deductible. Items yet to be included in the tax base after having filed the final corporate income tax return for 2015 are the following:

Company	Amounts pending inclusion in tax base in 2015	Amounts included in 2016	Amounts pending inclusion in tax base in 2016
Gas Natural Sao Paulo Sul, S.A.	7	(7)	--
Others	1	--	1
	8	**(7)**	**1**

Income tax expense is as follows:

	2016	2015
Current tax	(84)	(136)
Deferred tax	--	29
Total	**(84)**	**(107)**

Current corporate income tax is the result of applying a 25% tax rate (28% in 2015) to taxable income. In the tax consolidated group, tax credits applied in 2016 amounted to Euros 7 million (Euros 8 million in 2015) and no tax losses were offset. Adjustments are also included for prior-year taxable differences, entailing an increase in expense of Euros 10 million (increase of Euros 8 million in 2015).

On 27 November 2014, Corporate Income Tax Law 27/2014 was approved, stipulating a general tax rate cut from 30% to 28% for 2015 and to 25% as from 2016. However, in order to neutralise the tax rate cut, a deduction for the reversal of temporary measures has been provided to offset the economic cost of the rate cut for taxpayers that were affected by the 30% limit on the deduction of depreciation charges, or that restated fixed assets, in both cases under Law 16/2012 (27 December) on tax measures to consolidated public finances and encourage economic activities. Finally, Law 27/2014 provides an exemption regime for the transfer of significant shareholdings in resident entities that eliminates related temporary taxable differences.

Royal Decree-Act 3/2016, adopting tax-related measures to strengthen public finances, was enacted on 3 December 2016; it made significant amendments to the law on corporate income tax. Those amendments include: the obligation, from 1 January 2016, to reverse, within at most five years, any impairment recognised on holdings that were deductible prior to 2013; limitation of tax loss carryforwards for large companies (revenues over Euros 60 million) to 25% of the preceding taxable base; and limitation of the application of the earned or unused internal or international double-taxation tax credit to 50% of the pre-existing gross tax payable. Additionally, with effects from 1 January 2017, the transmissions losses of participations will not be deducted.

In 2016 these measures had a non-material impact in the financial statements of Gas Natural Fenosa.

Incomes that qualify for the tax credit for reinvestment of extraordinary profits provided by Article 42 of the revised Corporate Income Tax Act introduced under Legislative Royal Decree-Law 4/2004 (TRLIS) and the resulting investments made in previous periods are explained in the annual accounts for the relevant years. The breakdown is as follows:

Year of sale	Amount obtained from sale	Amount reinvested	Income qualifying for deduction	Year reinvested
2011	2	2	1	2011
2014	412	412	209	2014
Total	**414**	**414**	**210**	

The reinvestment made in fixed assets used in business activities both by the Company and by the other companies in the tax group, pursuant to Article 75 of the Corporate Income Tax Act.

Income qualifying for the tax scheme for transfers of assets made in compliance with competition law (Additional Provision 4 of the revised CIT Act) is explained below:

Year of sale	Amount obtained from sale	Amount reinvested	Initial capital gain	Capital gain included in tax base at year end	Capital gain yet to be included in tax base at year end
2002	917	917	462	18	444
2003	39	39	20	--	20
2004	292	292	177	9	168
2005	432	432	300	1	299
2006	309	309	226	--	226
2009	161	161	87	--	87
2010	752	752	551	--	551
2011	450	450	394	--	394
2012	38	38	32	--	32
Total	**3,390**	**3,390**	**2,249**	**28**	**2,221**

The reinvestment has been made in fixed assets used in business activities both by the Company and by the other companies in the tax group, pursuant to Article 75 of the Corporate Income Tax Act.

A breakdown of the tax effect of each item on the Statement of Recognised Income and Expenses is as follows:

	At 31.12.16			At 31.12.15		
	Gross	**Tax effect**	**Net**	**Gross**	**Tax effect**	**Net**
Cash flow hedges	34	(8)	26	2	(1)	1
Actuarial gains and losses and other adjustments	3	(1)	2	4	(1)	3
	37	**(9)**	**28**	**6**	**(2)**	**4**

A breakdown of deferred taxes is as follows:

	At 31.12.16	At 31.12.15
Deferred tax assets:	128	123
- Non-current	118	114
- Current	10	9
Deferred tax liabilities:	(231)	(234)
- Non-current	(231)	(234)
Net deferred tax	**(103)**	**(111)**

Movements and breakdown of deferred asset accounts are as follows:

Deferred tax assets	Provisions	Tax credits	Valuation of assets and financial instruments	Goodwill	Other	Total
At 1.1.2015	**144**	**5**	**5**	**8**	**12**	**174**
Creation (reversal)	(31)	(1)	--	2	--	(30)
Movements linked to equity adjustments	(1)	--	(1)	--	--	(2)
Demerger scope (Note 5)	--	--	--	--	(9)	(9)
At 31.12.2015	**112**	**4**	**4**	**10**	**3**	**133**
Creation (reversal)	(4)	--	--	1	--	(3)
Movements linked to equity adjustments	(1)	--	(1)	--	--	(2)
Others	(2)	2	--	--	--	--
At 31.12.2016	**105**	**6**	**3**	**11**	**3**	**128**

Deferred tax liabilities	Depreciation differences	Deferred gains	Merger (1)	Other	Total
At 1.1.2015	**62**	**210**	**37**	**25**	**334**
Creation (reversal)	--	--	--	(1)	(1)
Demerger scope (Note 5)	(58)	--	(36)	(1)	(95)
Other	--	--	(1)	(3)	(4)
At 31.12.2015	**4**	**210**	**--**	**20**	**234**
Creation (reversal)	(1)	--	--	(2)	(3)
Movements linked to equity adjustments	--	--	--	7	7
Other	--	--	--	(7)	(7)
At 31.12.2016	**3**	**210**	**--**	**18**	**231**

(1) "Merger" relates basically to the tax effect of the part of the merger difference resulting from the merger of Unión Fenosa, S.A. into Gas Natural SDG, S.A. in 2009, allocated to net assets acquired, which is not expected to have tax effects.

In 2015, the demerger of Gas Natural SDG, S.A. was completed in favour of Gas Natural Fenosa Generación, S.L.U. (Note 5), relating to the nuclear power generation business. Pursuant to Article 76.3 of Law 27/2014, this operation was defined as a non-cash contribution of a line of business and was thus subject to the special scheme provided by Title VII, Chapter VIII of that law. Note 5 provides a breakdown of the carrying amount of the assets handed over, which matches the value recognised for the shareholding in the company Gas Natural Fenosa Generación, S.L.U.

In 2014, the demerger of the thermal and hydroelectric power generation business from Gas Natural SDG, S.A. to Gas Natural Fenosa Generación, S.L.U. was completed. Pursuant to Article 83.3 of Royal Decree-Law 4/2004 whereby the Corporate Income Tax Act (CIT Act) was approved, this operation is defined as a non-cash contribution of a line of business and is thus subject to the special scheme provided for in Title VII, Chapter VIII of said Act.

In 2009, the companies Unión Fenosa, S.A. and Unión Fenosa Generación S.A. were merged into Gas Natural SDG, S.A. under the special tax scheme for mergers, spin-offs, asset contributions, share exchanges and changes of registered address of European companies or European cooperatives from one European Union Member State to another, provided by Title VII, Chapter VIII TRLIS. The information requirements stipulated in the special tax scheme are fulfilled in the notes to Gas Natural SDG, S.A.'s 2009 annual accounts.

In October 2015, the tax inspection of Gas Natural SDG, S.A. and Gas Natural Distribución Latinoamérica, S.A. (formerly Gas Natural Internacional SDG, S.A.) for corporate income tax

(2009 and 2010) and value added tax (2010) came to an end without any material issues having been identified and without any significant impacts on the income statement.

Gas Natural SDG, S.A.'s tax group is open to inspection for 2011 and subsequent periods and the taxes to which it is subject.

As a result, among other things, of the different interpretations to which current tax legislation lends itself, additional liabilities could arise as a result of an inspection. The Company considers, however, that any liabilities that might arise would not significantly affect these Annual accounts.

Gas Natural Fenosa has recorded provisions for obligations deriving from a number of tax claims. At 31 December 2016 the main tax litigation affecting the Group relates to the tax credit for export activities. As a result of the inspection proceedings on tax periods 2003 to 2008, the Inspectorate has questioned the admissibility of the tax credit for export activities applied by Gas Natural Fenosa; the tax assessments have been contested and appeals have been lodged at the Tax and Treasury Court and the Supreme Court. At 31 December 2016, the assessments amount to Euros 93 million, including interest, and are fully provisioned (Note 14).

Note 20. Net turnover

Sales break down as follows:

	2016	2015
Electricity sales	1,460	1,696
Natural gas sales	1,620	1,938
Other sales	8	6
Income from equity instruments of Group companies and associates (Note 9)	1,560	1,542
Income from marketable securities and other financial instruments of Group companies and associates	414	458
Total	**5,062**	**5,640**

Electricity and gas sales are made basically in the domestic market.

Note 21. Supplies

This caption includes natural gas purchases under supply contracts in force and electricity purchases relating to the energy supply business.

Note 22. Personnel costs

The breakdown of this account in the income statement for 2016 and 2015 is as follows:

	2016	2015
Wages and salaries	152	143
Social security costs	22	22
Defined contribution plans	13	13
Defined benefit plans (Note 14)	2	2
Others	12	11
Total	**201**	**191**

The average number of employees of Gas Natural SDG, S.A. during 2016 and 2015 is a follows:

	2016	2015
Executives	478	467
Middle managers	192	189
Specialists	709	681
Workers	356	380
Total	**1,736**	**1,716**

The average number of employees of Gas Natural SDG, S.A. during 2016 and 2015 with a disability equal to or greater than 33% is as follows:

	2016		2015	
	Hombres	Mujeres	Hombres	Mujeres
Executives	3	--	2	--
Middle managers	--	1	--	1
Specialists	11	12	10	10
Workers	8	9	10	9
Total	**22**	**22**	**22**	**20**

The number of Company employees by gender and categories at year-end 2016 and 2015 is as follows:

	2016		2015	
	Hombres	Mujeres	Hombres	Mujeres
Executives	323	159	316	156
Middle managers	110	88	101	82
Specialists	340	375	342	353
Workers	94	257	88	276
Total	**867**	**879**	**847**	**867**

Note 23. Other operating expenses

A breakdown of this heading on the income statement account for 2016 and 2015 is as follows:

	2016	2015
Taxes	2	2
Leases, royalties, operation and maintenance	79	88
Professional services and insurance	60	51
Advertising and other commercial services	25	25
Contribution to Gas Natural Fenosa Foundation	2	2
Impairment losses and changes in trade provisions (Note 11)	5	8
Others	164	189
Total	**337**	**365**

The Company makes contributions to the Gas Natural Fenosa Foundation to enable it to carry out its energy and environmental projects in the community area, as well as to fund international initiatives and the activities of the Gas Museum and Historical Archive.

Note 24. Other operating income

This account includes Euros 370 million in transactions with group companies and associates in 2016 (Euros 354 million in 2015).

Note 25. Net financial income/(expense)

The breakdown of this account in the Income statement for 2016 and 2015 is as follows:

	2016	2015
Income from marketable securities and other financial instruments	30	29
Total financial income	**30**	**29**
Cost of borrowings	(633)	(663)
Interest expense on pensions (Note 14)	(6)	(6)
Other financial expense	(25)	(29)
Total financial expense	**(664)**	**(698)**
Variation in fair value of financial instruments	(1)	2
Trading portfolio and other available-for-sale assets	(1)	2
Net exchange differences	1	(13)
Net financial income/(expense)	**(634)**	**(680)**

Note 26. Foreign currency transactions

Transactions effected in foreign currencies are analysed below, the main currency being the US dollar:

	2016	2015
Sales	624	894
Income from equity instruments of Group companies and associates	46	66
Income from marketable securities and other financial instruments of Group companies and associates	4	23
Purchases	(886)	(874)
Services received	(23)	(14)
Total	**(235)**	**95**

Note 27. Information on transactions with related parties

The following are related parties for the purposes of this Note:

Significant shareholders of Gas Natural SDG, S.A., shareholders that directly or indirectly hold an interest equal to or greater than 5%, as well as the shareholders who, without being significant, have exercised the power to put forward appointments of a member of the Board of Directors.

Based on this definition, the significant shareholders of Gas Natural SDG, S.A. are Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona ("la Caixa"), Repsol, S.A. (Repsol) and Global Infrastructure Partners III (GIP) and subsidiaries.

- Directors and executives of the Company and their immediate families. The term "director" means a member of the Board of Directors; "executive" means a member of the Management Committee of Gas Natural Fenosa and the Internal Audit Director. The operations with directors and executives are disclosed in Note 28.
- Group companies or entities. Transactions effected between group companies form part of the ordinary course of business and they have been done at market conditions.

The aggregated amounts of operations with significant shareholders are as follows (in thousand Euros):

	2016			2015	
Income and expense (in thousand Euros)	**"la Caixa"**	**Repsol**	**GIP (*)**	**"la Caixa"**	**Repsol**
Financial expenses	1,515	--	--	2,565	--
Services received	9,378	1	--	8,518	1
Purchases of goods	--	2,331	--	--	2,798
Other expenses (1)	10,125	--	--	14,389	--
Total expenses	**21,018**	**2,332**	--	**25,472**	**2,799**
Financial income	148	--	--	1,818	--
Services provided	--	39	--	--	5
Total income	**148**	**39**	**--**	**1,818**	**5**

	2016			2015	
Other transactions (in thousand Euros)	**"la Caixa"**	**Repsol**	**GIP (*)**	**"la Caixa"**	**Repsol**
Financing agreements, loans and capital contributions(lender) (2)	341,770	--	--	599,298	--
Financing agreements, loans and capital contributions(borrower) (3)	100,000	--	--	200,000	--
Warranties and guarantees received	100,000	--	--	201,667	--
Dividends and other profit distributions	424,923	367,291	66,045	311,716	273,873
Other operations (4)	173,884	--	--	489,199	--

(*) Since 21 September 2016.

(1) Includes contributions to pension plans, group insurance policies, life insurance and other expenditure.

(2) Includes cash and cash equivalents.

(3) At 31 December 2016, credit lines contracted with "la Caixa" amounted to Euros 569,000 thousand (Euros 569,000 thousand at 31 December 2015), of which no amounts having been utilised. "la Caixa" also has shares of other loans totalling Euros 100,000 thousand. At 31 December 2014, its shares in other loans amounted to Euros 200,000 thousand.

(4) At 31 December 2016, the item "Other transactions" with "la Caixa" includes the amount of Euros 72,976 thousand in respect of foreign exchange hedges (Euros 207,996 thousand at 31 December 2015) and Euros 100,908 thousand in respect of interest rate hedges (Euros 201,203 thousand at 31 December 2015).

The aggregated amounts of operations with group companies and associates are as follows (in million Euros):

	2016		2015	
Expenses, income and other transactions	**Group companies**	**Jointly-controlled entities and associates**	**Group companies**	**Jointly-controlled entities and associates**
Financial expenses	(575)	--	(580)	--
Lease expenses	(53)	(6)	(60)	(6)
Services received	(24)	--	(25)	--
Purchases of goods	(2,215)	--	(2,560)	--
Total expenses	**(2,867)**	**(6)**	**(3,225)**	**(6)**
Financial income	431	1	458	--
Dividends received	1,623	2	1,528	14
Sale of goods	3,154	--	4,108	--
Other income	369	1	352	2
Total income	**5,577**	**4**	**6,446**	**16**
Sale of Property, plant and equipment, intangible and other assets	6	--	--	--
Other transactions	**6**	**--**	**--**	**--**

The item “Purchases” relates basically to electricity purchased from the other Group companies, since Gas Natural SDG, S.A. is their market representative.

Under the heading "Dividends received" are included the dividend payments from voluntary reserves, registered as a lower value on investments in group companies (Note 9).

Sales of natural gas and electricity are included under "Sale of goods".

The item "Other income" includes income from services rendered in accordance with the nature and extent thereof.

Costs shared between the Company and other group companies are allocated on the basis of business or cost generation parameters.

Detailed definitions are prepared of services to be provided and of related activities or tasks in order to determine the measurement indicators used to calculate costs allocated. Transactions between companies are objective, transparent, non-discriminatory and always effected at arm's length.

Note 28. Information regarding members of the Board of Directors andManagement Committee

<u>Remuneration of the members of the Board of Directors</u>

In accordance with the By-laws and the General Meeting resolution of 14 May 2015, the Company may earmark a maximum of Euros 5 million for Board directors’ remuneration each year.

The amount accrued by the members the Board of Directors of Gas Natural SDG, S.A., for belonging to the Board of Directors, Executive Committee (EC), Audit Committee (CA) and Appointments and Remuneration Committee (ARM), totalled Euros 4,573 thousand (Euros 4,205 thousand in 2015), broken down in euros as follows:

	Office	Board	EC	AC	ARC	Total
Mr. Isidro Fainé Casas [1]	Chairman	280,500	200,000	-	-	480,500
Mr. Salvador Gabarró Serra [2]	Chairman	400,000	400,000	-	-	800,000
Mr. Josu Jon Imaz San Miguel [3]	First Deputy Chairman	46,000	46,000	-	-	92,000
Mr. Antonio Brufau Niubó [4]	Deputy Chairman	92,000	-	-	18,182	110,182
Mr. William Alan Woodburn [3]	Second Deputy Chairman	46,000	46,000	-	9,091	101,091
Mr. Rafael Villaseca Marco	Chief Executive Officer	126,500	126,500	-	-	253,000
Mr. Ramón Adell Ramón	Director	126,500	126,500	40,000	-	293,000
Mr. Enrique Alcántara-García Irazoqui	Director	126,500	92,000	14,545	-	233,045
Mr. Xabier Añoveros Trías de Bes	Director	126,500	-	14,545	-	141,045
Mr. Marcelino Armenter Vidal [3]	Director	46,000	46,000	-	-	92,000
Mr. Mario Armero Montes [3]	Director	46,000	-	-	-	46,000
Mr. Francisco Belil Creixell	Director	126,500	46,000	29,091	9,091	210,682
Mr. Demetrio Carceller Arce [4]	Director	92,000	92,000	-	-	184,000
Ms. Benita María Ferrero-Waldner	Director	126,500	80,500	-	-	207,000
Mr. Alejandro García-Bragado Dalmau [3]	Director	46,000	-	-	9,091	55,091
Ms. Cristina Garmendia Mendizábal	Director	126,500	-	14,545	25,000	166,045
Ms. Elena Herrero Starkie [5]	Director	80,500	-	14,545	-	95,045
Mr. Emiliano López Achurra [6]	Director	46,000	46,000	-	-	92,000
Mr. Miguel Martínez San Martín	Director	126,500	126,500	-	9,091	262,091
Mr. Heribert Padrol Munté [4]	Director	92,000	-	-	-	92,000
Mr. Rajaram Rao [3]	Director	46,000	46,000	14,545	-	106,545
Mr. Juan Rosell Lastortras [4]	Director	92,000	92,000	-	-	184,000
Mr. Luis Suárez de Lezo Mantilla	Director	126,500	-	40,000	-	166,500
Mr. Miguel Valls Maseda [4]	Director	92,000	-	-	18,182	110,182
		2,681,500	**1,612,000**	**181,816**	**97,728**	**4,573,044**

[1] Since 21 September 2016, previously a Member of the Board of Directors.
[2] Until 21 September 2016. Appointed Honorary President, unremunerated, on 30 September 2016.
[3] Since 21 September 2016.
[4] Until 21 September 2016.
[5] Since 4 May 2016.
[6] Until 4 May 2016.

In 2016, as in 2015, no amounts were received for other items.

In 2016, the Chief Executive Officer received Euros 57 thousand (Euros 85 thousand in 2015) as a Board member of the investee company CGE. These amounts are deducted from the CEO's variable remuneration.

The amounts accrued to the Chief Executive Officer for executive functions in respect of fixed remuneration, annual variable remuneration, multi-year variable remuneration and other items totalled Euros 1,212 thousand, Euros 1,002 thousand, Euros 860 thousand and Euros 8 thousand, respectively, in 2016 (Euros 1,142 thousand, Euros 1,054 thousand, Euros 883 thousand and Euros 8 thousand in 2015).

Contributions to pension plans and group insurance policies, together with life insurance premiums paid, totalled Euros 328 thousand in 2016 (Euros 315 thousand in 2015). Funds accumulated due to these contributions amount to Euros 3,241 thousand at 31 December 2016 (Euros 2,930 thousand at 31 December 2015).

The members of the Board of Directors of the Company have not received remuneration from profit sharing, bonuses or indemnities, and have not been given loans or advances. Neither have they received shares or share options during the year, nor have they exercised options or have options to be exercised.

The members of the Board of Directors are covered with the same liability policy that insures all managers and directors of Gas Natural Fenosa. In 2016, the premium paid by Gas Natural SDG, S.A. for the entire policy amounted to 101 thousand euros.

The Chief Executive Officer's contract was amended in October 2016 to remove the clause under which the contract would be terminated in the event of a material change in the Company's shareholders and its duration was extended to cover the entire term of his current appointment as a Company director.

It contains an agreement whereby six months' prior notice must be provided by the Chief Executive Officer, except in the event of force majeure, an exclusivity pact for the period during which he is to fulfil his functions and a confidentiality agreement for both the duration of the contract and post-termination.

The Chief Executive Officer's contract provides for an indemnity of three yearly payments of his full emoluments at the date of contractual amendment for certain termination events: at the company's decision, except in the event of a serious and culpable breach of his professional obligations causing serious harm to the interests of Gas Natural SDG, S.A., at the Chief Executive Officer's decision, or due to the finalisation of the contract. In addition, as consideration for a post-contractual no-competition agreement with a duration of one year, an indemnity equivalent to one year's full remuneration is provided for.

The contract requires the Company to arrange third-party liability insurance.

Transactions with Directors

The Directors have the obligation to avoid conflicts of interest as established by Regulation of the Board of Gas Natural SDG, S.A. and Articles 228 and 229 of the Capital Companies Law. Additionally, these articles require that conflicts of interest incurred by the board shall be reported in the annual accounts.

The Directors of Gas Natural SDG, S.A. have not reported any conflict of interest that has to be informed.

In the operations with related parties (significant shareholders) that have been submitted for approval by the Board, subject to a favourable report of the Appointments and Remuneration Committee or Audit Committee, the Directors representing the related party involved have abstained.

During the years 2016 and 2015, the members of the Board have not carried out related transactions outside the ordinary course or transactions that are not conducted under normal market conditions with the company or Group companies.

Remuneration of Executive personnel

For the sole purposes of the information contained in this section, "executives" refers to the members of the Management Committee, excluding the CEO, whose remuneration has been included in the previous section, and the Internal Audit Director.

During 2016 a total of 11 persons formed part of the Management Committee. One person left the committee in April.

Amounts accrued to executives in respect of fixed remuneration, annual variable remuneration, multi-year variable remuneration and other items totalled Euros 4,827 thousand, Euros 2,553 thousand, Euros 1,945 thousand and Euros 120 thousand, respectively, in 2016 (Euros 4,962 thousand, Euros 2,528 thousand, Euros 1,982 thousand and Euros 112 thousand, respectively, in 2015).

Contributions to pension plans and group insurance policies, together with life insurance premiums paid, totalled Euros 2,389 thousand in 2016 (Euros 2,428 thousand in 2015). Funds accumulated due to these contributions amount to Euros 22,121 thousand at 31 December 2016 (Euros 24,955 thousand at 31 December 2015).

The executives have received no remuneration in respect of profit sharing or bonuses and no loans have been granted to them. Advances to management personnel at 31 December 2016 amounted to Euros 175 thousand. At 31 December 2015 no advances to management personnel were granted. No indemnities were received during 2016 or 2015.

The contracts of the executives contain a clause that stipulates a minimum indemnity of two years pay in certain cases of termination of contract and an indemnity equivalent to one year's fixed remuneration for the post-employment no-competition clause for a period of two years.

Note 29. Contingent liabilities and commitments

Guarantees

At 31 December 2016 Gas Natural SDG, S.A. has given guarantees to third parties for activities totalling Euros 251 million (Euros 260 million at 31 December 2015).

Financial guarantees have also been given totalling Euros 133 million (Euros 150 million at 31 December 2015), of which Euros 113 million relate to the guarantee for compliance with the obligations on loans received (Euros 132 million at 31 December 2015).

Gas Natural SDG, S.A. estimates that the unforeseeable liabilities at 31 December 2016, if any, that could arise from the guarantees given would not be significant.

Contractual commitments

At 31 December 2016, the Company is party to several gas supply contracts with "take or pay" clauses negotiated for "own use" (Note 6.5), by virtue of which it has gas purchase rights for the period 2017-2040 in the amount of Euros 8,358 million, calculated on the basis of natural gas prices at 31 December 2016.

Operating lease obligations breakdown as follows:

	2016	**2015**
Period	**Operating leases**	**Operating leases**
Up to one year	18	6
Between 1 and 5 years	70	14
Between 5 and 10 years	48	--
	136	**20**

Lease commitments include the rent of the "Torre del Gas" building owned by Torre Marenostrum, S.L., for which Gas Natural SDG has an operating lease without a purchase option for a period of ten years as from March 2006, extended at market value during the year in course for three years, as extensions are provided for at market value for successive periods of three years, on a discretionary basis for Gas Natural and an obligatory basis for Torre Marenostrum S.L.

It also includes operating leases without a purchase option that were written down in December 2016 of four buildings in Madrid (Avenida San Luís 77, Antonio López 193, Acanto 11-13 and Avenida América 38), for a term of ten years, expect for Avenida América 38, extendable for five years more (Note 6).

Contingent liabilities

Gas Natural SDG, S.A. reports no relevant contingent liabilities relating to litigation or arbitration at the date of these Annual accounts.

Note 30. Auditors' fees

The fees accrued in thousand Euros by the different companies trading under the PwC brand are as follows:

	Thousand Euros	
	2016	**2015**
Auditing services	674	658
Assurance services and services related to the audit	289	402
Total fees	**963**	**1,060**

Note 31. Environment

Environmental actions

Gas Natural Fenosa's main activities related to the company's environmental strategy so as to assure compliance with environmental legislation, reduce environmental impacts, mitigate climate change, preserve biodiversity, optimise consumption of natural resources such as water, prevent pollution and promote continuous improvement, going beyond the stipulations of applicable laws.

Measures continued to make energy development compatible with environmental protection. General activities included the promotion of continuous improvement by updating and extending environmental management, involving our suppliers and encouraging our customers to use energy responsibly.

This is achieved through environmental management of Gas Natural Fenosa based on the ISO 14001 model, the correct functioning of which is verified periodically, providing the tools required to assure environmental management. In 2016, certification was obtained for the environmental management system applied to electricity distribution in Chile. Along similar lines, progress was made in the process to adapt environmental management of rest of the Chilean activities to ensure consistency with the rest of the company.

Gas Natural Fenosa's positioning in relation to climate change is based on its contribution to climate change mitigation by using low-carbon and renewable energies, promoting energy saving and efficiency, applying new technologies and capturing carbon in the Group's projects. During 2016 there have been significant reductions in direct CO_2 emissions with respect to 2015, as a result of lower production in coal generation in Spain which has been replaced by cleaner generation options. As a result, specific emission per unit of energy generated was significantly reduced compared with 2015. There was also a reduction in emissions of other substances due to lower thermal generation in Spain.

In 2016, Gas Natural Fenosa undertook numerous actions to promote the conservation of biodiversity, some in response to requirements implemented by environmental authorities and others voluntarily. During this period, the initial steps have been taken to implement biodiversity action plans and highly significant progress has been made in the creation of tools to support the company's biodiversity strategy.

Gas Natural Fenosa is aware of the essential role played by water in the production process; as part of its ongoing commitment to the environment and to the efficient management of natural resources, in 2016 progress was made in its water strategy by determining management indicators and lines of action to optimise water use in the most significant production processes. Within the commitment towards the environment and the efficient management of natural resources, during 2016 Gas Natural Fenosa started work on bringing together, in 2017, the lines of action in the circular economy area on which it has been working for some time.

The environmental activities undertaken in 2016 amounted to Euros 7 million, relating to the costs of environmental management at facilities (Euros 12 million related to environmental management at facilities in 2015).

Possible contingencies, indemnities and other environmental-related risks in which Gas Natural Fenosa could be incur are adequately covered by subscribed liability insurance policies.

Note 32. Subsequent events

On 11 January 2017 Gas Natural Fenosa Finance, B.V., through its Euro Medium Term Notes (EMTN) programme, for which the Company acts as guarantor, carried out a bond issue amounting to Euros 1,000 million, maturing in January 2027 with an annual coupon of 1.375%.

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APPENDIX I. GAS NATURAL TAX GROUP COMPANIES

The companies in the Gas Natural tax group are as follows:

Gas Natural SDG, S.A.	Gas Natural Redes Distribución Gas SDG, S.A.
Ampliación de Nerea, S.L.U.	Gas Natural Redes GLP, S.A.
Banteay Srei, S.L.U	Gas Natural Rioja, S.A.
Boreas Eólica 2, S.A.	Gas Natural S.U.R. SDG, S.A.
Compañía Española de Industrias Electroquímicas, S.A.	Gas Natural Servicios SDG, S.A.
Energías Ambientales de Somozas, S.A.	Gas Natural Transporte SDG, S.L.
Energías Especiales Alcoholeras, S.A.	Gas Natural Wind 4, S.L.U.
Energías Especiales De Extremadura, S.L.	Gas Navarra, S.A.
Eólica La Vega I, S.L.U.	Gecal Renovables, S.A.
Eólica La Vega II, S.L.U.	General de Edificios y Solares, S.L.
Estela Eólica, S.L.U.	Genroque, S.L.U.
Europe Maghreb Pipeline Limited	Global Power Generation, S.A.
Explotaciones Eólicas Sierra de Utrera, S.L.	Holding Negocios Regulados Gas Natural, S.A.
Fenosa Wind, S.L.	JGC Cogeneración Daimiel, S.L.
Fenosa, S.L.U.	La Energía, S.A.
Gas Directo, S.A.U.	La Propagadora del Gas Latam, S.L.U.
Gas Natural Almacenamiento Andalucía, S.A.	La Propagadora del Gas, S.A.
Gas Natural Andalucía, S.A.	Lanzagorta Comunicaciones, S.L.
Gas Natural Aprovisionamientos SDG, S.A.	Lignitos de Meirama, S.A.
Gas Natural Aragón SDG, S.A.	Operación y Mantenimiento Energy, S.A.
Gas Natural Balears, S.A.	Parque Eólico Cova Da Serpe, S.L.U.
Gas Natural Capital Markets, S.A.	Parque Eólico La Rabia, S.L.U.
Gas Natural Castilla La Mancha, S.A.	Parque Eólico Las Claras, S.L.U.
Gas Natural Castilla y León, S.A.	Parque Eólico El Hierro, S.L.
Gas Natural Catalunya SDG, S.A.	Parque Eólico Los Pedreros, S.L.
Gas Natural Cegas, S.A.	Parque Eólico Montamarta, S.L.
Gas Natural Comercializadora, S.A.	Parque Eólico Nerea, S.L.
Gas Natural Distribución Latinoamérica, S.A.	Parque Eólico Peñarroldana, S.L.
Gas Natural Exploración, S.L.	Petroleum Oil & Gas España, S.A.
Gas Natural Fenosa Electricidad Colombia, S.L.	Sagane, S.A.
Gas Natural Fenosa Engineering, S.L.	Sociedad de Tratamiento Hornillos, S.L.
Gas Natural Fenosa Generación Nuclear, S.L.	Societat Eòlica de L'Enderrocada, S.A.
Gas Natural Fenosa Generación, S.L.U.	Tratamiento Almazán, S.L.
Gas Natural Fenosa Ingeniería y Desarrollo de Generación, S.L.U.	Tratamiento Cinca Medio, S.L.
Gas Natural Fenosa Internacional, S.A.	Unión Fenosa Distribución, S.A.
Gas Natural Fenosa LNG, S.L.	Unión Fenosa Financiación, S.A.
Gas Natural Fenosa Renovables, S.L.U.	Unión Fenosa Minería, S.A.
Gas Natural Informática, S.A.	Unión Fenosa Preferentes, S.A.U.
Gas Natural Madrid SDG, S.A.	

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1. Company situation

Gas Natural Fenosa's business model is characterised by responsible and sustainable management of all resources. Our commitment to sustainability and value creation over time is reflected specifically in our corporate responsibility policy, approved by the Board of Directors and implemented across all the Company's business processes; it comprises seven corporate responsibility commitments to stakeholders, which guide our activities: commitment to results, customer orientation, environmental protection, concern for people, health and safety, commitment to society and integrity.

Gas Natural Fenosa is an integrated energy company that supplies gas and electricity to almost 22 million customers. Its main purpose is to supply energy to society so as to maximise development and welfare, using innovation, energy efficiency and sustainability as the fundamental pillars of the business model. It is a leading energy company and a pioneer in the integration of gas and electricity. The business focuses on the full gas life cycle and on electricity generation, distribution and supply. There are other business lines, such as energy services, that favour diversification of activities and revenues, anticipating new market trends, meeting specific customer needs and providing an integrated service not focused only on selling energy.

Gas Natural Fenosa's business model is implemented through a large number of companies, basically in Spain, the rest of Europe, Latin America and Africa; there are four major business areas:

- **Gas distribution (Spain, rest of Europe and Latin America)**

  Gas Natural Fenosa has a leading position in the markets in which it operates, allowing organic growth opportunities to be leveraged both by winning new customers in municipalities to which gas is supplied and by expanding networks into zones without a gas supply. It is the leader in Spain and has a solid presence in Italy. It is also the leader in Latin America, with a presence in Mexico, Chile, Colombia, Brazil, Argentina and Peru.

- **Electricity distribution (Spain, rest of Europe and Latin America)**

  Gas Natural Fenosa is one of the most efficient operators in terms of operating and maintenance costs in electricity distribution. It is the third-ranked operator in the Spanish market and the leader in Moldova. In Latin America, it operates in Chile, Argentina, Panama and Colombia.

- **Gas (Infrastructures, Supply and Unión Fenosa Gas)**

  Gas Natural Fenosa has a unique, integrated gas infrastructure that provides considerable business stability, operational flexibility and the capacity to transport gas towards the best business opportunities.

  For Gas Natural Fenosa, our suppliers play a critical role in the optimal functioning of the value chain; accordingly, long-term contracts are concluded, a commitment to society is assumed and environmental impacts are minimised so as to guarantee supply.

  Gas Natural Fenosa responds with value-added services to customers' demands for speed, guarantees, quality and energy efficiency.

- **Electricity (Spain and International)**

  Gas Natural Fenosa has broad knowledge of all power generation technologies and an infrastructure that can be tailored to the needs of any energy model and each country's circumstances. A competitive, flexible gas supply allows the Company to achieve better margins than its competitors when managing combined cycle plants.

  Our leading position in the combined retailing of natural gas and electricity brings major advantages, such as a lower service cost, integrated customer service and lower acquisition costs, as well as greater proximity to customers.

  In the international market, Gas Natural Fenosa, through Global Power Generation, is established in Mexico, Puerto Rico, the Dominican Republic, Costa Rica, Panama, Kenya, Australia and, most recently, Chile and Brazil.

Our operations throughout the gas value chain provide Gas Natural Fenosa with a competitive advantage and a leading position in the sector. Our electricity management capacity and experience, combined with a unique integrated position in the gas and electricity markets, make the company a benchmark in this sector. International presence guarantees a privileged position to achieve growth in new regions that are in the process of economic development, making the Company one of the world's leading operators.

Appendix I to the Consolidated Annual Accounts contains a list of Gas Natural Fenosa's investees.

1.1. Corporate governance

Gas Natural Fenosa develops and continuously updates its corporate governance rules, which are formed by:

- Company By-laws.
- General Shareholders' Meeting Regulations.
- Board of Directors and Board Committee Regulations.
- Internal Code of Conduct with regard to the Securities Markets.
- Code of Ethics.
- Corporate Responsibility Policy.

Gas Natural Fenosa has continued to enhance its commitment to transparency and good practices, with the participation of the General Shareholders' Meeting, the Board of Directors and the Board committees: Executive Committee, Appointments and Remuneration Committee, and Audit Committee. The Management Committee also plays a significant role. In 2015, Gas Natural Fenosa adapted its corporate governance rules to the requirements of Act 31/2014, 3 December, which amended the Spanish Companies Act 2010 to improve corporate governance, and to the new the recommendations of the corporate governance code for listed companies of February 2015.

The accompanying 2016 Annual Corporate Governance Report contains a more detailed description.

The Board of Directors represents the Company and is Gas Natural Fenosa's ultimate decision-taking body, except for decisions reserved for the General Meeting. In particular, the Board is responsible for the following matters:

- Determining strategy and economic objectives.
- Supervising and verifying that the top executives fulfil the strategies and objectives.
- Assuring the company's future viability and competitiveness.
- Approving codes of conduct.

The Executive Committee is the Board committee responsible for continuous monitoring of Company management.

The Appointments and Remuneration Committee proposes Board remuneration criteria and general management remuneration policies. It also reviews the Board's structure and composition, supervising the appointment of new members and establishing guidelines for the appointment of directors.

The Audit Committee supervises internal control and risk management systems and evaluates their effectiveness, and also oversees the preparation of financial information and internal audit services.

The Management Committee coordinates business and corporate areas. Its main functions include studying and proposing Objectives, the Strategic Plan and the Annual Budget, as well as assessing, for the main Governing Bodies, action proposals that could affect the fulfilment of the Company's Strategic Plan. All the Management Committee members participate in the preparation of the Corporate Risk Map through work meetings in which they express opinions on the main uncertainties and potential impacts on the businesses.

2. Business evolution and results

The main financial aggregates of Gas Natural SDG and their performance are as follows:

	2016	2015	%
Net turnover	5,062	5,640	(10.2)
Operating profit	1,617	1,597	1.3
Profit for the year	1,067	1,024	4.2
Shareholders' equity	13,431	13,298	1.0
Net equity	13,444	13,285	1.2
Current liabilities	3,597	3,780	(4.8)
Average period for payment to suppliers	22 days	24 days	--

Gas Natural SDG, S.A., is a company that developes its activity basically through the tendency of other group and associated companies shares, so information bellow refers to de Consolidated group of Gas Natural Fenosa.

2.1. Main milestones in 2016

Net profit amounted to Euros 1,347 million in 2016, 10.3% less than in 2015.

EBITDA amounted to Euros 4,970 million in 2016, 5.6% less than in 2015, after discontinuation of the liquefied petroleum gas business in Chile; these results were affected by a very demanding macroeconomic and energy situation. This situation had a particular impact on the contribution by the gas supply business, while the depreciation of Latin American currencies on translation to euro impacted EBITDA in the amount of Euros 112 million, mainly attributable to the Colombian peso and the Mexican peso.

As of 31 December 2016, the indebtedness ratio was 44.8%, i.e. lower than at 2015 year-end (45.8%), and the net financial debt/EBITDA ratio was 3.1, compared with 3.0 at the end of 2015, despite bringing forward the 2016 interim dividend.

The sale of a 20.0% stake in GNL Quintero, S.A. (Chile) to Enagas for Euros 182 million by Aprovisionadora Global de Energía, S.A. (AGESA), a subsidiary of Gas Natural Chile, S.A., was completed in November 2016, providing Euros 128 million in capital gains before taxes and non-controlling interests (Euros 50 million net capital gains).

On 14 November 2016, the Superintendence for Residential Public Services of the Republic of Colombia ("the Superintendence") ordered, as a necessary measure to ensure the provision of electrical energy services, the seizure of the goods, assets and businesses of Electricaribe. The Superintendence also ordered the removal of the members of the governing body and the general manager, and their replacement by a special agent appointed by the Superintendence. In the fulfilment of his functions, this agent has replaced the executive personnel appointed by Gas Natural Fenosa and has centralised decision-making on the information to be supplied to Gas Natural Fenosa. Therefore, at 31 December 2016, Gas Natural Fenosa had lost control and any significant influence over Electricaribe as it does not take part in, and has no direct information about, material business activities or decisions. Subsequently, on 11 January 2017, the Superintendence extended this government take-over until 14 March 2017. In the light of the above facts and in accordance with IFRS 10, on 31 December 2016, Electricaribe ceased to be consolidated on the consolidated balance sheet of Gas Natural Fenosa, and its assets, liabilities and non-controlling interests have been derecognised for a net amount of Euros 475 million. In addition, the investment in

Electricaribe has been recorded at fair value as defined by IAS 39 (Euros 475 million) under Available-for-sale financial assets.

Gas Natural Fenosa confirms its guidance for net profit for 2017 to be between Euros 1,300 million and Euros 1,400 million, as well as the continuity of its dividend policy in accordance with the Strategic Vision 2016 - 2020.

The Board of Directors will propose to the Ordinary Shareholders' Meeting that it allocate Euros 1,001 million out of 2016 income to dividends, i.e. the same as in the previous year, in line with the new dividend policy for 2016-18, which was approved in March 2016. The interim dividend of Euros 0.330 per share was paid in full in cash on 27 September 2016, and the supplementary dividend amounting to Euros 0.670 per share will also be paid in cash in June 2017, representing a payout of 74.3%.

2.2. Main aggregates

Gas Natural Fenosa's financial information contains magnitudes and measurements prepared in accordance with the International Financial Reporting Standards (IFRS), as well as others prepared in accordance with the Group's own reporting model, referred to as Alternative Performance Metrics (APM), which are considered to be adjusted magnitudes with respect to those presented in accordance with IFRS. In the last chapter of the Consolidated Directors' Report there is a glossary of terms and the definitions of the APMs.

Financial main aggregates

	2016	2015	%
Net sales	23,184	26,015	(10.9)
EBITDA	4,970	5,264	(5.6)
Operating income	3,006	3,261	(7.8)
Net income attributable to equity holders of the Company	1,347	1,502	(10.3)
Cash flows from operating activities	3,375	3,500	(3.6)
Investments	2,225	1,422	56.5
Net equity (at 31/12)	19,005	18,518	2.6
Attributed net equity (at 31/12)	15,225	14,367	6.0
Net borrowings (at 31/12)	15,423	15,648	(1.4)

Main financial ratios

	2016	2015
Leverage	44.8%	45.8%
EBITDA / Net financial expenses	6.7x	6.4x
Net borrowings / EBITDA	3.1x	3.0x
Liquidity ratio	1.1x	1.2x
Solvency ratio	1.0x	1.0x
Return on equity (ROE)	8.8%	10.5%
Return on assets (ROA)	2.9%	3.1%

Main stock market ratios and shareholder remuneration

	2016	2015
Average number of shares (thousand)	1,000,468	1,000,689
Share price at 31/12 (euro)	17.91	18.82
Stock market capitalisation at 31/12 (million euro)	17,922	18,828
Earnings per share (euro)[1]	1.35	1.57
Attributable equity per share (euro)	15.21	14.36
Price-earnings ratio (P/E)	13.3	12.5
EV/EBITDA	6.7	6.5

[1] Profit at 31 December 2015 adjusted in accordance with IAS 33 due to the carrying amount of the preference shares exceeding the amount paid to redeem them, net of the tax effect.

Main physical aggregates

	2016	2015	%
Gas distribution:			
Sales - TPA[1]:	458,265	473,831	(3.3)
Europe	188,197	181,212	3.9
Latin America	270,068	292,619	(7.7)
Gas distribution connections points (thousand) (at 31/12):	13,546	13,172	2.8
Europe	5,773	5,724	0.9
Latin America	7,773	7,448	4.4
Electricity distribution:			
Sales - TPA[1]:	68,258	68,731	(0.7)
Europe	34,697	34,676	0.1
Latin America*	33,561	34,055	(1.5)
Electricity distribution connections (thousand) (at 31/12):	8,202	10,622	(22.8)
Europe	4,580	4,550	0.7
Latin America	3,622	6,072	(40.3)
ICEIT [2] (minutes)	43	44	(2.3)
Gas:			
Gas supply (MW):	325,384	316,268	2.9
Spain	178,916	185,851	(3.7)
Rest of Europe	77,136	54,787	40.8
LNG International	69,332	75,630	(8.3)
Gas transportation – EMPL (MW)	111,720	112,861	(1.0)

* Figures for Colombia are as of 30/11/2016 since the December data are not available.

[1] Third-Party Access (energy distributed)
[2] Installed capacity equivalent interruption time in Spain

	2016	2015	%
Electricity:			
Electricity generated (GWh):	46,552	49,548	(6.0)
Spain:	28,504	31,568	(9.7)
Hydroelectric	3,933	2,457	60.1
Nuclear	4,463	4,544	(1.8)
Coal	5,687	7,973	(28.7)
CCGTs	11,963	14,494	(17.5)
Renewables and Cogeneration	2,458	2,100	17.0
Global Power Generation:	18,048	17,980	0.4
Hydroelectric	496	481	3.1
CCGTs	15,648	15,519	0.8
Oil – gas	1,111	1,130	(1.7)
Wind	793	850	(6.7)
Installed capacity (MW):	15,418	15,471	(0.3)
Spain:	12,716	12,769	(0.4)
Hydroelectric	1,954	1,954	-
Nuclear	604	604	-
Coal	2,010	2,065	(2.7)
CCGTs	7,001	7,001	-
Renewables and Cogeneration	1,147	1,145	0.2
Global Power Generation:	2,702	2,702	-
Hydroelectric	123	123	-
CCGTs	2,035	2,035	-
Oil – gas	310	310	-
Wind	234	234	-
Electricity supply (GWh)	36,384	35,241	3.2

3. Sustainability

3.1 Environment

Main aggregates

	2016	2015	% Var.
Zero emissions installed capacity (%)	22.1	22.0	0.4
Zero emissions net production (%)	16.4	11.8	39.1
Direct GHG emissions[1] (Mt CO_2 eq.)	19.5	22.4	(12.9)
CO_2 emissions/electricity production (t CO_2/GWh)	411	445	(7.6)
Methane emissions in gas distribution (t CO_2 eq./km network)	9.3	9.3	-
Environmentally certified activities (% of environmentally certified EBITDA/total Group EBITDA potentially certifiable)[2]	90.1	88.3	(2.0)

[1] Scope 1 direct greenhouse gas emissions in accordance with "*The Greenhouse Gas Protocol. A Corporate accounting and reporting standard*".

[2] Approximately 86.8% of Group EBITDA is potentially certifiable.

Gas Natural Fenosa works to ensure compliance with environmental legislation, reduce environmental impact, mitigate climate change, optimise the consumption of natural resources such as water, preserve biodiversity in the environment, prevent pollution and foster continuous improvement, going beyond the legal requirements.

In 2016, new environmental management systems were certified in accordance with ISO 14001 and internal requirements, and there was a slight increase in the percentage of EBITDA certified as a result of the addition of part of the Chilean electricity distribution business. The work to adapt environmental management systems and certify them to international standards and internal requirements will conclude in 2017.

Regarding climate change, there was a significant reduction in direct CO_2 emissions with respect to 2015 as a result of lower coal-fired output in Spain, replaced by less polluting output. As a result, specific emissions per unit of power generated were reduced considerably with respect to 2015.

In 2016, Gas Natural Fenosa carried out numerous and varied activities in favour of conserving biodiversity, many of which have gone beyond the requirements set by the environmental authorities and others are voluntary in nature.

As part of its commitment to the environment and to efficient management of natural resources, in 2016 Gas Natural Fenosa made progress with its water strategy and commenced work to define lines of action in connection with the circular economy in 2017.

Note 36 to the annual accounts contains other relevant information on the main environmental and sustainability activities, emissions and environmental investments.

3.2 <u>People</u>

Main aggregates

Employment indicators	2016	2015	% Var.
Number of employees at 31/12	17,229	19,939	(13.6)
Voluntary turnover rate (%)	2.5	3.5	(28.6)
Integration rate (persons with disabilities)[1]	2.4	2.4	-
Employee training hours	50.9	61.4	(17.1)
Absenteeism	2.2	2.0	10.0
Days lost	2,424	3,674	(34.0)
Number of accidents resulting in days lost	65	125	(48.0)

[1] Spain

Human and social development

Gas Natural Fenosa provides stable and quality employment (96% of positions are indefinite) and a solid, structured and appealing professional career.

During 2016, the implementation of the Human and Social Development project continued, the main objective of which is to promote a quality work environment based on respect, diversity and personal and professional development. Through this project, a number of programmes have been promoted and coordinated on the basis of two essential pillars: equality of opportunities, and training as a lever to raise internal awareness about disability.

Gas Natural Fenosa has a common global model for personnel selection for all the geographies in which it operates. This ensures that it applies uniform approach as an employer, using standard criteria and best practices in identifying, attracting and retaining the professional talent necessary to carry on its business.

Gas Natural Fenosa continues to offer all employees the opportunity to participate in the internal mobility programme. Through this programme, employees can apply for any vacant position in any location, irrespective of where the employee's work place is located. This is one of the main components for enhancing career development within the company. To ascertain employees' preferences and concerns in connection with mobility, work continues on the "Conocerte" project. This initiative, which commenced in 2015, has helped to provide individual and centralised information for the entire Company. Aimed at technical professionals not include in executive programmes or the Savia programme, the initiative gathered information about 10,000 employees in 15 countries.

Ethical behaviour, promoting and respecting equality, and occupational health and safety are essential parts of the commitment made by Gas Natural Fenosa to its employees.

These principles are reflected in the company's day-to-day performance through the Code of Ethics, the II Collective Agreement, the Equality Plan and the Protocol for the Prevention of Workplace, Sexual and Gender-based Harassment.

In 2016, progress was made on the implementation of equality and diversity actions for employees, with the design of a Comprehensive Diversity Plan focused on gender, age and disability.

Concerning disability, the Capacitas and Aflora programmes aimed at normalising the professional integration of professionals with disability. Since implementation of these two projects commenced, a total of 156 persons with special needs have received aid relating to employment in Spain, i.e. over 87% of employees with disabilities have availed themselves of these programmes. Gas Natural Fenosa renewed the Bequal Plus Seal in recognition of our inclusion policy as a pioneer in disability commitment within the energy industry.

Gas Natural Fenosa promotes work-life balance through a major set of labour flexibility measures, services and benefits adapted to employees' needs. Our professionals can thus design their own life options in line with their development plans and the company's interests.

Training and talent management

Talent management at Gas Natural Fenosa's is centred on employees' individual development and professional careers, helping to define professional learning in a controlled and consistent manner to ensure that their development is aligned with the company's objectives.

The leadership and talent management model seeks to foster responsibility as well as individual and career development by using innovative tools and methodologies in training and development.

The model was simplified in 2016 to make it more accessible to all employees, the goal being to have a single, homogeneous, standardised model for professional evaluation and development.

The Talent Management and Corporate University unit is responsible for the development of Gas Natural Fenosa's professionals on all organisational levels and for knowledge management in all areas of the company. Training is a success factor for the company since our employees are the ones who achieve business objectives and drive our corporate strategies.

The Corporate University has a network of alliances with academic institutions in Spain and other countries. The Advisory Board, comprising the Polytechnic Universities of Barcelona and Madrid, the Monterrey Institute of Technology, IESE, ESADE and Boston Consulting Group, with the internal units of Gas Natural Fenosa, ensure a permanent link between the company's strategy and the programmes that are implemented.

Gas Natural Fenosa has established itself as a leader in health and safety following the implementation in 2012 of an ambitious “Health and Safety Commitment Plan” aimed at achieving a profound cultural change. The Corporate University has contributed to this process through a related training scheme, under which 100% of the company’s employees have been trained.

Remuneration

Gas Natural Fenosa's remuneration policy is guided by the principles of internal equality and competitiveness in the market. Employees' remuneration depends on whether or not they are covered by the Collective Agreement.

The salary levels of employees covered by the Collective Agreement are based on the professional group and sub-group to which they belong.

For those not covered, salaries are defined individually, in line with the Company's remuneration policy.

Variable remuneration under Gas Natural Fenosa's remuneration policy is designed to promote employee commitment and motivate performance, in line with the long-term interests of the Company and its shareholders.

Annual variable remuneration rewards the achievement of individual targets depending on the position, applying financial, efficiency and growth variables, as well as on quality and security issues, directly related to the fulfilment of the objectives proposed in the Management by Objectives Plan.

Management by Objectives and Commercial Variable Remuneration are methodologies deployed in Gas Natural Fenosa to encourage employee involvement in achieving the objectives of the company and their direct participation in results. Both are arranged through two types of Annual Variable Remuneration, depending on the group addressed:

- Management: based on management by objectives and performance appraisal. Applies to management personnel not covered by the Collective Agreement.
- Commercial: based on the fulfilment of commercial objectives. Aimed at employees with commercial functions.

The compensation package for employees of Gas Natural Fenosa is complemented by a benefits system which includes the pension plan, the main vehicle for funding post-employment commitments.

Furthermore, Gas Natural Fenosa offers a range of social benefits that complement the employees' remuneration package. The "Mis Beneficios" (My Benefits) platform for the workforce in Spain went live in 2016; it provides a single, comprehensive solution for managing and communicating compensation and benefits programmes. The platform continues to be developed to adapt to the various compensation and benefits strategies.

It includes such modules as: "Sistema de previsión social" to help employees understand their retirement and be aware of the Company's retirement plans, and "Bienestar y Salud", which enables employees to manage their well-being and health related plans.

All personnel in Spain also have a flexible remuneration system, which was implemented in 2012. The system enables beneficiaries to design the composition of their compensation package by combining a range of products on offer.

Personnel structure

Note 25 to the Consolidated Annual Accounts provides a breakdown of personnel by category, gender and geographic area at 31 December.

3.3 Taxation

Tax policies and tax risk management

Gas Natural Fenosa's tax policies are aligned with the Gas Natural Fenosa Corporate Responsibility Policy, which establishes as one of the commitments and principles of action to "act responsibly in managing business and comply with tax obligations in all the jurisdictions in which the company operates, assuming the commitment to transparency and collaborate with the relevant tax authorities."

To this end, since 2010 Gas Natural Fenosa has adhered to the "Code of Best Tax Practices" drawn up by the Large Companies Forum in conjunction with the Spanish tax authorities. This initiative, supported by the Spanish government, aims to promote transparency, good faith and cooperation with the tax authorities in business tax practices, and legal certainty in the application and interpretation of tax regulations.

In this respect, the company has expressly undertaken to: (a) avoid opaque structures for tax purposes, (b) collaborate with the tax authorities, (c) regularly report on tax policies to the Board of Directors, and (d) apply tax criteria in line with administrative pronouncements and case law.

To ensure that the tax practices of Gas Natural Fenosa are based on these principles, the group has a General Procedure governing Best Practices in the area of Tax.

In addition, Gas Natural Fenosa has a risk map specifically identifying tax risks and disputes concerning the interpretation and application of tax law. Information on the main tax-related actions is disclosed in Note 21 (Tax Situation) to the consolidated annual accounts.

The tax repercussions of any material or unique transactions are reported to the Board of Directors when they are deemed to be material. The creation or acquisition of holdings in entities domiciled in designated tax havens must be reported to the Board of Directors through the Audit Committee.

On the basis of Spanish legislation concerning countries classified as tax havens (Royal Decree 1080/1991, of 5 July, and Royal Decree 116/2003, of 31 January), Gas Natural Fenosa has interests in only two companies incorporated in such territories:

- 95.0% of Buenergía Gas & Power, Ltd., domiciled in the Cayman Islands. This company indirectly owns only one industrial holding, in a company that engages in power generation by means of a combined cycle gas turbine plant in Puerto Rico (Ecoeléctrica, L.P.), whose income is taxed in that country and which does not provide Gas Natural Fenosa with any tax benefits.
- 52.2% of Gasoducto del Pacífico (Cayman), Ltd., domiciled in the Cayman Islands. This company, which is dormant, was acquired by the Group as a consequence of the acquisition of the CGE group and does not provide any tax advantage for Gas Natural Fenosa.

In 2016, the domicile of the 47.5% holding in Ecoeléctrica Holding, Ltd. and the 47.5% holding in Ecoeléctrica Limited was changed from the Cayman Islands to Puerto Rico; accordingly, they have ceased to be classified as holdings in tax havens.

Intragroup transactions with these entities relate to dividends received, as follows:

Receiving subsidiary	Distributing subsidiary	Amount (thousand Euros)
Global Power Generation, S.A.	Buenergía Gas & Power, Ltd.	6,036

Tax contribution

Gas Natural Fenosa is aware of its responsibility for the economic development of the communities in which it conducts its business. The taxes it pays represent a significant part of the economic contribution made to the countries in which it operates. Therefore, Gas Natural Fenosa pays priority attention to fulfilling its obligation to pay taxes under the laws of each territory.

The taxes paid by Gas Natural Fenosa have considerable economic importance and involve a major compliance effort under formal obligations and cooperation with the tax authorities.

The total tax contribution of Gas Natural Fenosa amounted to Euros 3,423 million in 2016 (Euros 3,636 million in 2015). The following table details the taxes actually paid by Gas Natural Fenosa, by country, segmenting those that represent actual expenditure by the group (called group taxes) and those that are withheld or charged to the end taxpayer (called third-party taxes):

Country	Group taxes						Third-party taxes								Total	
	Corporate income tax (1)		Others (2)		Total		VAT		Tax on hydrocarbons		Others (3)		Total			
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Spain	199	347	512	549	711	896	1,007	1,169	352	362	229	200	1,588	1,731	2,299	2,627
Argentina	10	4	42	40	52	44	13	13	-	-	22	16	35	29	87	73
Brazil	38	51	49	44	87	95	58	56	-	-	9	18	67	74	154	169
Colombia	75	69	78	78	153	147	7	9	-	-	14	22	21	31	174	178
Chile	42	48	11	16	53	64	117	99	-	-	18	22	135	121	188	185
Mexico	31	33	3	4	34	37	39	32	-	-	11	12	50	44	84	81
Panama	89	8	7	11	96	19	-	-	-	-	3	4	3	4	99	23
Rest LatAm	12	11	1	1	13	12	2	3	-	-	3	2	5	5	18	17
Total LatAm	297	224	191	194	488	418	236	212	-	-	80	96	316	308	804	726
Italy	19	14	7	5	26	19	27	30	42	34	5	5	74	69	100	88
Rest	10	10	23	35	33	45	128	112	49	32	6	6	183	150	216	195
Total	**525**	**595**	**733**	**783**	**1,258**	**1,378**	**1,398**	**1,523**	**443**	**428**	**320**	**307**	**2,161**	**2,258**	**3,419**	**3,636**

(1) Corporate income tax actually paid during the year. Does not include accrued amounts. Information on the reconciliation between the recognised corporate income tax amount and the amount that would result from applying the nominal income tax rate currently prevailing in the country of the parent company (Spain) to pre-tax profits is detailed in Note 21 (Tax Situation) to the consolidated annual accounts.

(2) Includes energy taxes which in Spain amounted to Euros 244 million in 2016 (Euros 262 million in 2015), local taxes, employer social security contributions and other taxes specific to each country.

(3) Basically includes employee income tax withholdings and employee social security contributions.

4. Main risks and uncertainties

4.1. Operating risks

4.1.1. Regulatory risk

Gas Natural Fenosa and its subsidiaries are required to comply with legislation governing the natural gas and electricity sectors. In particular, gas and electricity distribution are regulated activities in most of the countries in which Gas Natural Fenosa performs them.

Legislation applicable to the natural gas and electricity sectors in the countries in which Gas Natural Fenosa operates is generally revised on a regular basis by the competent authorities. Any amendments may affect the current remuneration system for regulated activities, adversely impacting Gas Natural Fenosa's business, profits, grants and financial position.

In the event that competent public or private bodies interpret or apply such regulations based on criteria that differ from those of Gas Natural Fenosa, its compliance might be questioned or appealed and, in the event that an infringement were proven, there might be a material adverse impact on Gas Natural Fenosa's business, prospects, profits, grants and financial position.

Regulatory risk management is founded on smooth communication between Gas Natural Fenosa and regulators. Additionally, in the course of its regulated activities, Gas Natural Fenosa ensures that its costs and investments are aligned with the rates of return recognised for each business.

4.1.2. Gas and electricity volume risk

Most purchases of natural gas and liquefied natural gas (LNG) are made under long-term contracts containing clauses whereby Gas Natural Fenosa is obligated to purchase certain annual volumes of gas ("take-or-pay" clauses). Under such contracts, even if Gas Natural Fenosa does not need to acquire the committed volume of gas at a given time, it is contractually obligated to pay for the minimum volume committed in the take-or-pay clauses.

The contracts stipulate gas volumes in line with Gas Natural Fenosa's estimated needs. However, actual needs may be below the volumes estimated when the contracts were arranged. In the event of significant departures from the estimates, Gas Natural Fenosa will be obligated to purchase a large volume of gas than is actually needed or, failing this, to pay for the minimum volume of gas committed, irrespective of whether or not it acquires the volume that exceeds its needs; this could have a significant adverse effect on Gas Natural Fenosa's operating costs.

In the electricity business, Gas Natural Fenosa's results are exposed to a reduction in the amount of electricity generated, which is shaped by trends in demand for electricity. Additionally, in view of the major role played by CCGT technology in Gas Natural Fenosa's generating fleet, the amount of power generated might be reduced because of the growing importance of power generation from renewable sources.

A decrease in volumes generated would increase uncertainty as regards the achievement of generation/supply objectives.

Gas Natural Fenosa manages contracts and assets on a globally integrated basis to optimise energy balances, enabling it to correct any deviation in the most profitable manner possible.

4.1.3. Operational risk

a) Insurable risks

Gas Natural Fenosa's activities are exposed to a variety of operational risks such as faults in the distribution network, in electricity generation facilities and in gas carriers, explosions, polluting emissions, toxic spillage, fire, adverse weather conditions, contractual breaches, sabotage or accidents affecting the gas distribution network or electricity generation assets, and other damage and force majeure circumstances that might cause bodily harm and/or material damage, affecting or destroying Gas Natural Fenosa's facilities or property. Events such as these, or similar events, are unforeseeable and may interrupt the supply of gas and generation of electricity. In such situations, although coverage is provided by risk insurance policies, such as policies covering loss of profit and material damage, Gas Natural Fenosa's financial situation and results could be affected to the extent that any losses are not insured, coverage is insufficient, or economic losses are generated due to coverage limits or an increase in the excess, as well as potential increases in premiums paid to insurers.

Gas Natural Fenosa might also have to respond to third-party claims for bodily harm and/or other damage caused in the ordinary course of business. Such claims could result in the payment of indemnities under legislation applicable in the countries in which Gas Natural Fenosa operates, which could have a material adverse impact on the business, prospects, financial position and results if the its third-party liability insurance policies not cover the amount of the indemnities.

Gas Natural Fenosa prepares continuous improvement plans to reduce the frequency and severity of potential incidents. Specific asset supervision units have been created to intensify preventive and predictive maintenance, among other measures. Additionally, our approach to insurance coverage is based on optimising the total cost of risk.

b) Image and reputation

Gas Natural Fenosa is exposed to opinions and perceptions of a variety of stakeholders. Such perceptions may be adversely impacted by events caused by the Company or by third parties over which the Company has little or no control, impacting its own reputation or that of the industry. Such impacts might cause medium-term financial damage by increasing regulatory demands or funding costs or by requiring additional expenditure to win customers.

Gas Natural Fenosa is engaged actively in identifying and monitoring potential reputational events and the stakeholders affected. Transparency also forms part of our communication policy.

c) Environment

Gas Natural Fenosa's activities are subject to extensive legislation on environmental protection.

Gas Natural Fenosa and its subsidiaries must comply strictly with extensive environmental protection regulations requiring, among other aspects, the preparation of environmental impact analyses, obtainment of authorisations, licences and permits, and fulfilment of certain requirements. Considerations include:

– Environmental authorisations and licences might not be granted or might be revoked due to failure to comply with the attached conditions;
– The regulatory framework or its interpretation by the authorities might be amended, resulting in higher costs or deadlines for compliance with the new requirements.

In order to mitigate this risk, Gas Natural Fenosa has adopted an integrated environmental management system and has emergency plans for facilities where there is a risk of accidents with an environmental impact. Specific insurance policies have also been arranged to cover this type of risks.

d) Climate change

Demand for electricity and natural gas is related to the weather. A significant part of gas consumption during the winter months is driven by electricity generation and space heating, while summer consumption depends basically on electricity generation for air conditioning. Gas Natural Fenosa's revenue and results from natural gas distribution and supply activities might be adversely affected in the event that the autumn months become warmer or winters become milder. Demand for electricity might also fall if summers become milder, due to a decline in demand for air conditioning. Additionally, hydroelectric generation plant utilisation depends on rainfall in the plant locations and might be affected by drought.

European policies and measures to combat climate change could affect Gas Natural Fenosa's results in the event that the competitiveness of the Company's generation mix is altered.

Gas Natural Fenosa forms part of a number of work groups at European level, enabling strategy to be adapted to new regulations in advance. Gas Natural Fenosa also forms part of clean development projects designed to reduce CO_2 emissions.

e) Geopolitical exposure

Gas Natural Fenosa has interests in countries with different political, economic and social environments; in this regard, two main areas are particularly relevant:

- Latin America

  A large part of Gas Natural Fenosa's operating profits are generated by its Latin American subsidiaries. Latin American operations are exposed to a number of risks inherent in investment in this region. Risk factors linked to investment and business in Latin America include:

  - Considerable influence of local governments on the economy;
  - Significant fluctuation in the economic growth rate;
  - High inflation;
  - Devaluation, depreciation or overvaluation of local currencies;
  - Controls or restrictions on the repatriation of earnings;
  - Fluctuating interest rates;
  - Changes in financial, economic and fiscal policies;
  - Unexpected changes to regulatory frameworks;
  - Social tensions and
  - Political and macroeconomic instability.

- Middle East and Maghreb

  Gas Natural Fenosa has both its own assets and major contracts for the supply of gas from various Maghreb countries and the Middle East, particularly Egypt. Political instability in the zone may result in physical damage to the assets of Gas Natural Fenosa's investee companies or the obstruction of the operations of those or other companies, interrupting the Group's gas supply.

Gas Natural Fenosa has a diversified portfolio both in the countries in which it carries on energy distribution activities (Latin America, Europe) and the countries that supply gas (Latin America, Africa, Middle East, Europe). Diversification minimises the risk of expropriation and of supply interruption due to the knock-on effect of political instability in neighbouring countries. Specific insurance policies have also been arranged for these risks.

4.2. Financial risks

Financial risks (interest rate, exchange rate, commodity price, credit and liquidity risk) are detailed in Note 17 to the Consolidated Annual Accounts.

On 23 June 2016, the United Kingdom voted to withdraw from the European Union ("Brexit"). Although the UK's withdrawal will be accompanied by a process of negotiation over a period of time that cannot be determined as yet, the decision has already had consequences in the capital and foreign exchange markets. Gas Natural Fenosa's exposure to Brexit risk is practically non-existent.

4.3. Main opportunities

Gas Natural Fenosa's main opportunities are as follows:

- Generation mix: Gas Natural Fenosa's generating fleet, consisting mainly of CCGT facilities, has the necessary flexibility to adapt to different market circumstances; it is thus a valuable asset to leverage opportunities related to price and demand volume volatility in the gas and electricity markets.
- CO_2 market evolution: The mechanisms proposed by the European Commission to increase the cost of emission rights are intended to discourage the use of the more polluting technologies so as to counteract climate change. In this context, Gas Natural Fenosa's plants would be more competitive than coal plants and opportunities could also arise in the emissions market.
- Natural gas and LNG procurement portfolio: Management of gas pipelines, investment in plants and the fleet of gas carriers enable the Group to meet its business needs in a flexible, diversified manner, optimising its approach to different energy scenarios. Specifically, the fleet of gas carriers makes Gas Natural Fenosa one of the world's leading LNG operators and a principal in the Atlantic and Mediterranean.
- A balanced structural position in terms of businesses and geographies, many with stable flows, irrespective of commodities prices, making it possible to take the maximum advantage of growth in energy demand and of new business opportunities in new markets.

5. Group outlook

5.1. Strategic priorities

In order to achieve its objectives, Gas Natural Fenosa defines medium-term strategies that are updated periodically to adapt to current and future circumstances, taking into consideration the specific features of each of the Company's business lines.

In May 2016, Gas Natural Fenosa presented its updated Strategic Vision 2016-2020, establishing the Group's strategic priorities for the period.

5.2. Financial priorities

The strategic priorities for the period 2016-2020 are based on a financial policy consistent with growth and dividend targets:

- Strict financial discipline.
- Sustained dividend growth based on sustainable cash flow (70% payout commitment).
- Execute the efficiency plan.
- Manage the business portfolio.
- Maintain a solid business model with regulated or contracted activities accounting for approximately 70% of EBITDA and more than 80% of future capital expenditure.

The strategic objectives for 2018 are detailed below (Euros billion):

	2018 targets
EBITDA	~ **5.4**
Net profit	~ **1.6**
Dividend (Pay-out)	~ **70%**
Net debt/EBITDA	~ **3.0x**

5.3. Group outlook

The updated Strategic Vision 2016-2020 is based on three lines of growth (networks, power generation, and supply) that will enable Gas Natural Fenosa to continue expanding in the future:

- Networks: in gas networks, the investment in gas networks in Chile, Mexico and Colombia, the entry into the distribution business in the region of Arequipa in Peru, new licences, and additional growth derived from the conversion of the newly-acquired LPG distribution points in Spain; in electricity networks, investment in smart grids in Spain, investments to meet the additional demand in Chile and Panama, and electricity subtransmission in Chile driven by new renewable energy facilities.

- Electricity generation: improve the efficiency and performance of the generating fleet by adding 3,500 MW overall, of which 2,500 MW renewable (Spain and International) and 500-1,000 MW CCGTs that will contribute to the downstream development of the LNG business. Growth and development of the international power generation business through GPG.

- Gas supply: new gas supply contracts totalling approximately 11 bcm relating to the two Cheniere projects (Sabine Pass and Corpus Christi), the Yamal LNG project in

Russia, and the Shah Deniz II project in Azerbaijan; additionally, existing gas supply contracts will be adapted and renegotiated to reflect benchmark market conditions. The gas carrier fleet will be expanded by adding four new carriers (two of which were added in 2016) and a mobile regasification unit. That expansion will increase capacity by almost one millon cubic metres EBITDA is expected to increase by about 10%.

As a result, Gas Natural Fenosa is expected to maintain its organic growth trend in 2017 and beyond.

6. R&D and innovation

Innovation is one of the drivers of Gas Natural Fenosa's development; consequently, senior management is implementing an innovation model as part of the Group's updated Strategic Vision 2016-2020.

This model consists of a vision and a focus on innovation, project management methodology and a strong innovation culture within the company to ensure the most appropriate response to a changing situation.

Investment in technological innovation is analysed below:

	2016	2015
Total investment (Euro million)	59.2	15.7

The innovation plan is structured through priority lines of action to help achieve the goals set out in the Strategic Plan. This plan structures innovation around five multidisciplinary networks and eight areas of technology: Power Generation, Networks, Customers, Liquefied Natural Gas (LNG) and Automation and information management.

- Power generation:

  - Renewable energy: The company has a balanced generation mix that is able to respond appropriately to the demand for energy in the societies where it operates, and it always seeks the most environmentally-friendly generation technologies. Its priorities in this area include notably: developing new technologies to increase the percentage of renewable energy in its portfolio and integrate it into the power grid, and optimising the use of renewable facilities already in service, for example, by extending their useful lives or harnessing wind more efficiently.

  - Hydroelectric power: Gas Natural Fenosa's main innovation activities in the area of hydroelectric power are conducted through the Centro Internacional de Excelencia Hidráulica (CIEH). That institution's mission is to promote and channel R&D and innovation initiatives to harness conventional and marine hydroelectric energy that can be scaled up for application at the company's facilities around the world.

  - Storage: Innovation in the area of energy storage focuses primarily on storing electricity in batteries, both large installations that enhance power grid operations and small-scale facilities for distributed use.

  - Thermoelectric generation: Gas Natural Fenosa is working on two main lines of innovation in this area: improving power plant performance and reducing emissions from power generation.

– Networks: The main challenge in gas grids is to optimise safety and durability, as well as to increase the degree of optimisation and improve interactions with customers. In electrical networks, it continues to devote considerable efforts to optimising the electricity distribution network, focusing particularly on workplace safety, environmental aspects and supply quality. The goal is for electricity networks to be increasingly more intelligent.

– Customers: In the recently-established Smart Client area of innovation, the company is focused on offering value-added products and services to different categories of end customer.

– Liquefied Natural Gas (LNG):The overall objective is to strengthen LNG transportation, storage and distribution infrastructure, at all levels, so as to promote its use as an alternative to petroleum derivatives and as a more environmentally-friendly propulsion solution for shipping.

– Automation and information management is a horizontal area that seeks to agglutinate existing projects so as to reap synergies and enhance outcomes.

7. Annual Corporate Governance Report

Attached as an Appendix to this Director's Report, and forming an integral part of it, is the Annual Corporate Governance Report for 2016, as required under article 526 of the Spanish Capital Companies Act.

8. Treasury shares

On 14 May 2015, the General Meeting of Shareholders authorised the Board of Directors, for a period of not more than five years, to purchase, for good and valuable consideration, fully paid-up Company shares on one or more occasions, up to a total maximum amount of 10% of the share capital or the maximum figure applicable under the legislation in force at the time of acquisition, provided that the shares acquired directly or indirectly plus those already held by the Company and its subsidiaries never exceed 10% of subscribed capital or such other limit as may be established by law.

The minimum and maximum purchase price is the share price listed on Spain's electronic market, plus or minus 5%.

The variations in the treasury shares of Gas Natural SDG, S.A. in 2016 and 2015 are as follows:

	Number of shares	Amounts in million euro	% Share capital
At 1 January 2015	-	-	-
Acquisitions	2,899,180	58	0.3%
Disposals	(2,899,180)	(58)	(0.3%)
At 31 December 2015	**-**	**-**	**-**
Acquisitions	3,049,189	53	0.3%
Disposals	(2,298,644)	(40)	(0.2%)
At 31 December 2016	**750,545**	**13**	**0.1%**

Transactions with own shares of Gas Natural Fenosa in 2016 resulted in a gain of Euros 0.4 million, recognised under "Other reserves" (a gain of Euros 2 million in 2015).

For complete information about treasury shares see Note 13 to the Consolidated Annual Accounts.

9. Events after the reporting date

Events after the reporting date are described in Note 38 to the Consolidated Annual Accounts.

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