# GAS NATURAL SDG, S.A. AND ITS SUBSIDIARIES

Audit Report,
Consolidated Annual Accounts and
Directors' Report
as at 31 December 2017

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

# *Independent auditor´s report on the consolidated annual accounts*

To the Shareholders of Gas Natural SDG, S.A.:

## *Report on the consolidated annual accounts*

### *Opinion*

We have audited the consolidated annual accounts of Gas Natural SDG, S.A. (the Parent company) and its subsidiaries (the Group), which comprise the balance sheet as at December 31, 2017, and the income statement, statement of other comprehensive income, statement of changes in equity, cash flow statement and related notes, all consolidated, for the year then ended.

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

### *Basis for opinion*

We conducted our audit in accordance with legislation governing the audit practice in Spain. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated annual accounts* section of our report.

We are independent of the Group in accordance with the ethical requirements, including those relating to independence, that are relevant to our audit of the consolidated annual accounts in Spain, in accordance with legislation governing the audit practice. In this regard, we have not rendered services other than those relating to the audit of the accounts, and situations or circumstances have not arisen that, in accordance with the provisions of the aforementioned legislation, have affected our necessary independence such that it has been compromised.

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

### *Key audit matters*

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

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| Key audit matter | How our audit addressed the key audit matter |
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| *Evaluation of Electrificadora del Caribe, S.A. ESP*<br><br>As stated in Note 8 of the accompanying consolidated annual accounts, the Group owns 85.4% of the share capital of Electrificadora del Caribe, S.A. ESP (Electricaribe), engaged in the distribution of electricity in Colombia, which, in the last years, has suffered severe cash problems due to a high number of unpaid invoices of clients and major fraud with electricity consumption.<br><br>On 14 November 2016, the Superintendency of Residential Public Services of Colombia ordered taking possession of the assets and business of Electricaribe, with its board members being relieved of their duties and an agent appointed to replace the board in its duties. On 11 January 2017 the Superintendency agreed to extend its intervention until 14 March 2017, when it announced its decision to liquidate Electricaribe.<br><br>On 22 March 2017, the Group submitted the relevant documents to start arbitration proceedings with the Tribunal of the United Nations Commission on International Trade Law (UNICTRAL) to recover the company with a viable regulatory framework or, failing this, to obtain compensation in line with the company's fair value, as stated in Note 8 of the accompanying notes to the consolidated annual accounts.<br><br>In accordance with IFRS 10 "Consolidated financial statements", the Group concluded that, at 31 December 2016, it no longer controlled this subsidiary and, consequently, it proceeded to deconsolidate it and derecognise its assets and liabilities, and in accordance with IAS 39 "Financial instruments: recognition and measurement", it recognised an investment under the caption "Non current Financial assets" of the consolidated balance sheet as a Financial asset available for sale for €475 million.<br><br>At 31 December 2017, Gas Natural SDG, S.A.'s Management has reviewed the valuation of the interest and has concluded that there has been no variation to the parameters which the main assumptions refer to. Therefore, the valuation has only changed due to the exchange rate effect and it amounts to €416 million. | We have evaluated the seizure of Electricaribe's assets and business by the Superintendency of Residential Public Services of Colombia from 15 November 2016 and the implications and scope of the agent's functions to analyse the effects of the control of the current majority shareholder on Electricaribe in 2017 and we consider that the conclusions reached by the Group's Management on the loss of control of the company since last year are reasonable in the circumstances.<br><br>With the collaboration of our experts in valuations, we have also assessed the methodology and main assumptions used to determine the fair value of the investment in Electricaribe.<br><br>With our team of legal experts on the matter, we have assessed the analysis made by the Group's legal services on the implications of the seizure and the situation of the arbitration proceedings brought by the Group regarding the estimated amount that is reasonably likely to be recognised by the bodies and courts which may decide on a price or compensation in line with the the fair value stated in Note 8, considering the situation of juridical uncertainty commented in this note.<br><br>Regarding the Group's insurance policy for political risks, we have reviewed the documents exchanged between the Group and the insurance company.<br><br>We have also assessed whether the information disclosed in the consolidated annual accounts regarding this situation is adequate.<br><br>On the basis of the work carried out, we can conclude that Management's approach and information is reasonable and is supported by the evidence obtained. |

| Key audit matter | How our audit addressed the key audit matter |
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| All of these facts have led to an analysis of the situation, the main judgements and estimates made by the Group's Management on the situation and the valuation of the investment in Electricaribe. We therefore consider that its evaluation is a key audit matter. | |
| *Assessment of the recoverability of the carrying amount of certain assets of the Group*<br><br>The accompanying consolidated annual accounts present a goodwill and intangible assets with an indefinite useful life totalling €4,760 and €2,637 million, respectively. These assets, together with the corresponding net operating assets, are allocated to the corresponding cash-generating units (CGUs), as indicated in Notes 5 and 3.4.5 of the accompanying consolidated annual accounts.<br><br>In addition, as stated in Note 7 of the accompanying consolidated annual accounts, the Group has an investment in Union Fenosa Gas, accounted for by the equity method, whose carrying amount at year end is €925 million.<br><br>The recoverability of the carrying amount of those assets by CGU, has been determined on the basis of the present value of the cash flows they are expected to generate in the future. These cash flows are calculated on the basis of the business plans approved by Management. The key assumptions are detailed in Note 3.4.5 of the accompanying consolidated annual accounts.<br><br>Elsewhere, Management carried out a sensitivity analysis, varying the most significant on key assumptions that, based on historical experience, are reasonably likely to suffer changes.<br><br>As a result of the above analyses, the Group's Management has concluded that no impairment/reversal should be recorded for CGUs where impairment tests have been performed by Management in 2017. | Our analysis begins with the consideration of the adequacy of the allocation made of the assets to the CGUs and the process to identify those that require impairment analysis according to the requirements of accounting regulations.<br><br>We also checked that the cash flow projections prepared by the Group in the past have been consistently borne out by reality; this included monitoring delivery of the various business plans.<br><br>In addition, we evaluated the calculation process, concluding that the process used to prepare the calculations is subject to the opportune level of supervision and cross-checking by Management.<br><br>Elsewhere, with the assistance of our valuation experts, we checked the appropriateness of the valuation models used, the assumptions and estimates used in the calculations, specifically including short- and long-term forecasts for energy prices, tariffs and future regulated income, electricity output volumes, the cost of natural gas supplies, the volume of gas to be procured from suppliers, operation and maintenance costs, required capital expenditure levels, long-term growth expectations and discount rates.<br><br>We similarly confirmed the mathematical accuracy of the calculations and models prepared and the sensitivity analyses performed by Management and checked the estimated magnitude of change in the key inputs required for the assets to become impaired, factoring in the probability of such change.<br><br>Lastly, we evaluated the sufficiency of the information disclosed in the consolidated annual accounts with respect to the testing of these assets for impairment. |

| Key audit matter | How our audit addressed the key audit matter |
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| This is a key audit matter because it implies the use of significant estimates regarding the key assumptions made (which depend on market conditions) in the calculations performed by Management to assess the recoverability of the carrying amount of those assets; were these estimates to differ, the revised estimates could have a significant impact on the Group's consolidated annual accounts. | Based on the procedures performed, we can conclude that the approach taken and information disclosed by Management is reasonable and consistent with the evidence obtained. |
| *Recognition of the sale of Gas Natural, S.A. ESP (Colombia)*<br><br>As stated in Note 9 of the accompanying consolidated annual accounts, on 17 November 2017, the Group announced its agreement to sell the 59.1% interest in Gas Natural, S.A. ESP, a listed company in Colombia.<br><br>This agreement will be carried out in two stages. Firstly, Gas Natural Fenosa has transferred 17.2% of Gas Natural, S.A. ESP's share capital in several operations carried out on the Colombian stock exchange on 20, 21 and 22 December 2017. The interest in this company has therefore been reduced to approximately 41.9%, which has resulted in a loss of control.<br><br>At a second stage, to be completed in 2018, the rest of the company's share capital will be transferred by means of a public offer by the purchaser, after certain conditions precedent have been met, including, mainly, the condition that the purchaser obtain certain administrative authorisations in Colombia.<br><br>The consolidated annual accounts include the profit of the first stage of the transactions totalling €106 million and the effect of the revaluation of the retained interest in accordance with accounting standards, which totals €244 million. | In our audit of the disposal of Gas Natural, S.A.ESP., we have applied the following audit procedures:<br><br>• Procuring, reading and analysing the purchase-sale contract.<br><br>• Analysing the sale of 17.2% of the first stage of the operation and its recognition.<br><br>• Assessing whether the conclusion of the first stage of the operation has led to a loss of control by the Group in Gas Natural, S.A. ESP. based on the percentage of voting rights and number of representatives in the boards of directors.<br><br>• Analysing the valuation at fair value of the retained interest and whether it is reasonably presented as "Non-current assets held for sale", considering the likelihood that the operation will be completed in 2018.<br><br>• In addition, we have assessed the presentation of income and expenses of the sold business and related capital gains, as "After-tax profit/(loss) for the year from discontinued operations" of the consolidated income statement in accordance with applicable accounting standards.<br><br>• Evaluating the disclosures in the consolidated annual acconts for the disposal of Gas Natural, S.A. ESP |

| Key audit matter | How our audit addressed the key audit matter |
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| The interest retained at year end is presented in "Non-current assets held for sale" by €327 million of the consolidated balance sheet at 31 December 2017, as stated in Note 9 of the accompanying notes to the consolidated annual accounts, as Management considers that the disposal is highly probable. The gas distribution activity in Colombia is a major line of business and therefore the income and expenses for 2017 and 2016 are reported in "After-tax profit/(loss) for the year from discontinued operations" of the consolidated income statement totalling €430 million and €87 million, respectively, and the comparative figures are re-presented in the 2016 consolidated income statement in accordance with Notes 3.4.8 and 9.<br><br>This transaction is a key audit area as it involves applying critical judgements in assessing the control on the investment and considering the level of the amounts stated. We have therefore considered that this is a key audit issue. | Based on the procedures performed, we consider that Management's accounting treatment of the operation and the disclosures included in the consolidated annual accounts are reasonable. |
| *Recognition of revenue and settlements in regulated businesses*<br><br>As stated in Note 4 of the accompanying consolidated annual accounts, a significant portion of the Group's business activities are subject to comply with sectorial legislation applicable in the various countries where the Group is present. The regulatory framework of the Group's main activities is described in Note 2 of the accompanying consolidated annual accounts.<br><br>Interpreting the regulatory framework of each country and applying IFRS – EU involves making judgements to estimate income, including certain aggregates of other companies to estimate the global supply charges of the system which should materialise in the corresponding final supply charges.<br><br>In addition, in past years, the regulatory framework has grown increasingly more complex in several countries, where critical judgements and significant estimates are required to determine these matters (Notes 3.4.19 and 3.4.21.g) in the consolidated notes) This is therefore a key aspect of the audit. | In our audit response for the analysis of the regulatory recognition of income, we firstly gained an understanding of the framework for the activities of the different jurisdictions where the Group has a presence.<br><br>We have also analysed the regulatory changes made during the year, the regulatory changes approved and their impact on the consolidated annual accounts.<br><br>We have also verified during the audit process that regulated revenue has been recognized in accordance with the legislation in force in each country by carrying out test of details.<br><br>Finally, we consider that the information disclosed in the consolidated annual accounts is sufficient with respect to the regulatory framework and its accounting implications.<br><br>Based on the procedures carried out, the impacts regarding the different regulatory frameworks which the Group is exposed to are adequately reflected in the accompanying consolidated annual accounts. |

| Key audit matter | How our audit addressed the key audit matter |
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*Evaluation of derivative financial instruments*

As indicated in Notes 3.4.7.3 and 35 of the accompanying consolidated annual accounts, the Group is contractually committed to the purchase of natural gas under long-term arrangements. As is customary practice in the gas sector, those contracts have terms of between 20 and 25 years, involve minimum purchase commitments (take-or-pay clauses under which the buyer undertakes to pay for the minimum volume of gas contracted regardless of whether or not it takes receipt of it) and price review mechanisms indexed to international natural gas prices and natural gas prices in destination markets.

These contracts are entered into and maintained with the purpose of covering the Group's expected need to physically receive or deliver natural gas in keeping with regular purchase and sales estimates. As a result, the Group classifies these contracts as 'own use' contracts, thus removing them from the scope of IAS 39 "Financial instruments – recognition and measurement". At 31 December 2017, the Company had entered into commitments for the purchase €71,108 million of natural gas (Note 35).

Evaluation of the long-term natural gas supply contracts and specifically concluding whether they can be classified as 'own use' contracts, requires the use of judgement by the Group's Management with respect to supply and demand estimates over the short, medium and long term, the impact of price renegotiation processes, the trend in market prices for natural gas and compliance with the clauses embedded in the contracts. As a result, this is a key audit matter.

In addition, as detailed in Note 17, the Group has arranged a number of financial derivative instruments, recognised in the amount of €118 million on the asset side of the balance sheet and €139 million on the liability side. The designation of these instruments as accounting hedges and their measurement requires the use of judgement, documentation and estimates on the part of Management.

Our audit response to this matter included the performance of the following procedures:

- Procuring, reading and analysing the natural gas supply contracts entered into by the Group.
- Checking that the commitments to buy and sell natural gas in the short and long term are balanced with the aim of confirming that the contracts qualify as 'own use' contracts.
- Evaluating the amounts acquired during the year and checking that they met the minimum volumes contracted for.
- Analysing the price revision and arbitration proceedings to which the Group is party in order to analyse the magnitude of possible impacts on the consolidated annual accounts by reading the contracts and the available information in the course of meetings with the Group's Management.
- Together with our experts in financial derivatives, we analysed the designation of the instruments as accounting hedges and the measurement of the main derivatives.
- Lastly, we evaluated the sufficiency of the information disclosed in the consolidated annual accounts with respect to the gas purchase agreements and the derivative financial instruments.

Based on the procedures so performed, we can conclude that the measurement and disclosure of the Group's contractual commitments and financial derivative instruments in the accompanying consolidated annual accounts are reasonable.

## *Other information: Consolidated management report*

The other information comprises exclusively the consolidated management report for the year 2017, the formulation of which is the responsibility of the directors of the Parent Company and is not an integral part of the consolidated annual accounts.

Our audit opinion on the consolidated annual accounts does not cover the consolidated management report. Our responsibility for the information contained in the consolidated management report is defined in the regulations governing the audit activity, which establishes two different levels of the same:

a) A specific level that is applicable to the status of non-financial information, as well as to certain information included in the Annual Corporate Governance Report, as defined in art. 35.2. b) of Law 22/2015, on Audit of Accounts, which consists of verifying only that the aforementioned information has been provided in the consolidated management report and, if not, informing about it.

b) A general level applicable to the rest of the information included in the consolidated management report, which consists of evaluating and reporting on the concordance of the aforementioned information with the consolidated annual accounts, based on the knowledge of the entity obtained in the execution of the audit of the aforementioned annual accounts and without including information other than that obtained as evidence during the same, as well as evaluating and reporting whether the content and presentation of this part of the consolidated management report are in accordance with the regulations that result from application. If, based on the work performed, we conclude that there are material misstatements, we are obliged to report them.

Based on the work performed, as described previously, we have verified that the specific information mentioned in section a) above is provided in the consolidated management report and that the rest of the information contained in the consolidated management report agrees with the information of the consolidated annual accounts for the year 2017 and its content and presentation are in accordance with the applicable regulations.

## *Responsibility of the directors and the audit committee for the consolidated annual accounts*

The Parent company´s directors are responsible for the preparation of the accompanying consolidated annual accounts, such that they fairly present the consolidated equity, financial position and financial performance of the Group, in accordance with International Financial Reporting Standards as adopted by the European Union and other provisions of the financial reporting framework applicable to the Group in Spain, and for such internal control as the directors determine is necessary to enable the preparation of consolidated annual accounts that are free from material misstatement, whether due to fraud or error.

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

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

## *Auditor's responsibilities for the audit of the consolidated annual accounts*

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

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

As part of an audit in accordance with legislation governing the audit practice in Spain, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group´s internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Parent company´s directors.

- Conclude on the appropriateness of the Parent company´s directors´ use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group´s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor´s report to the related disclosures in the consolidated annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor´s report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated annual accounts, including the disclosures, and whether the consolidated annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated annual accounts. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

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

## *Report on other legal and regulatory requirements*

### *Report to the Parent company´s audit committee*

The opinion expressed in this report is consistent with the content of our additional report to the Parent company's audit committee dated 14 February 2018.

### *Appointment period*

The General Ordinary Shareholders' Meeting held on April 20, 2017 appointed us as auditors of the Group for a period of one year, for the year ended December 31, 2017.

Previously, we were appointed by resolution of the General Shareholders' Meeting of June 12, 1990 for the period of 9 years (1990 - 1998), we have been re-elected annually by the General Shareholders' Meeting since then, and we have been performing the work of audit of accounts in an uninterrupted form since the year ended on December 31, 1990.

### *Services provided*

Services provided to the Group for services other than the audit of the accounts, are disclosed in Note 35 to the consolidated annual accounts.

PricewaterhouseCoopers Auditores, S.L. (S0242)

Juan Manuel Anguita Amate (20367)

14 February 2018

# GAS NATURAL SDG, S.A.

Audit Report,
Annual Accounts and Directors' Report
as at 31 December 2017

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

# *Independent auditor´s report on the annual accounts*

To the Shareholders of Gas Natural SDG, S.A.:

## *Report on the annual accounts*

### *Opinion*

We have audited the annual accounts of Gas Natural SDG, S.A., which comprise the balance sheet as at December 31, 2017, and the income statement, statement of other comprehensive income, statement of changes in equity, cash flow statement and related notes for the year then ended.

In our opinion, the accompanying annual accounts present fairly, in all material respects, the equity and financial position of the Company as at December 31, 2017, as well as its financial performance and cash flows for the year then ended, in accordance with the applicable financial reporting framework (as identified in Note 2 of the notes to the annual accounts), and, in particular, with the accounting principles and criteria included therein.

### *Basis for opinion*

We conducted our audit in accordance with legislation governing the audit practice in Spain. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the annual accounts* section of our report.

We are independent of the Company in accordance with the ethical requirements, including those relating to independence, that are relevant to our audit of the annual accounts in Spain, in accordance with legislation governing the audit practice. In this regard, we have not rendered services other than those relating to the audit of the accounts, and situations or circumstances have not arisen that, in accordance with the provisions of the aforementioned legislation, have affected our necessary independence such that it has been compromised.

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

### *Key audit matters*

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



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| Key audit matter | How our audit addressed the key audit matter |
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| *Assessment of the recoverability of the carrying amount of investments in group companies and associates*<br><br>The accompanying annual accounts recognise investments in group companies and associates amounting to €13,400 million (Note 6).<br><br>The recoverability of the carrying amount of those assets was determined on the basis of the present value of the cash flows they are expected to generate in the future. These cash flows were calculated on the basis of the business plans approved by Management. The key assumptions are detailed in Note 3.3 of the accompanying annual accounts.<br><br>Elsewhere, Management carried out a sensitivity analysis, varying the most significant inputs which, based on historical experience, are reasonably likely to suffer changes.<br><br>As a result of the above analyses, the Company's Management has recognised an impairment loss of €133 million (Note 6) against these assets.<br><br>This is a key audit matter because it implies the use of significant estimates regarding the key assumptions made (which depend on market conditions) in the calculations performed by Management to assess the recoverability of the carrying amount of those assets; were these estimates to differ, the revised estimates could have a significant impact on the Company's annual annual accounts. | Our analysis began by identifying which investments should be tested for impairment according to prevailing accounting standards.<br><br>We also checked that the cash flow projections prepared by the Company in the past have been consistently borne out by reality; this included monitoring delivery of the various business plans.<br><br>In addition, we evaluated the calculation process, concluding that the process used to prepare the calculations is subject to the opportune level of supervision and cross-checking by Management.<br><br>Elsewhere, with the assistance of our valuation experts, we assessed the appropriateness of the valuation models used, the assumptions and estimates used in the calculations, specifically including short- and long-term forecasts for energy prices, tariffs and future regulated income, electricity output volumes, the cost of natural gas supplies, the volume of gas to be procured from suppliers, operation and maintenance costs, required capital expenditure levels, long-term growth expectations and discount rates.<br><br>We similarly confirmed the mathematical accuracy of the calculations and models prepared and the sensitivity analyses performed by Management and checked the estimated magnitude of change in the key inputs required for the assets to become impaired, factoring in the probability of such change.<br><br>Lastly, we evaluated the sufficiency of the information disclosed in the annual accounts with respect to the testing of these assets for impairment.<br><br>Based on the procedures performed, we can conclude that the approach taken and information disclosed by Management is reasonable and consistent with the obtained evidence. |

| Key audit matter | How our audit addressed the key audit matter |
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*Evaluation of derivative financial instruments*

As indicated in Notes 3.5.3 and 26 of the accompanying annual accounts, the Company is contractually committed to the purchase of natural gas under long-term arrangements. In keeping with customary practice in the gas sector, those contracts have terms of between 20 and 25 years, involve minimum purchase commitments (take-or-pay clauses under which the buyer undertakes to pay for the minimum volume of gas contracted regardless of whether or not it takes receipt of it) and price review mechanisms indexed to international natural gas prices and natural gas prices in destination markets.

These contracts are entered into and maintained with the purpose of covering the Company's expected need to physically receive or deliver natural gas in keeping with regular purchase and sales estimates. As a result, the Company classifies these contracts as 'own use' contracts, thus removing them from the scope of the financial instrument measurement standard. At 31 December 2017, the Company had entered into commitments for the purchase €8,056 million of natural gas (Note 26).

Evaluation of the long-term natural gas supply contracts and specifically concluding whether they can be classified as 'own use' contracts, requires the use of judgement by the Company's Management with respect to supply and demand estimates over the short, medium and long term, the impact of price renegotiation processes, the trend in market prices for natural gas and compliance with the clauses embedded in the contracts. As a result, this is a key audit matter.

In addition, as detailed in Note 13, the Company has arranged a number of financial derivative instruments, amounting to €182 million on the asset side of the balance sheet and €213 million on the liability side. The designation of these instruments as accounting hedges and their measurement requires the use of judgement, documentation and estimates on the part of Management.

Our audit response to this matter included the performance of the following procedures:

- Procuring, reading and analysing the natural gas supply contracts entered into by the Company.
- Checking that the commitments to buy and sell natural gas in the short and long term are balanced with the aim of confirming that the contracts qualify as 'own use' contracts.
- Evaluating the amounts acquired during the year and checking that they met the minimum volumes contracted for.
- Analysing the price revision and arbitration proceedings to which the Company is party in order to analyse the magnitude of possible impacts on the annual accounts by reading the contracts and the available information in the course of meetings with the Company's Management.
- Together with our experts in financial derivatives, we analysed the designation of the instruments as accounting hedges and the measurement of the main derivatives.
- Lastly, we evaluated the sufficiency of the information disclosed in the annual accounts with respect to the gas purchase agreements and the derivative financial instruments.

Based on the procedures so performed, we can conclude that the measurement and disclosure of the Company's contractual commitments and financial derivative instruments in the accompanying annual accounts are reasonable.

## *Other information: management report*

The other information comprises exclusively the management report for the year 2017, the formulation of which is the responsibility of the directors of the Company and is not an integral part of the annual accounts.

Our audit opinion on the annual accounts does not cover the management report. Our responsibility for the information contained in the management report is defined in the regulations governing the audit activity, which establishes two different levels of the same:

a) A specific level that is applicable to the status of non-financial information, as well as to certain information included in the Annual Corporate Governance Report, as defined in art. 35.2. b) of Law 22/2015, on Audit of Accounts, which consists of verifying only that the aforementioned information has been provided in the management report and, if not, informing about it.

b) A general level applicable to the rest of the information included in the management report, which consists of evaluating and reporting on the concordance of the aforementioned information with the annual accounts, based on the knowledge of the entity obtained in the execution of the audit of the aforementioned annual accounts and without including information other than that obtained as evidence during the same, as well as evaluating and reporting whether the content and presentation of this part of the management report are in accordance with the regulations that result from application. If, based on the work performed, we conclude that there are material misstatements, we are obliged to report them.

Based on the work performed, as described previously, we have verified that the specific information mentioned in section a) above is provided in the management report and that the rest of the information contained in the management report agrees with the information of the annual accounts for the year 2017 and its content and presentation are in accordance with the applicable regulations.

## *Responsibility of the directors and the audit committee for the annual accounts*

The Company´s directors are responsible for the preparation of the accompanying annual accounts, such that they fairly present the equity, financial position and financial performance of Gas Natural SDG, S.A., in accordance with the financial reporting framework applicable to the entity in Spain, and for such internal control as the directors determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

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

The audit committee is responsible for overseeing the process of preparation and presentation of the annual accounts.

## *Auditor's responsibilities for the audit of the annual accounts*

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

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

As part of an audit in accordance with legislation governing the audit practice in Spain, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company´s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Company´s directors.
- Conclude on the appropriateness of the directors´ use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company´s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor´s report to the related disclosures in the annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor´s report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual accounts, including the disclosures, and whether the annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

From the matters communicated with the Company´s audit committee, we determine those matters that were of most significance in the audit of the annual accounts of the current period and are therefore the key audit matters.

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

# *Report on other legal and regulatory requirements*

## *Report to the Company´s audit committee*

The opinion expressed in this report is consistent with the content of our additional report to the Company's audit committee dated 14 February 2018.

## *Appointment period*

The General Ordinary Shareholders' Meeting held on April 20, 2017 appointed us as auditors of the Company for a period of one year, for the year ended December 31, 2017.

Previously, we were appointed by resolution of the General Shareholders' Meeting of June 12, 1990 for the period of 9 years (1990 - 1998), we have been re-elected annually by the General Shareholders' Meeting since then, and we have been performing the work of audit of accounts in an uninterrupted form since the year ended on December 31, 1990.

## *Services provided*

Services provided to the Company for services other than the audit of the accounts, are disclosed in Note 27 to the annual accounts.

In relation to services other than the audit of the accounts, which have been provided to the subsidiaries of the Company, refer to the audit report of 14 February 2018 on the consolidated annual accounts of Gas Natural SDG. S.A. and its subsidiaries in which they are integrated.

PricewaterhouseCoopers Auditores, S.L. (S0242)

Juan Manuel Anguita Amate (20367)

14 February 2018

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

# INDEPENDENT LIMITED ASSURANCE REPORT ON THE NON-FINANCIAL INDICATORS

To the Board of Directors of Gas Natural SDG, S.A.:

We have carried out our work to provide limited assurance on certain non-financial indicators contained in the 2017 Consolidated Directors' Report of Gas Natural SDG, S.A. and its subsidiaries (hereinafter 'Gas Natural Fenosa') for the year ended 31 December 2017, prepared in accordance with the criteria defined by Gas Natural Fenosa described in the section 'Glossary of non-financial indicators' included as Annex III of the mentioned Consolidated Directors' Report.

Specifically, we have reviewed the quantitative non-financial indicators included in table format in the sections '5.3. Responsible environmental management, '5.4. Interest in people', '5.5. Health and safety', '5.6. Responsible supply chain', '5.7. Social commitment', 'Analysis of the 2017 results' within the section '5.8. Integrity and transparency', and '7. Sustainable innovation', hereinafter, 'the non-financial indicators', of the 2017 Consolidated Directors' Report of Gas Natural Fenosa.

## Responsibility of the Directors of Gas Natural Fenosa

The Directors of Gas Natural Fenosa are responsible for the preparation, content and presentation of the non-financial indicators included in the Consolidated Directors' Report in accordance with the criteria defined by Gas Natural Fenosa. This responsibility includes designing, implementing and maintaining the internal control required to ensure that the non-financial indicators are free from any material misstatement due to fraud or error.

The Directors of Gas Natural Fenosa are also responsible for defining, implementing, adapting and maintaining the management systems from which the information required to prepare the non-financial indicators included in the Consolidated Directors' Report, is obtained.

## Our responsibility

Our responsibility is to issue a limited assurance report based on the procedures that we have carried out and the evidence obtained. Our limited assurance engagement was done in accordance with the International Standard on Assurance Engagements 3000 (Reviewed) "Assurance Engagements other than Audits or Reviews of Historical Financial Information", issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC).

The scope of a limited assurance engagement is substantially less extensive than the scope of a reasonable assurance engagement and thus, less security is provided.

The procedures that we have carried out are based on our professional judgment and have included consultations, observation of processes, document inspection, analytical procedures and random sampling tests. The general procedures employed are described below:

- Meetings with Gas Natural Fenosa's personnel from various departments who have been involved in the preparation of the non-financial indicators.

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- Analysis of the procedures used for obtaining and validating the data presented in the non-financial indicators.

- Analysis of the Gas Natural Fenosa's non-financial indicators adaptation to the requirements established by Gas Natural Fenosa, described in the Annex III of the Consolidated Directors' Report.

- Verification, through random sampling tests revisions, internal control tests and substantive and analytical tests on the quantitative information of the Gas Natural Fenosa's non-financial indicators. We have also verified whether they have been appropriately compiled from the data provided by Gas Natural Fenosa's sources of information.

## Our Independence and Quality Control

We have fulfilled our work in accordance with the independence requirements and other ethical requirements of the Code of Ethics for Professional Accountants of the International Ethics Standards Board for Accountants (IESBA), which are based on basic principles of integrity, objectivity, professional competence and diligence, confidentiality and professional conduct.

Our firm applies the International Standard on Quality Control 1 (ISQC 1) and thus employs an exhaustive quality control system which includes documented policies and procedures on the compliance of ethical requirements, professional standards, statutory laws and applicable regulations.

## Limited assurance conclusion

As a result of the procedures carried out and the evidence obtained, no matters have come to our attention which may lead us to believe that the non-financial indicators included in the Gas Natural Fenosa's Consolidated Directors' Report, for the financial year ending 31 December 2017, contain significant errors or have not been prepared, in all of their significant matters, in accordance with the criteria defined by Gas Natural Fenosa.

## Use and Distribution

Our report is only issued to the Directors of Gas Natural Fenosa, in accordance with the terms and conditions of our engagement letter. We accept no responsibility to third parties other than the addressees of our report.

PricewaterhouseCoopers Auditores, S.L.

Mª Luz Castilla

February 14, 2018

# GAS NATURAL SDG, S.A.

Auditor’s Report on “Information regarding the Internal Control System over Financial Reporting (ICSFR)” of Gas Natural SDG, S.A. for the 2017 financial year

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

## AUDITOR´S REPORT ON "INFORMATION REGARDING THE INTERNAL CONTROL SYSTEM OVER FINANCIAL REPORTING (ICSFR)" OF GAS NATURAL SDG, S.A. FOR THE 2017 FINANCIAL YEAR

To the Board of Directors:

In accordance with the request of the Board of Directors of Gas Natural SDG, S.A. ("the Company") and our engagement letter dated November 27, 2017, we have applied certain procedures in respect of the attached "Information regarding the Internal Control System over Financial Reporting" ("ICSFR"), included in the complementary document to the Annual Corporate Governance Report of Gas Natural SDG, S.A. for the 2017 financial year, which includes a summary of the Company's internal control procedures relating to its annual financial information.

The Board of Directors is responsible for adopting the necessary measures to reasonably ensure the implementation, maintenance and supervision of an appropriate internal control system, and for developing improvements to that system and preparing and establishing the content of the accompanying Information regarding the ICSFR.

In this regard, it should be borne in mind that, regardless of the quality of the design and operating efficiency of the internal control system used by the Company in relation to its annual financial information, only a reasonable, but not absolute, degree of assurance may be obtained in relation to the objectives it seeks to achieve, due to the limitations inherent in any internal control system.

In the course of our audit work on the annual accounts and in accordance with Spanish Auditing Standards, the sole purpose of our evaluation of the Company's internal control system is to enable us to establish the scope, nature and timing of our audit procedures in respect of the Company's annual accounts. Accordingly, our internal control evaluation, performed for the purposes of our audit, is not sufficient in scope to enable us to issue a specific opinion on the effectiveness of such internal control over the regulated annual financial information.

For the purposes of the present report, we have exclusively applied the specific procedures described below, as indicated in the "Guidelines concerning the auditor's Report on the Information regarding the Internal Control System over Financial Reporting for listed entities" published by the National Securities Market Commission on its web site, which sets out the work to be performed, the scope of such work and the content of this report. In view of the fact that, in any event, the scope of the work resulting from these procedures is reduced and substantially less than the scope of an audit or review of the internal control system, we do not express an opinion on the effectiveness thereof, its design or operational efficiency, in relation to the Company's annual financial information for the 2017 financial year described in the accompanying Information regarding the ICSFR. Had we applied additional procedures to those determined by the aforementioned Guidelines, or had we performed an audit or review of the internal control system in relation to the regulated annual financial information, other matters could have come to light in respect of which you would have been informed. In addition, as this special engagement is not an audit of financial statements and is not subject to the Auditing Act, we do not express an audit opinion under the terms of the aforementioned legislation.

The procedures applied were as follows:

1. Reading and understanding the information prepared by the Company in relation to the ICSFR – as disclosed in the Directors' Report – and the evaluation of whether such information includes all the information required as per the minimum content set out in Section F regarding the description of the ICSFR, in the model of the Annual Corporate Governance Report, as established in Circular nº 7/2015 of the National Securities Market Commission dated December 22, 2015.

2. Making enquiries of personnel in charge of preparing the information mentioned in point 1 above in order to: (i) obtain an understanding of the preparation process; (ii) obtain information that enables us to assess whether the terminology used is in line with the framework of reference; (iii) obtain information as to whether the control procedures described have been implemented and are functioning in the Company.

3. Review of supporting documentation explaining the information described in point 1 above and which mainly comprises the information made directly available to the persons responsible for preparing the information on the ICSFR. Such documentation includes reports prepared by the internal audit function, senior management and other internal and external specialists in support of the functions of the audit committee.

4. Comparison of the information described in point 1 above with our knowledge of the Company's ICSFR, obtained by means of the application of the procedures performed within the framework of the audit engagement on the annual accounts.

5. Reading the minutes of meetings of the board of directors, audit committee and other committees of the Company, for the purposes of evaluating the consistency between the matters dealt with therein in relation to the ICSFR and the information described in point 1 above.

6. Obtaining a representation letter concerning the work performed, duly signed by the persons responsible for the preparation and drafting of the information mentioned in point 1 above.

As a result of the procedures applied in relation to the Information regarding the ICSFR, no inconsistencies or incidents have been identified which could affect such information.

This report has been prepared exclusively within the framework of the requirements of article 540 of the revised Spanish Companies Act and Circular nº 5/2013 of the National Securities Market Commission, dated June 12, 2013, as modified by Circular nº 7/2015 of the National Securities Market Commission, dated December 22, 2015, for the purposes of describing the ICSFR in Annual Corporate Governance Reports.

PricewaterhouseCoopers Auditores, S.L.

Juan Manuel Anguita Amate

February 14, 2018