Naturgás Energía Distribución, S.A.U. and Subsidiaries

Consolidated Annual Accounts

30 April 2017

Consolidated Directors' Report

2017

(With Independent Auditor's Report Thereon)

KPMG Auditores, S.L.
Ventura Rodríguez, 2, 1º
33004 Oviedo

Independent Auditor's Report on the Consolidated Annual Accounts

To the
Sole Shareholder of Naturgás Energía Distribución, S.A.U.

Opinion

We have audited the consolidated annual accounts of Naturgás Energía Distribución, S.A.U. (the "Company") and subsidiaries (together the "Group"), which comprise the consolidated balance sheet at 30 April 2017, and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the four-month period then ended, and consolidated notes.

In our opinion, the accompanying consolidated annual accounts give a true and fair view, in all material respects, of the consolidated equity and consolidated financial position of the Company at 30 April 2017, and of its consolidated financial performance and its consolidated cash flows for the four-month period then ended in accordance with the applicable financial reporting framework (specified in note 2 to the accompanying annual accounts) and, in particular, with the accounting principles and criteria set forth therein.

Basis for Opinion

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

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

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

Most Relevant Aspects of the Audit

The most relevant aspects of the audit are those that, in our professional judgement, have been considered as the most significant risks of material misstatement in the audit of the consolidated annual accounts for the current period. These risks 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 risks.

Recoverability of the Deferred Tax Asset related to the Sale of Assets within the Group

As mentioned in note 19 to the accompanying consolidated annual accounts the transactions carried out by the Company, domiciled in the territory of Vizcaya, and a subsidiary, domiciled in the general taxation territory, to reorganise the natural gas distribution and transmission assets have led to an increase in the assets' tax value generating a deferred tax asset of Euros 249,062 thousand in the consolidated annual accounts at 30 April 2017.

The Group prepares projections of future taxable income to analyse the recoverability of the above-mentioned deferred tax asset based on future cash flow projections and including tax planning measures, the estimation of which requires value judgements and involves inherent uncertainty.

As well as an assessment of whether the disclosures in the consolidated annual accounts comply with the requirements of the applicable financial reporting framework, our audit procedures included obtaining the projections of future taxable income used by the Group to calculate recoverability, contrasting the information in the projections with that contained in the business plan and the Group's budget, evaluating the reasonableness of the main assumptions considered, analysing the reasonableness of the tax planning measures included in the projections, and performing tests on the design and implementation of the key controls associated with the preparation of the projections.

Other Information: Consolidated Directors' Report

Other information solely comprises the Consolidated Directors' Report for the four-month period ended 30 April 2017, the preparation of which is the responsibility of the Company's Directors and which does not form an integral part of the consolidated annual accounts.

Our audit opinion on the consolidated annual accounts does not encompass the Consolidated Directors' Report. Our responsibility for the Consolidated Directors' Report, in accordance with the requirements of prevailing legislation regulating the audit of accounts, consists of assessing and reporting on the consistency of the Consolidated Directors' Report with the consolidated annual accounts, based on knowledge of the entity obtained during the audit of the aforementioned accounts and without including any information other than that obtained as evidence during the audit. It is also our responsibility to assess and report on whether the content and presentation of the Consolidated Directors' Report are in accordance with applicable legislation. If, based on the work we have performed, we conclude that there are material misstatements, we are required to report them.

Based on the work carried out, as described in the preceding paragraph, the information contained in the Consolidated Directors' Report is consistent with that disclosed in the consolidated annual accounts for the four-month period ended 30 April 2017 and the content and presentation of the report are in accordance with applicable legislation.

Directors' Responsibility for the Consolidated Annual Accounts

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

In preparing the consolidated annual accounts, the 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.

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 prevailing legislation regulating the audit of accounts in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence economic decisions of users taken on the basis of these consolidated annual accounts.

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

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, and 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 Company's Directors.

- Conclude on the appropriateness of the 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 a true and fair view.

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

We communicate with the Directors of the Company, 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.

From the significant risks communicated to the Directors of Naturgás Energía Distribución, S.A.U., we determine those that were of most significance in the audit of the consolidated annual accounts of the current period and which are therefore the most significant risks.

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

KPMG Auditores, S.L.

E. Bilbao

Estibaliz Bilbao Belda

(on the Spanish Official Register of Auditors ("ROAC") with No. 16.109)

6 June 2017

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Annual Accounts
30 April 2017

Consolidated Directors' Report
2017

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Balance Sheets at

30 April 2017 and 31 December 2016)

(Expressed in thousands of Euros)

Assets	*Note*	*30.04.2017*	*31.12.2016*
Intangible assets	**Note 5**	**38,894**	**52,109**
Patents, licences, trademarks and similar rights		8,325	9,367
Goodwill		27,675	39,898
Computer software		2,894	2,844
Property, plant and equipment	**Note 6**	**561,709**	**568,839**
Land and buildings		3,370	3,418
Technical installations, machinery, equipment, furniture and other items		547,171	551,973
Under construction and advances		11,168	13,448
Non-current investments in Group companies and associates		**646**	**14,747**
Equity-accounted investees	Note 9	646	595
Loans to companies	Note 11	-	14,152
Non-current investments	**Notes 10 and 11**	**59,602**	**63,692**
Loans to third parties		58,590	63,169
Other financial assets		1,012	523
Deferred tax assets	**Note 19**	**251,146**	**206,888**
Total non-current assets		**911,997**	**906,275**
Inventories	**Note 4 (h)**	**4,811**	**4,416**
Goods for resale		4,505	4,416
Advances to suppliers		306	-
Trade and other receivables	**Note 11**	**288,335**	**262,814**
Trade receivables – current		13,512	10,944
Trade receivables from Group companies and associates - current	**Note 21**	19,555	27,213
Equity-accounted investees – current	**Note 21**	48	1,536
Other receivables		14,282	8,059
Group companies and associates		1,014	11,767
Personnel		102	143
Public entities, other		239,822	203,152
Current investments in Group companies and associates	**Note 10 and 11**	**285,230**	**-**
Loans to companies		285,230	-
Current investments		**209**	**208**
Other financial assets		209	208
Prepayments for current assets	**Note 12**	**2,235**	**232**
Cash and cash equivalents		**-**	**6**
Cash		-	6
Total current assets		**580,820**	**267,676**
Total assets		**1,492,817**	**1,173,951**

The accompanying notes form an integral part of the consolidated annual accounts for 2017.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Balance Sheets at

30 April 2017 and 31 December 2016

(Expressed in thousands of Euros)

Equity and Liabilities	*Note*	*30.04.2017*	*31.12.2016*
Capital and reserves	**Note 13**	**(123,937)**	**(203,199)**
Capital			
Registered capital		100,000	100,000
Share premium		106,483	106,483
Reserves			
Legal and statutory reserves		118,272	118,272
Other reserves		269,046	(9,083)
Profit for the year		79,262	278,129
Interim dividend	**Note 3**	(797,000)	(797,000)
Grants, donations and bequests received	**Note 14**	**37,216**	**37,290**
Total equity		**(86,721)**	**(165,909)**
Non-current provisions		**1,220**	**358**
Other provisions		1,220	358
Non-current payables	**Note 17**	**2,195**	**1,684**
Other financial liabilities		2,195	1,684
Group companies and associates, non-current	**Note 17**	**952,000**	**952,000**
Deferred tax liabilities	**Note 19**	**53,301**	**69,320**
Total non-current liabilities		**1,008,716**	**1,023,362**
Current payables	**Note 17**	**2,838**	**4,432**
Other financial liabilities		2,838	4,432
Group companies and associates, current	**Note 17**	**464,362**	**62,209**
Trade and other payables	**Note 17**	**103,622**	**249,857**
Current payables to suppliers		1,096	9,306
Other payables		58,124	16,706
Payables to Group companies and associates		39,201	217,785
Personnel (salaries payable)		821	2,351
Public entities, other	**Note 19**	4,380	3,709
Total current liabilities		**570,822**	**316,498**
Total equity and liabilities		**1,492,817**	**1,173,951**

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Income Statements for the four-month period ended 30 April 2017 and the year ended 31 December 2016

(Expressed in thousands of Euros)

	Note	30.04.2017	31.12.2016
Revenues	**Note 22**	**82,149**	**201,137**
Sales		72,626	173,214
Services rendered		9,523	27,923
Self-constructed assets	**Note 6**	**1,552**	**4,876**
Supplies	**Note 22**	**(8,608)**	**(6,009)**
Merchandise used		(7,307)	(2,352)
Raw materials and consumables used		(6)	(8)
Subcontracted work	**Note 22**	(1,295)	(3,649)
Other operating income		**145**	**527**
Non-trading and other operating income		125	343
Operating grants taken to income		20	184
Personnel expenses		**(4,999)**	**(13,949)**
Salaries and wages		(3,878)	(11,316)
Employee benefits expense	**Note 22**	(1,121)	(2,506)
Provisions	**Note 22**	-	(127)
Other operating expenses		**(10,233)**	**(33,600)**
External services		(7,692)	(29,939)
Taxes		(2,406)	(3,464)
Losses, impairment and changes in provisions for commercial transactions	**Notes 11 and 16**	24	50
Other operating expenses		(159)	(247)
Amortisation and depreciation	**Notes 5 and 6**	**(26,989)**	**(92,681)**
Non-financial and other capital grants	**Note 14**	**871**	**3,345**
Provision surpluses		**(346)**	**6**
Impairment and gains on disposal of fixed assets	**Note 22**	**(30)**	**3,029**
Gains on disposal and other		(30)	3,029
Results from operating activities		**33,512**	**66,681**
Finance income		**178**	**149**
Marketable securities and other financial instruments			
Other	**Note 10**	178	149
Finance costs	**Note 16**	**(6,686)**	**(620)**
Group companies and associates		(6,664)	(543)
Other		(22)	(77)
Net finance cost		**(6,508)**	**(471)**
Share of profit of equity-accounted investees	**Note 9**	**50**	**122**
Profit before income tax		**27,054**	**66,332**
Income tax	**Note 19**	52,208	211,797
Profit for the year		**79,262**	**278,129**

The accompanying notes form an integral part of the consolidated annual accounts for 2017.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Statements of Changes in Equity
for the four-month period ended 30 April 2017
and the year ended 31 December 2016

A) Consolidated Statements of Recognised Income and Expense
for the four-month period ended 30 April 2017
and the year ended 31 December 2016

(Expressed in thousands of Euros)

	Note	30.04.2017	31.12.2016
Profit for the year		**79,262**	**278,129**
Income and expense recognised directly in equity			
Grants, donations and bequests		835	2,256
Tax effect		(234)	(632)
Total income and expense recognised directly in equity	**Note 14**	**601**	**1,624**
Amounts transferred to the income statement			
Grants, donations and bequests		(871)	(3,345)
Tax effect		196	1,241
Total amounts transferred to the income statement	**Note 14**	**(675)**	**(2,104)**
Total recognised income and expense		**79,188**	**277,649**

The accompanying notes form an integral part of the consolidated annual accounts for 2017.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Statements of Changes in Equity for the four-month period ended 30 April 2017 and the year ended 31 December 2016

B) Consolidated Statements of Total Changes in Equity for the four-month period ended 30 April 2017 and the year ended 31 December 2016

(Expressed in thousands of Euros)

	Registered capital	Share premium	Reserves	Prior years' profit and loss	Profit for the year	Interim dividend (Note 3)	Grants, donations and bequests received	Total
Adjusted balance at 1 January 2016	**100,000**	**799,664**	**320,940**	**-**	**178,019**	**-**	**37,770**	**1,436,393**
Recognised income and expense	-	-	-	-	278,129	-	(480)	**277,649**
Transactions with shareholders or owners								
Distribution of dividends	-	(682,358)	(250,642)	-	-	(797,000)	-	**(1,730,000)**
Distribution of profit for 2015								
Dividends	-	-	-	(149,942)	-	-	-	**(149,942)**
Distribution of profit for the year	-	-	-	178,019	(178,019)	-	-	**-**
Other changes in equity (note 3)	-	-	57,233	(57,233)	-	-	-	**-**
Other movements	-	(10,823)	(18,342)	29,156	-	-	-	**(9)**
Balance at 31 December 2016	**100,000**	**106,483**	**109,189**	**-**	**278,129**	**(797,000)**	**37,290**	**(165,909)**
Recognised income and expense	-	-	-	-	79,262	-	(74)	**79,188**
Distribution of profit for the year	-	-	-	278,129	(278,129)	-	-	**-**
Balance at 30 April 2017	**100,000**	**106,483**	**109,189**	**278,129**	**79,262**	**(797,000)**	**37,216**	**(86,721)**

The accompanying notes form an integral part of the consolidated annual accounts for 2017.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated statements of cash flows
for the four-month period ended 30 April 2017 and
the year ended 31 December 2016.

(Expressed in thousands of Euros)

	Note	30.04.2017	31.12.2016
Cash flows from operating activities			
Profit for the year before tax		**27,054**	**66,332**
Adjustments for:			
Amortisation and depreciation	Notes 5 and 6	26,989	92,681
Impairment		(1)	(13)
Change in provisions		1,591	89
Grants recognised in the income statement	Note 14	(871)	(3,345)
Proceeds from disposals of fixed assets		30	(3,029)
Finance income		(178)	(149)
Finance costs		6,686	620
Share of profit of equity-accounted investees		(50)	(122)
Other income and expenses		(1,552)	(4,876)
Changes in operating assets and liabilities			
Inventories		(395)	(4,274)
Trade and other receivables		(24,589)	(214,372)
Other current assets		(2,031)	(115)
Other current liabilities		25	
Trade and other payables		(155,279)	149,267
Provisions		-	-
Other non-current assets and liabilities		4,117	5,831
Other cash flows from operating activities			
Interest paid		(484)	(330)
Dividends received		-	93
Interest received		1,543	271
Income tax paid		-	(21,355)
Cash flows from operating activities		**(117,395)**	**63,204**
Cash flows from investing activities			
Payments for investments			
Group companies and associates		(282,692)	(14,152)
Intangible assets	Note 5	(396)	(3,479)
Property, plant and equipment	Note 6	(7,697)	(128,351)
Other financial assets		(683)	-
Other assets		(462)	(99)
Proceeds from sale of investments			
Group companies and associates		11,620	13
Property, plant and equipment		-	11,068
Other financial assets		-	998,172
Cash flows from investing activities		**(280,310)**	**863,172**
Cash flows from financing activities			
Proceeds from and payments for equity instruments			
Grants, donations and bequests received		1,262	1,851
Proceeds from and payments for financial liability instruments			
Issue			
Group companies and associates	Note 17	457,695	951,886
Other		485	-
Redemption and repayment of			
Group companies and associates		(61,743)	(165)
Dividends and interest on other equity instruments paid			
Dividends		-	(1,879,942)
Cash flows used in financing activities		**397,699**	**(926,370)**
Net increase in cash and cash equivalents		(6)	6
Cash and cash equivalents at beginning of year		6	-
Cash and cash equivalents at year end		-	6

The accompanying notes form an integral part of the consolidated annual accounts for 2017.

(1) Nature, Activities, Regulatory Framework and Composition of the Group

Naturgás Energía Distribución, S.A.U. (hereinafter the Company or the Parent) was incorporated as a corporation (*sociedad anónima*) under the name of Naturcorp Redes, S.A.U. on 31 December 2003 and adopted its current name in 2005. Its registered office is located in Bilbao (Vizcaya).

Pursuant to article 13.1 of the Revised Spanish Companies Act, the Company is registered at the Mercantile Registry as a solely owned company.

According to article 2 of its articles of association, the Company's statutory activity comprises:

a) The distribution of natural gas, including the construction, operation and maintenance of distribution facilities used to transmit natural gas from the transmission networks to consumption points.

b) The construction, maintenance and operation of secondary transmission network facilities for natural gas, in order to facilitate the transmission of natural gas to distribution networks or to end consumers, where appropriate.

c) The provision of services considered to be ancillary to supplies, to natural gas suppliers and end users.

d) The acquisition, import, storage, bottling, all manner of industrial handling, transport, distribution and supply of liquefied petroleum gas, and the acquisition, manufacture, distribution and supply of all machinery and equipment required to conduct this activity, and the provision of technical assistance.

The Company conducts its statutory activity under the terms and within the scope provided for in the Hydrocarbon Industry Law and related implementing legislation and pursuant to the legislation issued by the autonomous regional governments in accordance with their powers.

In cases where the Company must obtain prior authorisation, meet another requirement or legal, technical or economic-financial condition or procure special training in order to carry out its statutory activity, such prerequisites are met prior to conducting the related activities.

The Company forms part of the EDP Group, the parent of which is EDP Energías de Portugal S.A., with their registered office in Lisbon (Portugal).

During 2016 and 2017 the EDP Group undertook an internal restructuring of its operations in Spain in order to improve organisation and efficiency. This restructuring aimed to establish a corporate structure which is in line with the various legal frameworks applicable to the natural gas distribution areas where the EDP Group operates (general regime applicable in Asturias and Cantabria and the regional regime prevailing in the Basque Country). Moreover, from an economic and financial perspective, the restructuring allows for debt to be allocated in a manner that is more in line with the reality of the EDP Group and enables the financial structure of the distributors to be adapted so as to better reflect the market, taking into account the low-risk profile of distribution activities.

In this regard, the Company carried out the following transactions during 2016:

- On 4 November 2016 the Company set up the subsidiary EDP España Distribución de Gas, S.A.U., in which it has concentrated numerous secondary natural gas distribution and transmission assets, including distribution networks and secondary transmission gas pipelines, natural gas satellite plants, connection points, regulation and metering stations, reading and metering equipment, and communal gas tanks, as well as the rights to supply points, use, access, passage and other easements, in addition to the authorisations, permits and licences required for the flow of natural gas to the supply points located in various municipalities in Cantabria and Asturias.

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- On 29 November 2016 the Company set up the subsidiary Naturgás Suministro GLP, S.A.U., in which it has concentrated certain liquid petroleum gas (LPG) distribution and supply assets, including storage tanks and deposits, distribution networks and gas pipelines, reading and metering equipment, the rights to supply points, use, access, passage and other easements, as well as the authorisations, permits and licences in the Basque Country.

Therefore, in 2017 y 2016, Naturgás Distribución, S.A.U. is the parent of a Group comprising the subsidiaries EDP España Distribución Gas, S.A.U. and Naturgás Suministro GLP, S.A.U. The Group also holds investments in the associate Tolosa Gas, S.L. Information on the composition of the Group is provided in Appendix I.

Regulatory framework

Details of the basic regulatory framework applicable to the Group are as follows:

Hydrocarbon Industry Law 34/1998 of 7 October 1998, amended by Law 12/2007 and by Royal Decree-Law 13/2012, introducing mechanisms to foster competition within the sector and defining a new natural gas market model. This law implements the main system definitions as regards the parties that participate therein and organises the gas system, distinguishing between regulated activities (regasification, transmission, storage and distribution) and unregulated activities (supply and other services). Lastly, this law defines the rights and obligations of the parties that operate in the natural gas market and it regulates liquefied petroleum gas distribution activities.

1. Natural gas

The aforementioned Hydrocarbon Industry Law 34/1998, which repealed all other conflicting laws, and subsequent implementing legislation set out, inter alia, the following principles:

a) Gradual liberalisation of the natural gas system:

This law provides for the liberalisation of gas supply activities, gradually enabling different types of customers to select their supplier. Since 1 January 2003, different types of customers have been able to freely select their supplier. The schedule for implementing the last resort supply commenced on 1 July 2008, leading to the elimination of the previous tariff-based supplies from gas distributors.

Royal Decree 949/2001 of 3 August 2001 regulates third-party access to gas facilities and sets out an integrated economic system for the natural gas sector. This Royal Decree also sets out the model for calculating natural gas tariffs and the payments and fees charged for third-party use of the gas network.

Following approval by the Delegate Commission on Economic Affairs, the Ministry of Industry, Tourism and Trade set the new prices for last resort tariffs and the tolls and charges for basic third-party access services. The entitlement of direct market consumers and suppliers to use the basic grid and transmission and distribution facilities was also established, and a single nationwide toll was set for the use of these networks. Ministry of Industry, Energy and Tourism Order ETU/1977/2016, stipulating the tolls and charges for third-party access to gas facilities and the remuneration for regulated activities for 2017, was published on 18 December 2015.

Royal Decree 1434/2002 of 27 December 2002, implementing the Hydrocarbon Industry Law, regulates transmission, distribution, sale and supply activities and the authorisation procedures for gas facilities.

With respect to distributors, Ministry of Economy Order ECO/301/2002 set out the remuneration for distribution activities for the first time, to be determined as of that date on the basis of an annual revision, taking into account increases in the points of supply, the volume of gas transmitted and price fluctuations. Publication of Royal Decree-Law 8/2014 and Law 18/2014 brought about changes to the remuneration model applicable to distributors from the second half of 2014 onwards, although the annual revision of remuneration will continue to be determined by reference to the variation in demand.

In addition to tolls and changes, the aforementioned Ministry of Economy Order ETU/1977/2016 also sets the remuneration for regulated activities in 2017.

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Similarly, Ministry of Economy Order ECO/2692/2002 of 28 October 2002 defines the settlement procedures for the payment obligations and rights to receivables necessary to remunerate natural gas regasification, transmission, storage and distribution activities and the pertinent specifically allocated payments and charges, and defines a system for reporting on natural gas billings and consumption.

b) Settlements of regulated activities - gas sector:

Basically as a result of the entry into force of the Spanish Gas Industry Law 34/1998 and the corresponding implementing provisions, intercompany settlements have arisen since 2002. These settlements are performed by the Spanish National Markets and Competition Commission (which includes the defunct National Energy Commission) and give rise to receipts and payments between companies in the sector in order to redistribute the proceeds obtained from access tolls and charges so that each company receives the remuneration effectively allocated to it for regulated activities. Settlement functions, at present performed temporarily by the Commission, will be transferred when determined by the Ministry of Energy, Tourism and the Digital Agenda in accordance with Law 3/2013 on the creation of the Spanish National Markets and Competition Commission.

c) Financing of the cumulative deficit at 31 December 2016:

Law 18/2014 defines the treatment to be given to the tariff deficit affecting the gas sector, i.e. the financing of the negative imbalances between revenues and costs of the gas system for each year.

As such, the Law stipulates that the amount of the cumulative deficit at 31 December 2014 will be determined in the final settlement for 2014 (settlement 15), and that regulated parties will be entitled to recover the annual amounts of this cumulative deficit in the settlements for the next 15 years and accrue interest at market rates. Deficits incurred subsequent to 2014 will be paid in the next five annual amounts and will accrue interest at market rates. The amount of the deficit recognised, the corresponding annual amount and the interest rate applied are subject to approval by Order of the Ministry of Energy, Tourism and the Digital Agenda.

In accordance with Ministry of Energy, Tourism and the Digital Agenda Order ETU/1977/2016, the cumulative deficit of the sector at 31 December 2014 amounted to Euros 1,025 million, whilst the cumulative deficit for 2015 totalled Euros 27 million, Euros 55.9 million and Euros 1.7 million of the deficits for 2014 and 2015, respectively, corresponded to Naturgás Energía Distribución, S.A.U. These amounts have been recognised and began to be repaid, together with the corresponding interest, on 25 November 2016.

Furthermore, based on provisional settlement 14 for 2016 drawn up by the Spanish National Markets and Competition Commission (CNMC), the 2016 deficit amounts to Euros 108.25 million, of which Euros 6.35 million pertains to Naturgás Energía Distribución, S.A.U.

d) Correct functioning of the system guaranteed through the following measures:

Enagás GTS, S.A.U. carries out system technical manager activities, for which it receives remuneration. As the entity responsible for the technical management of the basic grid and secondary transmission networks, Enagás GTS, S.A.U. must guarantee the continuity and security of supply of natural gas and the correct coordination between access points, storage facilities and transmission facilities under criteria of non-discrimination.

e) Unbundling of activities

Activities pertaining to the supply of natural gas by pipeline are conducted by transmission agents, distributors and suppliers. Regasification, strategic storage, transmission and distribution are regulated activities, whilst supply activities are carried out freely and the corresponding economic regime is determined on the basis of the terms and conditions agreed between the parties.

(Continued)

In this regard, trading companies that carry out any of the regulated activities described in the preceding paragraph should have this activity as their sole statutory activity and may not, therefore, carry out any supply activities. Similarly, companies engaged in the supply of natural gas should have this activity as their sole statutory activity and may not carry out any regulated activities.

Natural gas companies that conduct more than one of the regulated activities described above must maintain separate accounts for each of these activities in their internal accounting records, exactly as would be required if these activities were conducted by different companies. Furthermore, the Law defines a number of mandatory unbundling requirements applicable to companies that carry out regulatory activities and belong to a corporate group that also includes companies that carry out supply activities.

2. LPG - Liquefied petroleum gas

The Hydrocarbon Industry Law implements the main system definitions as regards the parties that participate therein and organises activities relating to the supply of liquefied petroleum gas (hereinafter LPG), distinguishing between wholesale and retail supplies.

Subsequently, Law 8/2015 of 21 May 2015, amending Hydrocarbon Industry Law 34/1998 of 7 October 1998 and regulating certain tax and non-tax measures relating to the exploration, investigation and exploitation of hydrocarbons, introduces profound changes to the general framework for these activities. This law explicitly defines this supply, classified within bulk supply, and stipulates that the regulations governing the supply of combustible gases through pipelines will be applicable to the piped supply of bulk LPG, to the extent that there is no implementing legislation in this regard.

Conversely, Royal Decree 1085/1992 of 11 September 1992, approving the regulation on liquefied petroleum gas distribution activities, in implementation of Law 15/1992 of 5 June 1992, adopting urgent measures for the progressive adaptation of the oil industry to the Community framework, sets out the main details for the exercise of retail LPG supply activities, i.e. sales to consumers or end users. In this regard, the RD implements, inter alia, the requirements that must be met by entities in order to conduct these activities, matters relating to facilities, details of supplies, contractual arrangements and the tariff regime. This Royal Decree was subsequently updated by Royal Decree 197/2010 of 26 February 2010, adapting certain provisions relating to the hydrocarbons industry in accordance with Law 25/2009 of 22 December 2009, amending and adapting various laws to the Law on free access to and the exercise of service activities, in order to bring it into line with Law 34/1998.

a) Features of the LPG supply sector:

Liquefied petroleum gas is understood as the fractions of light hydrocarbons derived from crude oil or natural gas, specifically propane and butane.

The activities encompassed within the supply of LPG are as follows: Production, acquisition, intra-EU exchange, import and export; storage, mixture, bottling; transport; wholesale supply; retail supply; installation, maintenance and revision of facilities relating to the supply of LPG.

Amongst other means, LPG may be supplied in bulk. This in turn encompasses the distribution and/or supply of piped LPG, which is understood as referring to the distribution and supply of LPG through a pipeline from one or more tanks to more than one point of supply, from where the LPG is delivered to the customer in its gaseous state and consumption is individually metered.

"Wholesale supply" is understood as referring to supplies that are not made to one consumer or end user.

"Retail supply" is taken to mean sales to consumers or end users.

b) Requirements and conditions for conducting retail LPG distribution activities

Article 46 of Hydrocarbon Industry Law 34/1998 defines the concept of a retail distributor of bulk LPG. This article stipulates that, in order to be authorised to conduct this activity, an entity must have the required legal, technical and economic and financial capacity, and its facilities must meet the technical and safety conditions set forth in legislation.

(Continued)

In the absence of any regulations implementing article 46, transitional provision two of Law 34/1998 has been applied, which upholds the validity of the regulations governing the matters covered in Law 34/1998, until new regulation is issued. In this case, the prevailing legislation is the aforementioned regulation on LPG distribution activities (Royal Decree 1085/1992, Official State Gazette of 9 October 1992). Although this regulation does not consider the same figures, it is understood that retail distributors of bulk LPG must nevertheless meet the same requirements as those applicable to LPG suppliers.

This legislation stipulates that, in order to conduct these activities, retail distributors must have the following:

1. Financial capacity.

2. Technical capacity.

3. Contractually assured supplies.

4. Storage facilities.

5. Minimum level of inventories to ensure security of supply, equivalent to 30 days' of total sales, or the option of purchasing the LPG through a wholesale operator.

c) Economic regime:

With respect to the economic framework for piped LPG, the current wording of article 94 of Law 34/1998 stipulates that the Ministry will issue the provisions necessary for establishing the sale tariffs for piped LPG supplied to end consumers, as well as the corresponding assignment prices for distributors of piped combustible gases. The difference between the two prices gives rise to the margin obtained by suppliers in the exercise of their activities to supply gas to end customers, comprising a fixed component for each consumer, and a variable, consumption-based component.

The current economic framework stems from the Order of 31 July 1997, which defines the system of maximum pre-tax selling prices of liquefied petroleum gas (Official State Gazette of 1 August 1997). This Order has been subject to successive reviews and updates:

• Order of 16 July 1998, updating the supply costs for the system for automatically determining maximum pre-tax selling prices of liquefied petroleum gas, and liberalising certain supplies.

• Ministry of industry, Tourism and Trade Order ITC/3292/2008 of 14 November 2008 amending the system for automatically determining pre-tax selling prices of piped liquefied petroleum gas.

• Ministry of Industry, Energy and Tourism Order IET/389/2015 of 5 March 2015, updating the system for automatically determining maximum pre-tax selling prices of bottled liquefied petroleum gas and amending the system for automatically determining pre-tax selling prices of piped liquefied petroleum gas.

The maximum price of piped liquefied petroleum gas is established in the Resolution issued by the Director General for Energy Policy and Mining in accordance with the aforementioned legislation. These resolutions, which may be monthly, notably include a revision in July each year to determine the supply margin for these activities, for instance, in 2016, the Resolution of 11 July 2016 issued by Directorate-General for Energy Policy and Mining, which determined the new pre-tax selling prices of piped liquefied petroleum gas.

(Continued)

(2) Basis of Presentation

(a) True and fair view

The accompanying consolidated annual accounts have been prepared on the basis of the accounting records of Naturgás Energía Distribución, S.A.U. and subsidiaries. The consolidated annual accounts for 2017 have been prepared in accordance with prevailing legislation, the Spanish General Chart of Accounts and the standards for the preparation of consolidated annual accounts, to give a true and fair view of the consolidated equity and consolidated financial position at 30 April 2017 and consolidated results of operations, consolidated changes in equity, and consolidated cash flows for the four-month period then ended.

The Directors consider that the consolidated annual accounts for 2017, authorised for issue on 1 June 2017, will be approved with no changes by the sole shareholder.

(b) Comparative information

In accordance with the minutes drawn up on 24 April 2017 reflecting the decisions taken by the sole shareholder, the Company changed its reporting date to 30 April (previously 31 December). The consolidated annual accounts at 30 April 2017 therefore refer to a four-month period.

As the figures in the consolidated income statement, consolidated statement of changes in equity, consolidated statement of cash flows and the notes thereto for 2017 are for a period of only 4 months, they are not directly comparable with the prior twelve-month period.

(c) Functional and presentation currency

The figures disclosed in the consolidated annual accounts are expressed in thousands of Euros, the Company's functional and presentation currency, rounded off to the nearest thousand.

(d) Critical issues regarding the valuation and estimation of relevant uncertainties and judgements used when applying accounting principles

Relevant accounting estimates and judgements and other estimates and assumptions have to be made when applying the Group's accounting principles to prepare the consolidated annual accounts. A summary of the items requiring a greater degree of judgement or which are more complex, or where the assumptions and estimates made are significant to the preparation of the consolidated annual accounts, is as follows:

(i) Relevant accounting estimates and assumptions

Recoverability of deferred tax assets (see note 19). The Group recognises deferred tax assets following analysis of the capacity to generate future taxable income and/or tax payable against which to offset them. This analysis uses the best available estimate of future income and expenses.

Other estimates made by the Group relate to the useful life of property, plant and equipment and intangible assets, provisions and settlements for the regulated activities carried out, which are used as a basis for determining the revenues from these regulated activities.

(ii) Relevant judgements when applying accounting principles

Management has recognised deferred tax assets with a recoverability period of more than ten years, based on its understanding that gas distribution is a regulated, asset-intense, stable activity, and thus there are no doubts as to the recoverability of the assets.

(Continued)

(iii) Change in accounting estimates

Although estimates are calculated by the Company's directors based on the best information available at 30 April 2017, future events may require changes to these estimates in subsequent years. Any effect on the consolidated annual accounts of adjustments to be made in subsequent years would be recognised prospectively.

In 2017 the Company re-estimated the useful life of certain assets (see note 4.d)). As a result, the depreciation and amortisation expense for the four-month period ended 30 April 2017 was reduced by Euros 5.4 million with respect to the amount that would have been recognised based on the previous useful lives (useful lives were adjusted with effect from 1 January 2017).

(3) Distribution of Profit

The distribution of the Company's profit for the year ended 31 December 2016, approved by the sole shareholder on 22 May 2017, was as follows:

	Euros
Basis of allocation	
Profit for the year	881,307,990.13
Distribution	
Voluntary reserves	84,307,990.13
Interim Dividends	797,000,000.00
	881,307,990.13

On 19 December 2016, the Board of Directors agreed to distribute interim dividends totalling Euros 797 million with a charge to 2016 profit.

The amount distributed did not exceed the profits reported by the Parent since the end of the previous reporting period, after deducting the estimated income tax payable on these profits, as required by article 277 of the Revised Spanish Companies Act.

The provisional accounting statement prepared in accordance with statutory requirements demonstrating that sufficient cash was available for distribution of the aforementioned dividend is as follows:

	Euros
Forecast distributable profit of the Parent for 2016:	
Projected profit after income tax to 30/11/2016	819,399,961.45
Estimated distributable profit for 2016	819,399,961.45
Interim dividend	797,000,000.00
Forecast cash flow for the period from 1 December 2016 to 30 November 2017	
Cash and cash equivalents at 1 December 2016	1,837,002,517.57
Projected collections	638,275,995.00
Projected payments, including interim dividends, and cash pooling	(2,412,343,759.14)
Projected cash and cash equivalents at 30 November 2017	62,934,753.43

(Continued)

The proposed distribution of the Company's 2017 profit to be submitted to the sole shareholder for approval is as follows:

	Euros
Basis of allocation	
Profit for the year	210,270,329.81
Distribution	
Voluntary reserves	210,270,329.81

At 30 Abril 2017 y 31 December 2016 the Parent's non-distributable reserves are as follows:

	Thousands of Euros	
	30.04.2017	31.12.2016
Non-distributable reserves		
Legal reserve	20,000	20,000
Revaluation reserves	98,272	98,272
	118,272	118,272

Profit recognised directly in equity cannot be distributed, either directly or indirectly.

(4) Significant Accounting Policies

(a) Subsidiaries

Subsidiaries are entities, including special purpose entities (SPE), over which the Company, either directly or indirectly through subsidiaries, exercises control as defined in article 42 of the Spanish Code of Commerce. Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. In assessing control, potential voting rights held by the Group or other entities that are exercisable or convertible at the end of each reporting period are considered.

Subsidiaries are fully consolidated.

Information on the subsidiaries included in the consolidated Group is presented in Appendix I.

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

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

The subsidiaries' accounting policies have been adapted to Group accounting policies for like transactions and other events in similar circumstances.

The annual accounts or financial statements of the subsidiaries used in the consolidation process have been prepared as of the same date as those of the Parent.

(b) Associates

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

Investments in associates are accounted for using the equity method from the date that significant influence commences until the date that significant influence ceases. However, if on the acquisition date investments in associates qualify for recognition as non-current assets or disposal groups held for sale, they are recognised at fair value less costs of disposal.

Details of equity-accounted investees are included in Appendix I.

Investments in associates are initially recognised at cost plus goodwill. The cost is calculated as the Group's share of the fair value of the assets acquired, less the liabilities assumed, determined as described in the section on business combinations. Goodwill is calculated as the excess of this cost over the cost of the investment reflected in the individual annual accounts. The cost includes or excludes, respectively, the fair value of any consideration payable or receivable that is contingent on future events or on compliance with certain terms.

The Group's share of the profit or loss of an associate from the date of acquisition is recognised as an increase or decrease in the value of the investment, with a credit or debit to share in profit/loss of equity-accounted investees in the consolidated income statement. The Group's share of the total recognised income and expense of associates from the date of acquisition is recognised as an increase or decrease in investments in associates with a balancing entry in consolidated equity accounts. The distribution of dividends is recognised as a decrease in the value of the investment. The Group's share of profit or loss, including impairment losses recognised by the associates, is calculated based on income and expenses arising from application of the acquisition method.

Losses of an associate attributable to the Group are limited to the extent of its net investment, except where the Group has legal or constructive obligations or when payments have been made on behalf of the associate. For the purpose of recognising losses in associates, net investments are considered as the carrying amount of the investment after applying the equity method plus any other item which in substance forms part of the investment in the associate. The excess of the losses over the equity investment is applied to the remaining items in reverse order of settlement. Subsequent profits obtained by associates for which impairment losses are limited to the value of the investment are recognised to the extent that they exceed previously unrecognised losses.

Unrealised gains and losses on transactions carried out between the Group and associates are only recognised to the extent that they are interests held by other unrelated investors. This criterion is not applied to the recognition of unrealised losses which constitute evidence of the impairment of the asset transferred.

The accounting policies of associates have been harmonised in terms of timing and measurement, applying the policies described for subsidiaries.

The Group applies the impairment criteria set out in the section on financial instruments to determine whether additional impairment losses to those already recognised on the net investment in the associate, or on any other financial asset held as a result of applying the equity method, should be recognised.

(c) Intangible assets

Intangible assets are measured at cost of acquisition. Intangible assets are carried at cost, less any accumulated amortisation and impairment.

(Continued)

(i) Goodwill

Goodwill on the mergers carried out by the Company in prior years reflects the excess of the cost of the business combination over the acquisition-date fair value of the assets acquired, liabilities and contingent liabilities assumed from the acquired business.

The Group allocates goodwill on business combinations to each of the cash-generating units (CGUs) which are expected to benefit from the synergies of the business combination and determines the useful life of the business combination separately for each CGU. After initial recognition, goodwill is measured at cost less any accumulated amortisation and impairment losses.

(ii) Computer software

Computer software acquired by the Group is reflected at the cost incurred. Computer software maintenance costs are charged as expenses when incurred.

(iii) Patents, licences, trademarks and similar rights

These rights reflect the value assigned to customers / connection points by an independent expert in the acquisition cost identification and allocation process for a number of subsidiaries merged with the Company in prior years.

(iv) Subsequent costs

Subsequent costs incurred on intangible assets are recognised in profit and loss, unless they increase the expected future economic benefits attributable to the intangible asset.

(v) Useful life and amortisation rates

Intangible assets are amortised by allocating the depreciable amount of an asset on a systematic basis over its useful life, by applying the following criteria:

	Amortisation method	**Estimated years of useful life**
Computer software	Straight-line	4
Patents, licences, trademarks and similar rights	Straight-line	10
Goodwill	Straight-line	10

The depreciable amount of intangible assets is measured as the cost of the asset, less any residual value.

The Company reviews the residual value, useful life and amortisation method for intangible assets at each financial year end. Changes to initially established criteria are accounted for as a change in accounting estimates.

(vi) Impairment losses

The Company measures and determines impairment to be recognised or reversed based on the criteria in section (e) Impairment of non-financial assets subject to amortisation or depreciation.

(d) Property, plant and equipment

(i) Initial recognition

Property, plant and equipment are measured at cost of acquisition or production. The annual accounts of the Parent for 2013 included the revaluation of assets recognised up to 1 January 2013 permitted by Vizcaya Provincial Decree 11/2012 of 18 December 2012, which contained several tax measures aimed at consolidating public finances and boosting economic activity.

Capitalised production costs are recognised under self-constructed assets in the consolidated income statement. Property, plant and equipment are carried at cost less any accumulated depreciation and impairment.

Items of property, plant and equipment recognised prior to 31 December 1996 are carried at a revalued amount as permitted by pertinent legislation.

(ii) Depreciation

Property, plant and equipment are depreciated by allocating the depreciable amount of the asset on a systematic basis over its useful life. The depreciable amount is the cost of an asset, less its residual value.

Property, plant and equipment are depreciated using the following criteria:

	Depreciation method	**Estimated years of useful life**
Buildings	Straight-line	10 - 50
Technical installations and machinery (gas distribution network)	Straight-line	17.5 - 30
Technical installations and machinery (regulation and metering stations: civil works)	Straight-line	15
Technical installations and machinery (regulation and metering stations: machinery)	Straight-line	15
Technical installations and machinery (synthetic natural gas plants and installations)	Straight-line	12.5 - 25
Other installations, equipment and furniture	Straight-line	5 - 10
Other property, plant and equipment	Straight-line	4 - 6

The Group reviews residual values, useful lives and depreciation methods at each financial year end. Changes to initially established criteria are accounted for as a change in accounting estimates.

The Company re-estimated the useful lives of all secondary natural gas distribution and transmission assets, increasing them by five years. Changes in useful lives were applied prospectively from 1 January 2017. Details of the effect of these changes in estimates on the balance sheet and income statement are provided in note 2 (d).

Increases in value resulting from revaluations permitted by law are depreciated over the remaining useful life of the revalued assets.

(Continued)

(iii) Subsequent costs

Subsequent to initial recognition of the asset, only the costs incurred which increase capacity or productivity or which lengthen the useful life of the asset are capitalised. The carrying amount of parts that are replaced is derecognised. Costs of day-to-day servicing are recognised in profit and loss as incurred.

(iv) Impairment

The Group measures and determines impairment to be recognised or reversed based on the criteria in section (e) Impairment of non-financial assets subject to amortisation or depreciation.

(e) Impairment of non-financial assets subject to amortisation or depreciation

The Group evaluates whether there are indications of possible impairment losses on non-financial assets subject to amortisation or depreciation to verify whether the carrying amount of these assets exceeds the recoverable amount. The recoverable amount is the higher of the fair value less costs to sell and the value in use.

An asset's value in use is measured based on the future cash flows the Group expects to derive from use of the asset, expectations about possible variations in the amount or timing of those future cash flows, the time value of money, the price for bearing the uncertainty inherent in the asset and other factors that market participants would reflect in pricing the future cash flows the Group expects to derive from the asset.

Impairment losses are recognised in the consolidated income statement.

Recoverable amount is determined for each individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs.

(f) Leases

(i) Lessor accounting

The Group has conveyed the right to use certain assets (mainly gas meters) through lease contracts.

Finance leases are those in which the Group transfers to third parties the significant risks and rewards of ownership of the asset. All other leases are classified as operating leases. The Group has no finance leases at 30 April 2017 and 31 December 2016.

Assets leased to third parties under operating lease contracts are presented according to their nature, applying the accounting policies set out in the section on property, plant and equipment.

Income from operating leases, net of incentives granted, is taken to the income statement on a straight-line basis over the lease term.

(ii) Lessee accounting

The Group also has rights to use certain assets through lease contracts.

Leases in which the Group assumes substantially all the risks and rewards incidental to ownership are classified as finance leases, otherwise they are classified as operating leases. The Group has no finance leases at 30 April 2017 and 31 December 2016.

Lease payments under an operating lease, net of incentives received, are recognised as an expense on a straight-line basis over the lease term.

(Continued)

The Company recognises initial direct costs of operating leases as an expense when incurred.

(g) Financial instruments

(i) Recognition

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

Purchases or sales of financial assets are recognised, depending on the type of asset, at the trade date or the settlement date.

(ii) Classification and separation of financial instruments

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

The Group classifies financial instruments into different categories based on the nature of the instruments and the Company's intentions on initial recognition.

(iii) Offsetting principles

A financial asset and a financial liability are offset only when the Company currently has the legally enforceable right to offset the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

(iv) Loans and receivables

Loans and receivables comprise trade and non-trade receivables with fixed or determinable payments that are not quoted in an active market other than those classified in other financial asset categories. These assets are initially recognised at fair value, including transaction costs, and are subsequently measured at amortised cost using the effective interest method.

Nevertheless, financial assets which have no established interest rate, which mature or are expected to be received in the short term, and for which the effect of discounting is immaterial, are measured at their nominal amount.

(v) Financial assets and financial liabilities carried at cost

Investments in equity instruments for which the fair value cannot be reliably estimated are measured at cost less any accumulated impairment. Nonetheless, if the financial assets or liabilities can subsequently be reliably measured on an ongoing basis, they are accounted for at fair value and any gain or loss is recognised in accordance with their classification.

(vi) Interest and dividends

Interest is recognised using the effective interest method.

Dividends from investments in equity instruments are recognised when the Company is entitled to receive them.

(Continued)

(vii) Derecognition of financial assets

Financial assets are derecognised when the contractual rights to the cash flows from the financial asset expire or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

On derecognition of a financial asset in its entirety, the difference between the carrying amount and the sum of the consideration received, net of transaction costs, including any new asset obtained less any new liability assumed and any cumulative gain or loss deferred in consolidated recognised income and expense, is recorded in consolidated profit or loss.

(viii) Impairment of financial assets

The Group recognises impairment of loans and receivables when estimated future cash flows are reduced or delayed due to debtor insolvency.

Impairment of financial assets carried at amortised cost

The amount of the impairment loss of financial assets carried at amortised cost is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. For variable income financial assets, the effective interest rate corresponding to the measurement date under the contractual conditions is used.

The impairment loss is recognised in profit and loss and may be reversed in subsequent periods if the decrease can be objectively related to an event occurring after the impairment has been recognised. The loss can only be reversed to the limit of the amortised cost of the assets had the impairment loss not been recognised.

(ix) Financial liabilities

Financial liabilities, including trade and other payables, are initially recognised at fair value less any transaction costs that are directly attributable to the issue of the financial liability. After initial recognition, liabilities classified under this category are measured at amortised cost using the effective interest method.

Nevertheless, financial liabilities which have no established interest rate, which mature or are expected to be settled in the short term, and for which the effect of discounting is immaterial, are measured at their nominal amount.

(x) Security deposits

Security deposits received in relation to gas supply contracts are measured using the same criteria as for financial liabilities.

Security deposits paid in relation to lease contracts are measured using the same criteria as for financial assets.

(xi) Derecognition and modifications of financial liabilities

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

(Continued)

(h) Inventories

The Group's inventories comprise the LPG stored in tanks measured at cost of acquisition, which is calculated as the lower of weighted average price and market value.

When the cost of inventories exceeds net realisable value, materials are written down to net realisable value.

(i) Grants, donations and bequests

Grants, donations and bequests are recorded in consolidated recognised income and expense when, where applicable, they have been officially awarded, the conditions attached to them have been met or there is reasonable assurance that they will be received.

Monetary grants, donations and bequests are measured at the fair value of the sum received.

In subsequent years, grants, donations and bequests are recognised as income as they are applied.

(i) Capital grants

Capital grants are recognised as income over the same period and in the proportions in which depreciation on those assets is charged or when the assets are disposed of, derecognised or impaired.

Capital grants basically comprise those amounts received under the agreements between the Company (or subsidiaries) and the Regional Government of the Basque Country or the Asturias Department of Industry (up to 31 December 2016). The Directors consider that all the conditions of the award have been met or are being met.

(ii) Connection and extension charges

Amounts received from customers as connection charges in respect of the installation works required to enable new supply or extend existing supply are recognised under grants, donations and bequests and taken to profit and loss over the useful life of the extension facilities financed or, where appropriate, on disposal of the asset or on the recognition of an impairment loss.

(iii) Gas distribution network contracts

Prior to year 2000, when contracting supply to customers connected to a network at a pressure exceeding 4 bar, the former Sociedad de Gas de Euskadi, S.A. (now merged into Naturgás Energía Distribución, S.A.U.) undertook to construct a suitable distribution network to supply natural gas to consumers in exchange for monetary consideration at the contract execution date, in addition to the future revenue from gas sales. The constructed network would then be owned by the Company. This also includes revenues from end customers for the modification of the network layout. The Company recognises this revenue in profit and loss on a straight-line basis over the same period in which the distribution networks are depreciated.

(j) Provisions

(i) General criteria

Provisions are recognised when the Company has a present obligation (legal, contractual, constructive or tacit) as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

(Continued)

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period, taking into account all risks and uncertainties surrounding the amount to be recognised as a provision and, where the time value of money is material, the financial effect of discounting provided that the expenditure to be made each period can be reliably estimated.

The tax effect and gains on the expected disposal of assets are not taken into account in measuring a provision.

If it is not probable that an outflow of resources will be required to settle an obligation, the provision is reversed.

(k) Revenue from the sale of goods and rendering of services

Revenue from the sale of goods or services is measured at the fair value of the consideration received or receivable.

(i) Revenue from sales

The new regulatory framework for the gas sector in Spain entered into force in February 2002 (see note 1) and governs the settlement procedures for the redistribution between the sector companies of revenues from tolls, charges and tariffs, net of payments for specific purposes, so that each company receives the revenues allocated for its regulated activities.

The Company estimates these settlements accrued at 30 April 2017 and 31 December 2016 and pending settlement by the Spanish National Markets and Competition Commission (CNMC). The final settlement for 2016 had not been published at the date these consolidated annual accounts were authorised for issue. However, it is not expected to differ significantly from the estimates, including the deficit estimate.

The Ministerial Order of 28 October 2002, which regulates the settlement procedures, provides that deviations, arising from the application of final settlement procedures, between final net revenues subject to settlement and the remuneration allocated each year will be taken into account in the calculation of tariffs, tolls and charges for the following two years.

Revenues received as remuneration for distribution activity each year are set *ex ante*. The Ministerial Orders published at the end of each year establish the remuneration for the coming year based on expected sales and new customers for that year. As a result, the remuneration amount is subject to change for up to two years, until the definitive data on demand and new customers are available for the year analysed. Order ETU/1977/2016, published on 23 December 2016, adjusted the remuneration for 2016 and 2015 based on the most up-to-date figures on sales and consumers.

Order ETU/1977/2016, published on 23 December 2016, established the remuneration for distribution activity for 2017 calendar year through application of the parameters established by Law 18/2014 of 15 October 2014 approving urgent measures for growth, competitiveness and efficiency. This law reformed the remuneration for gas activities with a view to eliminating deficits in the settlement system.

This remuneration for distribution activities will be adjusted once the final amounts of this remuneration have been set by the Spanish Ministry of Energy, Tourism and the Digital Agenda based on the actual figures for the average increase in consumers and KWh distributed. The Group does not expect significant differences to arise between the amounts recognised and the final settlements. Nevertheless, any differences will be recognised as a change in accounting estimate in the consolidated income statement when they arise.

During 2016 the Group received the final settlement for regulated activities in the gas sector for 2014 and 2015, which had no material impact on the consolidated income statement. The 2014 deficit in the gas sector, which includes the deficits accumulated in prior years, closed the year at Euros 1,025 million, which regulated entities will be able to recover in 15 consecutive annual payments from 25 November 2016 until 24 November 2031 at market interest rates. This interest rate has yet to be determined (article 66.a of Law 18/2014). However, Ministry of Energy, Tourism and the Digital Agenda Order ETU/1977/2016 proposes a provisional rate of 1.104% in accordance with the proposal of the CNMC. The 2015 deficit in the gas sector closed the year at Euros 27 million, which regulated entities will be able to recover in five annual payments (from 25 November 2016 to 24 November 2021) at a market interest rate that has also yet to be determined. However, Ministry of Energy, Tourism and the Digital Agenda Order ETU/1977/2016 proposes a provisional rate of 0.836% in accordance with the proposal of the CNMC.

Furthermore, based on provisional settlement 14 for 2016 drawn up by the Spanish National Markets and Competition Commission (CNMC), the 2016 deficit amounts to Euros 108.25 million, of which Euros 6.35 million corresponds to Naturgás Energía Distribución, S.A.U. This represents a reduction of Euros 4 million with respect to the forecast at 31 December 2016.

In accordance with Ministry of Industry, Tourism and Trade Order ITC/3126/2005, and Ministry of Industry, Energy and Tourism Orders IET 2446/2013 and IET 2355/2014 and the technical gas system management standards (NGTS), the Group has recognised measurement differences (known as unaccounted-for gas) as regulated distribution revenue in the consolidated income statement for 2017 in the amount of Euros 3,357 thousand pending final settlement. These basically reflect the estimated measurement differences for 2012. In 2016 the Group recognised the measurement differences for 2015 and 2016, amounting to Euros 1,073 thousand.

(ii) Services rendered

Revenues from inspection, meter rental and other services are recognised when the service is rendered.

(l) Income tax

The income tax expense or tax income for the year comprises current tax and deferred tax.

Current tax assets or liabilities are measured at the amount expected to be paid to or recovered from the taxation authorities, using the tax rates and tax laws that have been enacted or substantially enacted at the reporting date.

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

In 2017 y 2016 the consolidated tax group under the regional Vizcaya regime includes the following companies: EDP Comercializadora, S.A.U. (parent of the tax group), EDP Iberia, S.L.U. and Naturgás Suministro GLP, S.A.U. (subsidiary).

The subsidiary EDP España Distribución Gas, S.A.U. files consolidated tax returns in the general taxation territory of Spain with the tax group headed by EDP Energías de Portugal, S.A. Sucursal en España.

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

- Temporary and permanent differences arising from the elimination of profits and losses on transactions between Group companies, derived from the process of determining consolidated taxable income.

(Continued)

- Deductions and credits corresponding to each company forming the consolidated tax group. For these purposes, deductions and credits are allocated to the company that carried out the activity or obtained the profit necessary to obtain the right to the deduction or tax credit.

Temporary differences arising from the elimination of profits and losses on transactions between tax group companies are allocated to the company which recognised the profit/loss and are valued using the tax rate of that company.

A reciprocal credit and debit arises between the companies that contribute tax losses to the tax group and the rest of the companies that offset those losses. Where a tax loss cannot be offset by the other tax group companies, these tax credits for loss carryforwards are recognised as deferred tax assets using the applicable recognition criteria, considering the tax group as a taxable entity.

The parent of the tax group records the total consolidated income tax payable (recoverable) with a debit (credit) to receivables (payables) from/to Group companies and associates.

The amount of the debt (credit) relating to the subsidiaries is recognised with a credit (debit) to payables (receivables) to/from Group companies and associates.

(i) Recognition of deferred tax liabilities

The Group recognises deferred tax liabilities in all cases except where they arise from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable income.

(ii) Recognition of deferred tax assets

The Group recognises deferred tax assets provided that it is probable that sufficient taxable income will be available against which they can be utilised or when tax legislation envisages the possibility of converting deferred tax assets into a receivable from public entities in the future.

(iii) Measurement of deferred tax assets and liabilities

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the years when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantially enacted. The tax consequences that would follow from the manner in which the Company expects to recover or settle the carrying amount of its assets or liabilities are also reflected in the measurement of deferred tax assets and liabilities.

(iv) Classification

Deferred tax assets and liabilities are recognised in the balance sheet under non-current assets or liabilities, irrespective of the expected date of recovery or settlement.

(m) Environmental issues

Expenses derived from environmental activities are recognised as other operating expenses in the period in which they are incurred.

Non-current assets acquired by the Group to minimise the environmental impact of its activity and protect and improve the environment, including the reduction and elimination of future pollution from the Group's activities are recognised as assets, applying the measurement, presentation and disclosure criteria described in section (d) Property, plant and equipment.

(Continued)

(n) Transactions between non-consolidated Group companies

Transactions between non-consolidated Group companies, except for those related to mergers, spin-offs and non-monetary contributions, are recognised for the fair value of the consideration given or received. The difference between this value and the amount agreed is recognised in line with the underlying economic substance of the transaction.

(o) Activity segments

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the Group's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

As described below, the Group is organised internally into operating segments, which are strategic business units. The strategic business units have different products and services and are managed separately.

The Group includes the following operating segments:

- Natural gas
- LPG - Liquefied petroleum gas

The accounting policies of the segments are those described in note 4.

Segment performance is measured based on profit before interest and tax. This indicator is used as a measure of performance as the Group considers that this is the most relevant information in the assessment of the profits generated by the segments in relation to other groups that operate in the same businesses.

The method for obtaining this segment information is based on allocating each consolidated company to an activity, as there is an unambiguous relationship between the companies and the segments. Naturgás Energía Distribución, S.A.U. is the only exception to this as it carries out its activity in both segments. In this case, the Company's individual financial statements were segregated as a precursor to presenting segment information.

Consolidation was strictly in line with the principles and standards governing legal consolidation. To obtain consolidated information by business segment, goodwill is allocated to the segment of the subsidiary where it was generated.

The profit and loss of associates are included in the segment in which they operate, which is the distribution of natural gas.

(Continued)

(5) Intangible Assets

Details of intangible assets, excluding goodwill, and movement at 30 April 2017 and 31 December 2016 are as follows:

	Thousands of Euros		
30.04.2017	**Patents, licences, trademarks and similar rights**	**Computer software**	**Total**
Cost at 1 January 2017	41,692	14,839	**56,531**
Additions	-	383	**383**
Disposals	-	-	**-**
Cost at 30 April 2017	41,692	15,222	**56,914**
Accumulated amortisation at 1 January 2017	(32,325)	(11,995)	**(44,320)**
Amortisation	(1,042)	(333)	**(1,375)**
Accumulated amortisation at 30 April 2017	(33,367)	(12,328)	**(45,695)**
Carrying amount at 30 April 2017	**8,325**	**2,894**	**11,219**

	Thousands of Euros		
31.12.2016	**Patents, licences, trademarks and similar rights**	**Computer software**	**Total**
Cost at 1 January 2016	41,692	11,529	**53,221**
Additions	-	3,479	**3,479**
Disposals	-	(169)	**(169)**
Cost at 31 December 2016	41,692	14,839	**56,531**
Accumulated amortisation at 1 January 2016	(28,498)	(11,254)	**(39,752)**
Amortisation	(3,827)	(906)	**(4,733)**
Disposals	-	165	**165**
Accumulated amortisation at 31 December 2016	(32,325)	(11,995)	**(44,320)**
Carrying amount at 31 December 2016	**9,367**	**2,844**	**12,211**

(Continued)

(a) General

In accordance with the sole transitional provision of Royal Decree 602/2016, of 2 December 2016, the Group amortises retrospectively the intangible assets associated with connection points deriving from various mergers of the Parent in prior years. This amortisation was on a straight-line basis over 10 years.

At 30 April 2017 and 31 December 2016 the Company has no commitments to acquire intangible assets.

(b) Goodwill

Details of goodwill and movement are as follows:

	Thousands of Euros	
	30.04.2017	**31.12.2016**
Cost at 1 January	366,674	366,674
Cost at 30 April and 31 December	366,674	366,674
Accumulated amortisation at 1 January	(326,776)	(290,108)
Amortisation	(12,223)	(36,668)
Accumulated amortisation at 30 April and 31 December	(338,999)	(326,776)
Carrying amount at 30 April and 31 December	**27,675**	**39,898**

The goodwill recognised on the consolidated balance sheet was generated in various corporate transactions of the Parent in 2003 (involving Gas de Asturias, S.A., inter alia), 2006 (Gas Pasaia, S.A., Gas Hernani, S.A., Compañía Distribuidora de Gas de Bilbao Bilbogas, S.A.), 2007 (Gas Natural de Alava, S.A.) and 2011 (Gas Energía Distribución Cantabria, S.A.). Details of these corporate transactions were included in the notes to the corresponding annual accounts of the Parent.

In accordance with the sole transitional provision of Royal Decree 602/2016, of 2 December 2016, the Group depreciates goodwill retrospectively over a period of 10 years from 1 January 2008, or from when it arose (if later).

(c) Fully amortised assets

The cost of fully amortised intangible assets in use at 30 April 2017 and 31 December 2016 is as follows:

	Thousands of Euros	
	30.04.2017	**31.12.2016**
Computer software	11,618	11,285
Supply points	8,128	7,045
	19,746	**18,330**

(d) Impairment

In 2017 and 2016 the Group has not identified any indications of impairment of any of its CGUs.

(Continued)

(6) Property, Plant and Equipment

Details of property, plant and equipment and movement are shown in Appendix II.

(a) General

On 25 January 2016 the Company and Repsol Butano, S.A. entered into a purchase-sale agreement for the liquefied petroleum gas facilities owned by Repsol Butano, S.A. in Asturias, Cantabria and the Basque Country, for approximately Euros 116 million. This agreement was subject to a number of conditions precedent, which were met in 2016, and thus at the 2016 year end the assets were transferred in said amount.

Disposals of the Group's fixed assets in 2016, with a carrying amount of Euros 7.6 million, reflected the sale of the Group's corporate buildings, generating total gains of Euros 3 million in 2016.

(b) Fully depreciated assets

Details of the cost of fully depreciated property, plant and equipment in use at 30 April 2017 and 31 December 2016 are as follows:

	Thousands of Euros	
	30.04.2017	**31.12.2016**
Buildings	1,964	1,964
Technical installations and machinery	149,398	149,606
Other installations, equipment and furniture	31,758	31,758
Other property, plant and equipment	4,284	4,283
	187,404	**187,611**

(c) Government grants received

The construction of distribution networks has been partly financed by a number of grants received by the Company amounting to Euros 335 thousand (Euros 483 thousand in 2016) (see note 14). The cost of constructing these distribution networks amounted to Euros 2,079 thousand at 30 April 2017 (Euros 1,592 thousand at 31 December 2016).

(d) Commitments

At 30 April 2017 and 31 December 2016 the Group has no commitments to acquire significant items of property, plant and equipment.

(e) Insurance

The Group has taken out insurance policies to cover the risk of damage to its property, plant and equipment. The coverage of these policies is considered sufficient.

(f) Asset revaluations

At 1 January 2013 the Parent revalued certain items of property, plant and equipment in accordance with Vizcaya Provincial Decree 11/2012 of 18 December 2012, which adopted tax measures aimed at consolidating public finances and boosting economic activity, with an impact of Euros 103,443 thousand. The effect of the revaluation on depreciation for 2017 amounts to Euros 1,564 thousand (Euros 9,707 thousand in 2016). At 30 April 2017 accumulated depreciation amounts to Euros 45,087 thousand (Euros 43,522 thousand at 31 December 2016).

(Continued)

The Parent also revalued property, plant and equipment in 1990 and 1996, as permitted by Provincial Law 11/1990 of 21 December 1990 and Provincial Law 6/1996 of 21 November 1996, respectively. The amount recognised in the balance sheet at 30 April 2017 is Euros 37,907 thousand, depreciated in an amount of Euros 37,028 thousand (Euros 37,907 thousand depreciated in an amount of Euros 36,980 thousand at 31 December 2016).

(7) Operating Leases

The Group has primarily leased gas meters under operating leases to third parties.

The meter lease agreements are entered into upon contracting the gas supply and the lease payment is billed every two months. The lease has no expiry date and is terminated automatically when the gas supply is terminated, with no contingencies for the lessee.

(8) Risk Management Policy

(a) Financial risk factors

The Group's activity consists of gas distribution in Spain, thus it is not subject to currency risk, country risk, etc. Furthermore, the Group does not have any financial derivatives of any kind. Since 1 July 2008, following the change in regulation of the gas sector (see note 1), the Company has not carried out significant transactions with end customers, only with gas suppliers and other agents in the gas system.

The Group's activities are exposed to various financial risks: credit risk, liquidity risk and cash flow interest rate risk. The Company's global risk management programme focuses on uncertainty in the financial markets and aims to minimise potential adverse effects on the Group's profits.

Adaptation of the systems to the Group's risk profile is managed individually by specifically analysing each of the risks and their conditioning factors and taking into consideration their nature, origin, possibility and probability of occurrence and the significance of their impact. Management measures (hedges, mitigation, opportunity, etc.) that are viable for each risk are also considered.

Controls are based on the approval of management policies and include mechanisms to set and control operational limits, as well as authorisation and supervision processes, together with operational procedures.

(i) Credit risk

The Group is not exposed to significant credit risk due to the regulated nature of its main activities.

(ii) Liquidity risk

At 31 December 2016 the Group's working capital was negative in an amount of Euros 48,822 thousand, which is explained by the Group's financial structure. This situation is typical of the sector in which the Group operates and, as shown in the consolidated statement of cash flows, the Group generates sufficient cash annually to cover this need.

The liquidity policy adopted ensures that payment obligations are met through the arrangement of sufficient credit facilities and access to the credit facilities of the ultimate Parent, EDP Energías de Portugal, S.A.

(iii) Interest rate risk

The fair value of fixed-rate financial liabilities is disclosed in note 16. Interest rate fluctuations affect future cash flows of liabilities pegged to variable interest rates.

(Continued)

The current accounts held with EDP Servicios Financieros España, S.A.U (see note 11 (a) and 15 (a)) accrues interest at a variable rate pegged to Euribor. The sensitivity of profit/loss (before tax) to changes in interest rates in respect of the current account held with EDP Servicios Financieros España, S.A.U (increases/decreases in basis points) is as follows:

		Thousands of Euros	
	Basis points	**Profit/(loss)**	**Reserves**
30/04/2017	10	87	-
	(10)	(87)	-
31/12/2016	10	15	-
	(10)	(15)	-

(9) Equity-accounted Investees

Details of investments in equity-accounted investees are provided in Appendix I.

Details of investments in equity instruments of Group companies and associates are as follows:

	Thousands of Euros 30.04.2017				
Company	**Balance at 1 January**	**Share of profits**	**Share of recognised income and expense**	**Dividends received**	**Balance at 30 April 2017**
Inkolan, A.I.E.	101	15	-	-	**116**
Tolosa Gasa, S.A.	494	35	1	-	**530**
	595	50	1	-	**646**

	Thousands of Euros 31.12.2016				
Company	**Balance at 1 January**	**Share of profits**	**Share of recognised income and expense**	**Dividends received**	**Balance at 31 December 2016**
Inkolan, A.I.E.	66	36	(1)	-	**101**
Tolosa Gasa, S.A.	500	86	1	(93)	**494**
	566	122	-	(93)	**595**

(Continued)

(10) Financial Assets by Category

(a) Classification of financial assets by category

The classification of financial assets by category and class is as follows:

	Thousands of Euros	
	Non-current	Current
	At amortised cost or cost	At amortised cost or cost
30.04.2017	Carrying amount	Carrying amount
Loans and receivables		
Loans		
Variable rate	58,590	285,230
Security and other deposits	1,012	209
Trade receivables	-	33,115
Trade receivables	-	15,296
Other receivables	-	102
Total	59,602	333,952
Total financial assets	**59,602**	**333,952**

	Thousands of Euros	
	Non-current	Current
	At amortised cost or cost	At amortised cost or cost
31.12.2016	Carrying amount	Carrying amount
Loans and receivables		
Loans		
Variable rate	77,321	-
Security and other deposits	523	208
Trade receivables	-	39,693
Trade receivables	-	19,826
Other receivables	-	143
Total	77,844	59,870
Total financial assets	**77,844**	**59,870**

The carrying amount of financial assets recognised in the balance sheet at amortised cost does not differ significantly from their fair value.

Net losses and gains on financial assets amount to Euros 178 thousand at 30 April 2017 and reflect finance income measured at amortised cost (Euros 149 thousand at 31 December 2016).

(Continued)

(11) Investments and Trade Receivables

(a) Investments in Group companies and associates

Current loans to Group companies at variable rates amounting to Euro 285,230 thousand at 30 April 2017 comprise the current cash pooling accounts held by the subsidiaries with EDP Servicios Financieros España, S.A.U. These accounts accrue interest at variable market rates. At 31 December 2016 these current accounts were presented under non-current loans to Group companies in an amount of Euros 14,152 thousand.

(b) Investments

Details of investments are as follows:

	Thousands of Euros 30.04.2017 Non-current	Current
Unrelated parties		
Loans	58,590	-
Security and other deposits	1,012	209
Total	**59,602**	**209**

	Thousands of Euros 31.12.2016 Non-current	Current
Unrelated parties		
Loans	63,169	-
Security and other deposits	523	208
Total	**63,692**	**208**

Non-current security and other deposits have no established expiry date.

At 30 April 2017 non-current receivables amount to Euros 58.6 million in relation to gas sector deficits pending collection (Euros 63 million at 31 December 2016) (see note 1.1 (c)).

(c) Trade and other receivables

Details of trade and other receivables are as follows:

	Thousands of Euros	
	Current	
	30.04.2017	31.12.2016
Group (note 21)		
Trade receivables	19,555	27,213
Other receivables	1,014	11,767
Associates (note 21)		
Trade receivables	-	1,536
Other receivables	48	-
Unrelated parties		
Trade receivables	13,693	10,951
Other receivables	14,282	8,059
Personnel	102	143
Public entities, other (note 19)	239,822	203,152
Impairment	(181)	(7)
Total	**288,335**	**262,814**

At 30 April 2017, other receivables from Group companies amounting to Euros 908 thousand reflect income tax receivable from EDP Energías de Portugal, S.A. Sucursal en España, the parent of the tax group in the general taxation territory of Spain, Euros 69 thousand reflecting the balance due to the Group from EDP Iberia, S.L.U. in respect of VAT, as well as other balances receivable from Group companies in an amount of Euros 85 thousand.

At 31 December 2016, other Group receivables amounting to Euros 11,767 thousand comprise the VAT balance receivable from EDP Iberia, S.L.U. and the income tax balance receivable from EDP Energías de Portugal, S.A. Sucursal en España. Both companies are parents of the respective tax groups for these taxes.

At 30 April 2017 other receivables from unrelated parties include the amount pending collection from the Ministry of Energy, Tourism and the Digital Agenda for the gas sector intercompany settlements, reflecting the estimated current cumulative deficit corresponding to the 15/2014 settlement (see note 1.1 (c)) and the deficit for 2015 corresponding to the 15/2015 settlement attributable to the Group, totalling Euros 4,039 thousand and Euros 376 thousand, respectively (Euros 4,106 thousand and Euros 383 thousand, respectively, in 2016).

(12) Prepayments

A contract was signed on 20 April 2017 whereby EDP Iberia, S.L.U. ensures Naturgás Suministro GLP, S.A.U. a minimum gross margin for each supply point acquired from Repsol Butano, S.A. prior to 31 December 2016, which shall be at least the margin budgeted by the EDP Group in its valuation of the purchase transaction. If the minimum agreed gross margin is not achieved, EDP Iberia, S.L.U. is to pay an effective amount equal to the difference between the amount estimated in the valuation of the supply points for the purchase from Repsol and the actual margin.

This contract shall remain in force until the expiry date, i.e. 1 January 2021.

A contract was signed on 20 April 2017 whereby EDP Iberia, S.L.U. ensures that Naturgás Energía Distribución, S.A.U. will be compensated for any changes in regulations affecting the remuneration from gas meter rentals with respect to the regulations approved for 2017. This guarantee only covers the impact on the 2018 to 2021 period of such regulatory changes introduced before 31 December 2017.

Prepayments for current assets mainly comprise Euros 1,933 thousand reflecting the prepayment of these two insurance policies held by Naturgás Energía Distribución, S.A. and Naturgás Suministro GLP, S.A.U. with EDP Iberia, S.L.U., amounting to Euros 1,000 thousand each.

(13) Equity

Details of consolidated equity and movement during the year are shown in the consolidated statement of changes in equity.

The Group's consolidated equity at 30 April 2017 is negative in an amount of Euros 86,721 thousand (Euros 165,909 thousand at 31 December 2016) due to the adjustment to eliminate the Group's internal transactions in relation to gains on the sale of assets that were distributed as dividends by the Parent (see note 3). The Company's equity is positive, totalling Euros 635,332 thousand (Euros 424,722 thousand at 31 December 2016), and it is therefore not subject to compulsory liquidation. The equity of the subsidiaries is also positive and at an amount greater than share capital.

(a) Capital

At 30 April 2017 and 31 December 2016 the Company’s share capital is represented by 1,000,000 registered shares of Euros 100 par value each, subscribed and fully paid. All shares have the same voting and profit sharing rights.

These shares are freely transferable.

At 30 April 2017 and 31 December 2016 the sole shareholder of the Company is EDP Iberia, S.L., thus the Company is solely owned and is registered as such at the Mercantile Register. Transactions with the sole shareholder are detailed in note 21.

(b) Share premium

This reserve is freely distributable.

(c) Reserves

Details of reserves and profit, and movement during the period, are shown in Appendix III.

(i) Legal reserve

The legal reserve has been appropriated in compliance with article 274 of the Spanish Companies Act, which requires that companies transfer 10% of profits for the year to a legal reserve until this reserve reaches an amount equal to 20% of share capital.

The legal reserve is not distributable to shareholders and if it is used to offset losses, in the event that no other reserves are available, the reserve must be replenished with future profits.

At 30 April 2017 and 31 December 2016, the Company has appropriated to this reserve the minimum amount required by law.

(ii) Revaluation reserves

Revaluation reserves comprise the reserve permitted by Vizcaya Provincial Decree 11/2012.

In accordance with Vizcaya Provincial Decree 11/2012 of 18 December 2012, which introduced several tax measures to consolidate public finances and boost economic activity, the Company revalued its property, plant and equipment, effective from 1 January 2013. The revaluation amounted to Euros 98,272 thousand, net of the 5% capital gains tax, which totalled Euros 5,172 thousand.

(Continued)

The revaluation is open to inspection by the Spanish taxation authorities for a three-year period from the date of filing the 2012 income tax return. Once the three-year period has elapsed, the balance may be used to offset losses or increase the Company's capital.

Once a period of ten years has elapsed this balance may be released to freely distributable reserves. The balance of this account will only be distributable, either directly or indirectly, to the extent that gains have been realised. The gain will be deemed to have been realised to the extent that the revalued assets have been depreciated, transferred or derecognised.

(iii) Goodwill reserve

The goodwill reserve was appropriated in compliance with article 273.4 of the Revised Spanish Companies Act, which required companies to transfer profits equivalent to at least 5% of goodwill to a non-distributable reserve until this reserve reached an amount equal to recognised goodwill. In the absence of profit, or if profit is insufficient, freely distributable reserves should be used. This reserve is freely distributable as at 1 January 2016.

(iv) Production investment reserve

As permitted by Provincial Law 24/1996 of 5 July 1996, in 2015, 2012, 2011 and 2010 the Company created a special reserve for production investment with appropriations of Euros 38,900 thousand, Euros 18,000 thousand, Euros 30,000 thousand and Euros 25,000 thousand, respectively.

The production investment reserve will be restricted to the extent that the assets invested in should continue to be used for the Company's activity.

This reserve was fully distributed in 2016, thus no tax credits generated through its creation have been used.

(v) Voluntary reserves

These reserves are freely distributable.

(d) Profit/loss for the year attributable to the Parent

The contribution of each full consolidated company to consolidated profit and loss, indicating the portion attributable to non-controlling interests, is as follows:

	Thousands of Euros	
	Consolidated profit/(loss)	
Company	**30.04.2017**	**31.12.2016**
Fully consolidated companies		
Naturgás Energía Distribución, S.A.U.	23,811	75,676
EDP España Distribución Gas, S.A.U.	55,017	202,353
Naturgás Suministro GLP, S.A.U.	384	(22)
	79,212	278,007
Equity-accounted investees		
Inkolan, A.I.E.	15	35
Tolosa Gasa, S.A.	35	87
	50	122
Total	**79,262**	**278,129**

(Continued)

(e) Dividends

On 22 December 2016 the sole shareholder of the Company agreed to distribute an additional dividend with charges to share premium, the production investment reserve and voluntary reserves of Euros 682 million, Euros 111.9 million and Euros 138.7 million, respectively.

On 19 December 2016, the Board of Directors agreed to distribute interim dividends totalling Euros 797 million against the profit for 2016.

(14) Grants, Donations and Bequests Received

Movement in non-refundable grants, donations and bequests received is as follows:

	Thousands of Euros	
	30.04.2017	**31.12.2016**
Balance at 1 January	37,290	37,770
Additions	607	1,726
Disposals	(6)	(102)
Amounts transferred to the consolidated income statement	(675)	(2,104)
Balance at 30 April and 31 December	**37,216**	**37,290**

Grants, donations and bequests include capital grants, connection and extension charges, and other deferred income (see note 4 (i)).

Details of the amounts recognised in the consolidated income statement by type of grant are as follows:

	Thousands of Euros	
	30.04.2017	**31.12.2016**
Capital grants	293	1,347
Connection and extension charges	516	1,813
Other deferred income	62	185
	871	**3,345**

Details of main capital grants

	Thousands of Euros	
Grantor	**30.04.2017**	**31.12.2016**
European Economic Community	971	1,006
Principality of Asturias	8,836	9,100
Basque Government	2,925	2,967
CNMC	2,358	2,365
	15,090	**15,438**

(Continued)

(15) Commitments Undertaken with Third Parties

Guarantees provided to third parties (local councils and other public entities) at 30 April 2017 total Euros 6,395 thousand (Euros 8,573 thousand at 31 December 2016), whereas guarantees received from suppliers amount to Euros 3,549 thousand (Euros 6,187 thousand at 31 December 2016).

Guarantees provided to local councils and other public entities are for the use and replacement of public assets affected by construction work for gas pipelines and distribution networks. No losses are expected in respect of these guarantees.

(16) Financial Liabilities by Category

(a) Classification of financial liabilities by category

A classification of financial liabilities by category and class is presented in Appendix IV.

Net losses and gains on financial liabilities at 30 April 2017 amount to Euros 6,686 thousand and comprise borrowing costs on debts and payables at amortised cost (Euros 620 thousand at 31 December 2016).

(17) Payables and Trade Payables

(a) Group companies and associates

At 30 April 2017 and 31 December 2016 non-current payables to Group companies and associates comprise three loans extended by the group company EDP Servicios Financieros España, S.A.U. on 12 December 2016 to Naturgas Energía Distribución, S.A.U., EDP España Distribución Gas, S.A.U. and Naturgás Suministro GLP, S.A.U., for Euros 410 million, Euros 492 million and Euros 50 million, respectively. These loans all fall due on 13 December 2021 and accrue interest at fixed rates of 1.928%, 1.928% and 2.428%, respectively.

At 30 April 2017, current payables to Group companies and associates reflect the cash pooling balance payable by the Company to EDP Servicios Financieros España, S.A.U. amounting to Euros 457,695 thousand (Euros 61,743 thousand at 31 December 2016) and accrued interest payable on non-current loans in an amount of Euros 6,667 thousand (Euros 466 thousand at 31 December 2016). This cash pooling account is subject to variable interest at market rates.

(b) Payables

Details of payables are as follows:

	Thousands of Euros	
	30.04.2017	
	Non-current	**Current**
Unrelated parties		
Suppliers of fixed assets	-	1,042
Payables	1,044	1,684
Security and other deposits received	1,151	112
Total	**2,195**	**2,838**

(Continued)

	Thousands of Euros	
	31.12.2016	
	Non-current	Current
Unrelated parties		
Suppliers of fixed assets	-	4,272
Payables	1,075	48
Security and other deposits received	609	112
Total	**1,684**	**4,432**

Non-current payables reflect interest-free loans from public entities at amortised cost.

(c) Trade and other payables

Details of trade and other payables are as follows:

	Thousands of Euros	
	Current	
	30.04.2017	31.12.2016
Group (note 21)		
Payables	39,201	217,785
Unrelated parties		
Suppliers	1,096	9,306
Payables	58,124	16,706
Personnel	821	2,351
Public entities, other (note 19)	4,380	3,709
Total	**103,622**	**249,857**

Payables to unrelated parties include Euros 35,785 thousand payable for gas sector intercompany settlements, reflecting the estimate at 30 April 2017, which, based on costs recognised for the distribution activity, are allocated to the Group in the corresponding settlement period to adjust the settlements to the remuneration calculated by the Ministry of Energy, Tourism and the Digital Agenda, pursuant to the legislation applicable to the gas sector (Euros 15,614 thousand at 31 December 2016).

At 30 April 2017, payables to Group companies include Euros 38,235 thousand reflecting income tax payable to EDP Comercializadora, S.A.U., which files consolidated tax returns (see note 4 (l)), as well as other payables to Group companies in an amount of Euros 966 thousand.

At 31 December 2016 Group payables include VAT of Euros 188,474 thousand payable to EDP Gas Iberia, S.L.U. and income tax of Euros 29,311 thousand payable to EDP Comercializadora, S.A.U. as a result of filing consolidated tax returns (see note 4 (l)).

(Continued)

(18) Average Supplier Payment Period

Details of the average supplier payment period are as follows:

	Days	
	30.04.2017	31.12.2016
Average supplier payment period	22	22
Transactions paid ratio	20	24
Transactions payable ratio	47	4

	Amount in Euros	
	30.04.2017	31.12.2016
Total payments made	20,341	46,545
Total payments outstanding	1,520	4,216

(19) Taxation

Details of balances with public entities are as follows:

	Thousands of Euros	
	30.04.2017	
	Non-current	Current
Assets		
Deferred tax assets	251,146	-
Value added tax	-	239,822
	251,146	239,822
Liabilities		
Deferred tax liabilities	53,301	-
Social Security	-	284
Withholdings and charges	-	4,096
	53,301	**4,380**

	Thousands of Euros	
	31.12.2016	
	Non-current	Current
Assets		
Deferred tax assets	206,888	-
Value added tax	-	203,152
	206,888	**203,152**
Liabilities		
Deferred tax liabilities	69,320	-
Social Security	-	248
Withholdings and charges	-	3,461
	69,320	**3,709**

(Continued)

At 30 April 2017 withholdings and charges include Euros 3,687 thousand (Euros 2,890 thousand at 31 December 2016) of charges for the use of subsoil.

At 30 April 2017 the Group has recognised Euros 38,236 thousand payable to EDP Comercializadora, S.A.U. (Euros 29,311 in 2016) as a result of filing consolidated income tax in the territory of Vizcaya (Euros 8,933 thousand for 2017 and Euros 29,303 thousand for 2016).

At 30 April 2017 EDP España Distribución Gas, S.A.U. holds a current account with EDP Energías de Portugal, S.A. Sucursal en España reflecting a balance receivable of Euros 908 thousand (Euros 110 thousand in 2016) as a result of filing consolidated income tax in the general taxation territory of Spain (Euros 798 thousand for 2017 and Euros 110 thousand for 2016).

The Group has the following main applicable taxes open to inspection by the Spanish taxation authorities:

Tax	**Years open to inspection**
Income tax	2012 – 2015
Value added tax	2013 – 2017
Personal income tax	2013 – 2017

Income tax returns must be filed within 25 calendar days after the six months subsequent to the conclusion of the tax period. Consequently, income tax for 2017 and 2016 will not be open to inspection until 25 November 2017 and 25 July 2017, respectively.

Due to the treatment permitted by fiscal legislation of certain transactions, additional tax liabilities could arise in the event of inspection. In any case, the Parent's directors do not consider that any such liabilities that could arise would have a significant effect on the annual accounts.

The Parent files consolidated VAT returns with the following companies: EDP Iberia, S.L.U. (parent of the tax group), EDP Comercializadora, S.A.U. and Naturgás Suministro GLP, S.A.

(Continued)

(a) Income tax

The Group files consolidated tax returns as indicated in note 4 (l).

A reconciliation of net income and expenses for the year with the taxable income is provided in the following table:

	Thousands of Euros					
	Income statement			Recognised income and expense		
30.04.2017	**Increases**	**Decreases**	**Net**	**Increases**	**Net**	**Total**
Consolidated income and expense for the period			79,262		(74)	**79,188**
Income tax			(52,208)		38	**(52,170)**
Profit before income tax			27,054		(36)	**27,018**
Permanent differences:						
Individual company	191	232,676	(232,485)	-	-	**(232,485)**
Temporary differences:						
Individual companies						
originating in current year	799	957	(158)	36	36	**(122)**
originating in prior years	62,794	64	62,730	-	-	**62,730**
Consolidation adjustments						
originating in current year	189,475	-	189,475	-	-	**189,475**
originating in prior years	494	18,588	(18,094)	-	-	**(18,094)**
Taxable income			**28,522**			**28,522**

	Thousands of Euros					
	Income statement			Recognised income and expense		
31.12.2016	**Increases**	**Decreases**	**Net**	**Increases**	**Net**	**Total**
Consolidated income and expense for the period			278,129		(480)	**277,649**
Income tax			(211,797)		(609)	**(212,406)**
Profit before income tax			66,332		(1,089)	**65,243**
Permanent differences:						
Individual company	-	916,245	(916,245)	-	-	**(916,245)**
Temporary differences:						
Individual companies						
originating in current year	-	4,788	(4,788)	1,089	1,089	**(3,699)**
originating in prior years	157,305	9,540	147,765	-	-	**147,765**
Consolidation adjustments						
originating in current year	816,367	-	816,367	-	-	**816,367**
Taxable income			**109,431**		**-**	**109,431**

(Continued)

The Group has opted to avail of the tax relief (exemption for reinvestment) provided for in article 36 of Provincial Corporate Income Tax Law 11/2013 of 5 December 2013, undertaking to reinvest Euros 233 million of the gains obtained on various transactions carried out between Group companies during the year (Euros 916 million in 2016).

The Group has already met the reinvestment requirement for the amounts obtained on the sales as EDP Iberia, S.L.U., which is part of the same consolidated income tax group, acquired all the shares of Hidrocantábrico Distribución Eléctrica, S.A. for Euros 1,501 million on 1 December 2016.

Increases due to taxable temporary differences of individual companies from prior years derive from differences between the amortisation/depreciation for accounting and tax purposes recognised in prior years.

Increases due to taxable temporary differences of consolidation adjustments primarily relate to the EDP Group's reorganisation indicated in note 1, whereby the Group has concentrated in EDP España Distribución Gas, S.A.U. certain gas distribution assets located in Asturias and Cantabria, which were previously owned by Naturgás Energía Distribución, S.A.U. Following this reorganisation, the tax value of these assets has risen by Euros 189,475 thousand (Euros 810,736 thousand in 2016), generating deferred tax assets of Euros 47,369 thousand (Euros 202,684 thousand in 2016).

Details of the income tax income related to profit for the year are shown in the following table:

	Thousands of Euros		
30.04.2017	**Profit and loss**	**Recognised income and expense**	**Total**
Consolidated income and expenses before tax for the period	27,054	(36)	**27,018**
Tax at 28%	7,575	(10)	**7,565**
Non-deductible expenses	53	-	**53**
Non-taxable income			
Exempt gains on sale of assets between Group companies	(65,148)	-	**(65,148)**
Effect of differences in tax rates	5,322	-	**5,322**
Prior year adjustments	(10)	-	**(10)**
Income tax income			
Continuing operations	**(52,208)**	**(10)**	**(52,218)**

(Continued)

31.12.2016	Thousands of Euros Profit and loss	Recognised income and expense	Total
Consolidated income and expenses before tax for the period	66,332	(1,089)	**65,243**
Tax at 28%	18,573	(305)	**18,268**
Non-taxable income			
Exempt gains on sale of assets between Group companies	(256,548)	-	**(256,548)**
Effect of differences in tax rates	26,308	(435)	**25,873**
Prior year adjustments	(104)	-	**(104)**
Previously unrecognised tax deductions applied	(26)	-	**(26)**
Expense for reduction in deferred tax assets	-	128	**128**
Other	-	3	**3**
Income tax income Continuing operations	**(211,797)**	**(609)**	**(212,406)**

The effect of differences in tax rates reflects the difference between the tax rate in the Vizcaya territory (28%) and that in the general taxation territory of Spain (25%).

Details of the tax income in the consolidated income statement are as follows:

	Thousands of Euros 30.04.2017	31.12.2016
Current income tax		
Present year	7,986	30,641
Prior year adjustments	(10)	229
Previously unrecognised tax deductions applied	-	(26)
	7,976	30,844
Deferred tax		
Source and reversal of temporary differences		
Property, plant and equipment	(56,691)	(232,888)
Goodwill	(3,713)	(10,341)
Other intangible assets	311	268
Provisions	(229)	261
Other	138	392
Prior year adjustments	-	(333)
Total deferred tax	(60,184)	(242,641)
	(52,208)	**(211,797)**

In accordance with Vizcaya Provincial Decree 11/2012 of 18 December 2012 on asset revaluations, depreciation resulting from the revaluation of property, plant and equipment in 2013 and 2014 was not tax deductible until 2015. In this regard, at 31 December 2016 the Group has reversed a deferred tax asset of Euros 1,011 thousand.

(Continued)

Details of deferred tax assets and liabilities by type of asset and liability are as follows:

	Thousands of Euros	
	30.04.2017	
	Assets	Liabilities
Property, plant and equipment	249,062	(30,851)
Goodwill	-	(7,454)
Other intangible assets	-	(2,666)
Connection charges up to 31 December 2007	1,741	-
Connection charges since 1 January 2008		(826)
Capital grants	-	(10,566)
Provisions	343	-
Other	-	(938)
Total assets/liabilities	251,146	(53,301)

	Thousands of Euros	
	31.12.2016	
	Assets	Liabilities
Property, plant and equipment	204,994	(43,474)
Goodwill	-	(11,168)
Other intangible assets	-	(2,355)
Connection charges up to 31 December 2007	1,784	-
Connection charges since 1 January 2008	-	(826)
Capital grants	-	(10,088)
Provisions	110	-
Other	-	(938)
Rights to tax deductions and credits	-	-
Total assets/liabilities	206,888	(68,849)

All of the Group's goodwill was tax deductible in prior years.

Details of deferred tax assets and liabilities that are expected to be realised or reversed in periods exceeding 12 months are as follows:

	Thousands of Euros	
	30.04.2017	31.12.2016
Deferred tax assets relating to temporary differences	240,318	205,945
Total assets	240,318	205,945
Deferred tax liabilities	14,169	35,828
Net	**226,149**	**170,117**

Provincial Corporate Income Tax Law 11/2013, of 5 December 2013, was approved as effective from 1 January 2014 and restricts the offsetting of tax loss carryforwards and the use of tax deductions to 15 years from the law's entry into force.

(Continued)

(b) Value added tax

On 28 March 2017 the subsidiary EDP España Distribución Gas, S.A.U. received notice of the initiation of a limited verification of value added tax for 2016. On 11 May 2017, this same company received notice that the scope of the limited verification was to be extended to that of a general inspection of VAT for that period. This inspection focuses primarily on the effective transfer of the VAT by Naturgás Energía Distribución, S.A.U. (the transferor) and the resulting deduction of VAT borne by EDP España Distribución Gas, S.A.U. (the acquirer) in the sale of practically the entire gas distribution network located in Asturias and Cantabria. The directors of the Company do not expect that this tax inspection will have any impact on the equity of the Company.

(20) Environmental Information

The very nature of the Group's activity, the distribution of natural gas as a substitute for oil and coal derivatives, which are more polluting due to the effects of combustion, helps to improve the environment and provides greater thermal efficiency which promotes energy efficiency and therefore savings.

Natural gas contributes to improving the environment as it reduces the emission of greenhouse gases and causes less air pollution since its composition (90% methane) generates less CO_2 during combustion. Furthermore, natural gas contains practically no sulphur.

Throughout 2017 and 2016 the Group has continued its efforts to coordinate environmental safety in gas distribution works, having expanded this action to network maintenance work, including periodic visits. In accordance with the environmental procedures of the integrated management system, noise levels are measured at the distribution regulation and metering stations, the location of which makes them susceptible to exceeding the permitted limits.

The Group has received no environmental grants or income from activities related to the environment in 2017 and 2016. The Company has not received any environmental grants or income from activities related to the environment in 2017 or 2016.

As a result of the aforementioned actions undertaken by the Group, the Directors consider that any contingencies that could arise from environmental issues, which are very unlikely, are sufficiently covered by their civil liability insurance policies.

(21) Related Party Balances and Transactions

(a) Related party balances

Balances receivable from and payable to Group companies, associates and related parties, and the main details of these balances, are disclosed in notes 9, 11, 16 and 17.

Details of balances by category are as follows:

	Thousands of Euros			
30.04.2017	**Sole shareholder**	**Group companies**	**Associates**	**Total**
Non-current investments in Group companies and associates				
Loans to companies	-	-	-	**-**
Equity-accounted investees	-	-	646	**646**
Total non-current assets	-	-	646	**646**
Current investments in Group companies and associates				
Loans to companies	-	285,230	-	**285,230**
Trade and other receivables				
Trade receivables, current	-	19,555	-	**19,555**
Other receivables	78	936	48	**1,062**
Prepayments	1,933	-	-	**1,933**
Total current assets	2,011	305,721	48	**307,780**
Total assets	2,011	305,721	694	**308,426**
Group companies and associates, non-current	-	952,000	-	**952,000**
Total non-current liabilities	-	952,000	-	**952,000**
Current payables				
Other financial liabilities	-	165	-	**165**
Group companies and associates, current	-	464,362	-	**464,362**
Trade and other payables				
Other payables	(1,872)	41,073	-	**39,201**
Total current liabilities	(1,872)	505,600	-	**503,728**
Total liabilities	(1,872)	1,457,600	-	**1,455,563**

(Continued)

	Thousands of Euros			
31.12.2016	**Sole shareholder**	**Group companies**	**Associates**	**Total**
Non-current investments in Group companies and associates				
Loans to companies	-	14,152	-	**14,152**
Equity-accounted investees	-	-	595	**595**
Total non-current assets	-	14,152	595	**14,747**
Trade and other receivables				
Trade receivables, current	-	27,213	1,536	**28,749**
Other receivables	11,657	110	-	**11,767**
Total current assets	11,657	27,323	1,536	**40,516**
Total assets	11,657	41,475	2,131	**55,263**
Group companies and associates, non-current	-	952,000	-	**952,000**
Total non-current liabilities	-	952,000	-	**952,000**
Group companies and associates, current	-	62,209	-	**62,209**
Trade and other payables				
Other payables	188,474	29,311	-	**217,785**
Total current liabilities	188,474	91,520	-	**279,994**
Total liabilities	188,474	1,043,520	-	**1,231,994**

(Continued)

(b) Related party transactions

The Group's transactions with related parties are as follows:

30.04.2017	Thousands of Euros			
	Sole shareholder	Group companies	Associates	Total
Income				
Net sales				
Invoicing issued	-	70,397	-	**70,397**
Services rendered	-	6,105	-	**6,105**
Other services rendered	47	27	96	**170**
Financial instruments				
Dividends	-	-	-	**-**
Total revenues	47	76,529	96	**76,672**
Expenses				
Other services received	(868)	5,550	-	**4,682**
Personnel expenses	-	120	-	**120**
Financial instruments				
Finance costs	-	6,664	-	**6,664**
Total expenses	(686)	12,334	-	**11,466**
Investments				
Proceeds from the sale of property, plant and equipment	-	-	-	**-**
Total investments	-	-	-	**-**
Other				
Dividends and other allocated benefits	-	-	-	**-**
Total other	-	-	-	**-**

(Continued)

31.12.2016	Sole shareholder	Group companies	Associates	Total
	Thousands of Euros			
Income				
Net sales				
Invoicing issued	-	117,287	6,039	**123,326**
Services rendered	-	17,990	1,124	**19,114**
Other services rendered	-	17	301	**318**
Financial instruments				
Dividends	-	-	93	**93**
Total revenues	-	135,294	7,557	**142,851**
Expenses				
Other services received	-	19,858	2,031	**21,889**
Financial instruments				
Finance costs	-	466	-	**466**
Total expenses	-	20,324	2,031	**22,355**
Investments				
Carrying amount of assets sold and profit on disposal				
Proceeds from the sale of property, plant and equipment	-	960	-	**960**
Total investments	-	960	-	**960**
Other				
Dividends and other allocated benefits	1,879,941	-	-	**1,879,941**
Total other	1,879,941	-	-	**1,879,941**

Invoicing issued and services rendered to Group companies mainly comprise the tolls and meter reading services invoiced to EDP Comercializadora, S.A.U.

Other services primarily reflect management services invoiced by the EDP Group.

(c) Information on the Company's directors and senior management personnel

In 2017 the Company's directors and senior management have accrued remuneration of Euros 98 thousand (Euros 223 thousand in 2016) and Euros 21 thousand (Euros 29 thousand in 2016) is receivable from them in respect of advances. The Company has not extended any guarantees on their behalf or paid any civil liability insurance premiums for damage or loss caused by actions or omissions in the performance of their duties. The Company has no pension or life insurance obligations with its former or current directors.

(d) Transactions other than ordinary business or under terms differing from market conditions carried out by the directors of the Company

In 2017 and 2016 the directors of the Company have not carried out any transactions other than ordinary business or applying terms that differ from market conditions with the Company or any other Group company.

(e) Conflicts of interest concerning the Directors

The directors of the Company and their related parties have had no conflicts of interest requiring disclosure in accordance with article 229 of the Revised Spanish Companies Act.

(Continued)

(22) Income and Expenses

(a) Revenues

Details of revenues by category of activity and geographical market are as follows:

	Thousands of Euros	
	Domestic	
	30.04.2017	31.12.2016
Revenue from the sale of propane gas	12,142	4,057
Revenue from installations	1	3
Revenue from regulated activities	60,483	169,154
Revenue from the rendering of services	9,523	27,923
	82,149	**201,137**

Revenue from regulated activities comprises the amount accrued in 2017 and 2016 for regulated remuneration for gas distribution companies.

(b) Supplies

Details of merchandise, raw materials and other supplies used are as follows:

	Thousands of Euros	
	30.04.2017	31.12.2016
Merchandise used		
Purchases	7,396	6,697
Change in inventories	(89)	(4,345)
	7,307	2,352
Raw materials and other supplies used		
Other purchases	3	1
Change in inventories	3	7
	6	8
	7,313	**2,360**

At 30 April 2017 and 31 December 2016 subcontracted work comprises periodic inspections subcontracted to third parties.

(Continued)

(c) Employee benefits expense

Details of employee benefits expense are as follows:

	Thousands of Euros	
	30.04.2017	31.12.2016
Employee benefits expense		
Social Security payable by the Company	814	2,112
Pension plan contributions	157	285
Other employee benefits expenses	150	109
Annual contributions	-	127
	1,121	**2,633**

The Group has a defined contribution pension plan arranged through an insurance policy.

(d) Gains/losses on disposal of fixed assets

Details of gains and losses on the disposal of fixed assets are as follows:

	Thousands of Euros	
	30.04.2017	31.12.2016
Gains		
Property, plant and equipment	-	3,082
Losses		
Property, plant and equipment	(30)	(53)
	(30)	**3,029**

(23) Employee Information

The average headcount of the Group at 30 April 2017 and 31 December 2016, distributed by category, is as follows:

	Number	
	30.04.2017	31.12.2016
Directors	9	7
Managers	35	25
Other	146	119
	190	**151**

(Continued)

At 30 April 2017 and 31 December 2016, the distribution by gender of Company personnel is as follows:

	Number	
	30.04.2017	
	Female	Male
Directors	3	8
Managers	17	27
Other	72	117
	92	**152**

	Number	
	31.12.2016	
	Female	Male
Directors	-	7
Managers	9	20
Other	26	96
	35	**123**

At 30 April 2017 and 31 December 2016, the Group had no employees with a disability rating of 33% or higher (or equivalent local rating).

At 30 April 2017 and 31 December 2016 all three members of the Board of Directors are male.

(24) Audit Fees

The auditor of the annual accounts of the Group has invoiced the following net fees during the years ended at 30 April 2017 and 31 December 2016:

	Thousands of Euros	
	30.04.2017	31.12.2016
Audit services, consolidated annual accounts	26	36
Audit services, individual annual accounts of the Company	47	47
Audit services, annual accounts of subsidiaries	58	23
Other services	-	8
	131	**114**

This amount includes the total fees for services rendered in 2017 and 2016, irrespective of the date of invoice.

In addition, during the fiscal year ended April 30, 2017, fees for professional services in the net amount of Eur 15 thousand were invoiced by other KPMG International affiliated companies to the Group. In 2016, no professional services were provided by other KPMG International affiliated companies to the Group.

(Continued)

(25) Events after the Reporting Period

On 2 May 2017, as part of the internal restructuring of EDP's operations in Spain mentioned in note 1 and with no impact other than the tax effect for consolidated purposes, the Parent sold:

- secondary natural gas distribution and transmission assets to its subsidiary EDP España Distribución Gas, S.A.U, including secondary distribution and transmission networks and gas pipelines, natural gas satellite plants, connection points, regulation and metering stations, reading and metering equipment, and communal gas tanks, as well as the rights to supply points, use, access, passage and other easements, in addition to the authorisations, permits and licences required for the flow of natural gas to the supply points located in the municipality of Castro Urdiales in Cantabria. This sale completes the restructuring of the gas distribution and transmission assets. As a result, the Basque Country assets are now concentrated in Naturgás Energía Distribución, S.A.U. while the Asturias and Cantabria are concentrated in EDP España Distribución Gas, S.A.U.

- to its subsidiary Naturgás Suministro GLP, S.A.U. certain LPG distribution and supply assets, including storage tanks and deposits, distribution networks and gas pipelines, reading and metering equipment, the rights to supply points, use, access, passage and other easements, as well as the authorisations, permits and licences in Asturias and Cantabria. As a result of this sale, all LPG distribution and supply assets are now concentrated in Naturgás Suministro GLP, S.A.U.

On 31 May 2017, the Group carried out a number of transactions aimed at restructuring the Group's financing. Namely:

- On 31 May 2017 Naturgás Energía Distribución, S.A.U. obtained two loans from EDP Servicios Financieros España, S.A.U. for Euros 250.9 million and Euros 241.1 million, respectively, which fall due in five years.

- On 31 May 2017 Naturgás Energía Distribución, S.A.U. extended three loans to the subsidiary EDP España Distribución de Gas S.A.U., under the following terms and conditions:

    - Euros 250.9 million loan falling due in five years.

    - Euros 241.1 million loan falling due in nine days, convertible into capital upon maturity.

    - Euros 300 million loan falling due in five years.

- Using the loans obtained, EDP España Distribución Gas, S.A.U. has made early repayment of the loan received from EDP Servicios Financieros España, S.A.U. in an amount of Euros 492 million, and has settled its current cash pooling account with EDP Servicios Financieros España, S.A.U.

- EDP Servicios Financieros España, S.A.U. has extended a Euros 72 million loan to Naturgás Suministro GLP, S.A.U. that falls due in five years, which this company has used to settle the balance payable to EDP Servicios Financieros España, S.A.U. in respect of the cash pooling account.

- EDP España Distribución Gas, S.A.U. has been granted a Euros 268 million loan by EDP Servicios Financieros España, S.A.U. to finance the balance receivable by the latter from the taxation authorities in respect of VAT borne on the asset purchase, which is currently under inspection (see note 19).

(Continued)

(26) Segment Reporting

Segment reporting at 30 April 2017 and 31 December 2016 for each of the businesses operated within the Group, obtained applying the criteria described in note 4 (o), is as follows:

	Thousands of Euros		
	Segment		Total
30.04.2017	Natural gas	LPG	
Item			
Revenues			
External customers	67,062	12,827	**79,889**
Inter-segment	-	-	**-**
Supplies	(1,141)	(7,467)	**(8,608)**
Personnel expenses	(4,999)		**(4,999)**
Amortisation and depreciation	(24,035)	(2,954)	**(26,989)**
Other operating expenses	(9,753)	(856)	**(10,609)**
Other income	4,808	20	**4,828**
Results from operating activities	31,942	1,570	**33,512**
Finance income	228	-	**228**
Finance costs	(6,273)	(413)	**(6,686)**
Profit/(loss) from discontinued operations			
Profit before income tax	25,897	1,157	**27,054**
Segment assets	1,367,140	125,677	**1,492,817**
Segment liabilities	1,447,782	131,756	**1,579,538**
Cash flows from			
Operating activities	85,936	(198)	**85,738**
Investing activities	(280,271)	(39)	**(280,310)**
Financing activities	194,979	(413)	**194,566**
Acquisitions of non-current assets during the year	6,513	-	**6,513**

(Continued)

	Thousands of Euros		
	Segment		Total
31.12.2016	Natural gas	LPG	
Item			
Revenues			
External customers	197,080	4,057	**201,137**
Inter-segment	-	-	**-**
Supplies	(3,734)	(2,275)	**(6,009)**
Personnel expenses	(13,949)		**(13,949)**
Amortisation and depreciation	(91,146)	(1,535)	**(92,681)**
Other operating expenses	(33,360)	(234)	**(33,594)**
Other income	11,777	-	**11,777**
Results from operating activities	66,668	13	**66,681**
Finance income	271	-	**271**
Finance costs	(620)	-	**(620)**
Profit/(loss) from discontinued operations			
Profit before income tax	66,319	13	**66,332**
Segment assets	1,051,111	122,840	**1,173,951**
Segment liabilities	1,347,691	(6,620)	**1,341,071**
Cash flows from			
Operating activities	63,201	-	**63,201**
Investing activities	747,117	116,056	**863,173**
Financing activities	(926,369)	-	**(926,369)**
Acquisitions of non-current assets during the year	23,175	116,055	**139,230**

(Continued)

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Details of Investments in Subsidiaries and Associates

at 30 April 2017 and 31 December 2016

(Expressed in thousands of Euros)

Subsidiaries

Name	Registered office	Activity	Auditor	Investment: Group company holding the investment	% ownership	Effective % ownership of the Company	Amount of the investment	Extent of control
EDP España Distribución Gas, S.A.U.	Oviedo (Asturias)	Supply and distribution of natural gas	KPMG Auditores, S.L.	Naturgás Energía Distribución, S.A.U.	100.00	100.00	185,000	100% of voting rights
Naturgas Suministro GLP, S.A.U.	Bilbao (Vizcaya)	Distribution of natural gas; construction, maintenance and operation of secondary natural gas transmission networks; acquisition, contribution, storage and bottling of liquid petroleum gas.	KPMG Auditores, S.L.	Naturgás Energía Distribución, S.A.U.	100.00	100.00	10,000	100% of voting rights
							195,000	

Associates

Name	Registered office	Activity	Auditor	Investment: Group company holding the investment	% ownership	Effective % ownership of the Company	Amount of the investment
Inkolan, A.I.E.	Bilbao (Vizcaya)	Collection and management of all information related to the networks installed by each of its partners in the Basque Country.	Not audited	Naturgás Energía Distribución, S.A.U.	12.50	12.50	69
Tolosa Gasa, S.A.	Tolosa (Guipuzcoa)	Supply and distribution of natural gas	KPMG Auditores, S.L.	Naturgás Energía Distribución, S.A.U.	40.00	40.00	260
							329

This appendix forms an integral part of note 4 (a) to the consolidated annual accounts, in conjunction with which it should be read.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Details of Property, Plant and Equipment and Movement
for the four-month period ended 30 April 2017 and the year ended 31 December 2016

	Thousands of Euros						
30.04.2017	**Land**	**Buildings**	**Technical installations and machinery**	**Other installations, equipment and furniture**	**Under construction and advances**	**Other property, plant and equipment**	**Total**
Cost at 1 January 2017	684	6,738	1,158,378	86,419	13,448	7,435	**1,273,102**
Additions	-	-	76	470	5,652	104	**6,302**
Disposals	-	-	-	-	(41)	-	**(41)**
Transfers	-	-	7,891	-	(7,891)	-	**-**
Cost at 30 April 2017	684	6,738	1,166,345	86,889	11,168	7,539	**1,279,363**
Accumulated depreciation at 1 January 2017	-	(4,004)	(630,558)	(63,997)	-	(5,704)	**(704,263)**
Depreciation	-	(48)	(11,400)	(1,818)	-	(125)	**(13,391)**
Disposals	-	-	-	-	-	-	**-**
Accumulated depreciation at 30 April 2017	-	(4,052)	(641,958)	(65,815)	-	(5,829)	**(717,654)**
Carrying amount at 30 April 2017	**684**	**2,686**	**524,387**	**21,074**	**11,168**	**1,710**	**561,709**

This appendix forms an integral part of note 6 to the consolidated annual accounts, in conjunction with which it should be read.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Details of Property, Plant and Equipment and Movement for the four-month period ended 30 April 2017 and the year ended 31 December 2016

	Thousands of Euros						
31.12.2016	**Land**	**Buildings**	**Technical installations and machinery**	**Other installations, equipment and furniture**	**Under construction and advances**	**Other property, plant and equipment**	**Total**
Cost at 1 January 2016	3,434	11,623	1,034,049	89,289	5,159	7,017	**1,150,571**
Additions	-	-	112,108	1,329	21,896	418	**135,751**
Disposals	(2,750)	(4,885)	(211)	(5,342)	(32)	-	**(13,220)**
Transfers	-	-	12,432	1,143	(13,575)	-	**-**
Cost at 31 December 2016	684	6,738	1,158,378	86,419	13,448	7,435	**1,273,102**
Accumulated depreciation at 1 January 2016	-	(4,435)	(584,024)	(64,349)	-	(5,359)	**(658,167)**
Depreciation	-	(288)	(46,083)	(4,564)	-	(345)	**(51,280)**
Disposals	-	719	209	4,256	-	-	**5,184**
Transfers	-	-	(660)	660	-	-	**-**
Accumulated depreciation at 31 December 2016	-	(4,004)	(630,558)	(63,997)	-	(5,704)	**(704,263)**
Carrying amount at 31 December 2016	**684**	**2,734**	**527,820**	**22,422**	**13,448**	**1,731**	**568,839**

This appendix forms an integral part of note 6 to the consolidated annual accounts, in conjunction with which it should be read.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Details of Reserves and Profits and Movement for the four-month period ended 30 April 2017 and the year ended 31 December 2016

(Expressed in thousands of Euros)

	Legal and statutory reserve	Revaluation reserves	Goodwill reserve	Investment reserve	Other reserves	Voluntary reserves	Reserves in consolidated companies	Profit/(loss) for the year	Total
Adjusted balance at 1 January 2016	20,000	98,272	-	73,000	(9,083)	138,751	-	178,019	498,959
Profit for 2016	-	-	-	-	-	-	-	278,129	278,129
Distribution of profit									
Reserves	-	-	18,333	38,900	-	-	-	(57,233)	-
Dividends	-	-	-	-	-	-	-	(149,942)	(149,942)
Distribution of dividends	-	-	-	(111,900)	-	(138,742)	-	-	(250,642)
Other movements	-	-	(18,333)	-	-	(9)	-	29,156	10,814
Balance at 31 December 2016	**20,000**	**98,272**	**-**	**-**	**(9,083)**	**-**	**-**	**278,129**	**387,318**
Profit for the period from 1 January 2017 to 30 April 2017	-	-	-	-	-	-	-	79,262	79,262
Distribution of profit									
Reserves	-	-	-	-	9,083	269,046	-	(278,129)	-
Others movements	-	-	-	-	-	-	-	-	-
Balance at 30 April 2017	**20,000**	**98,272**	**-**	**-**	**-**	**269,046**	**-**	**79,262**	**466,580**

This appendix forms an integral part of note 13 to the consolidated annual accounts, in conjunction with which it should be read.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

**Details of Financial Liabilities by Category
for the four-month period ended 30 April 2017
and the year ended 31 December 2016**

	Thousands of Euros				
	Non-current			Current	
	At amortised cost or cost			At amortised cost or cost	
30.04.2017	Carrying amount	Fair value	Total	Carrying amount	Total
Debts and payables					
Payables to Group companies					
Fixed rate	952,000	1,043,525	952,000	6,667	6,667
Variable rate	-	-	-	457,695	457,695
Security deposits	1,151	1,151	1,151	112	112
Other financial liabilities	1,044	1,044	1,044	2,726	2,726
Trade and other payables					
Suppliers	-	-	-	1,096	1,096
Payables	-	-	-	98,146	98,146
Total financial liabilities	**954,195**	**1,045,720**	**954,195**	**566,442**	**566,442**

This appendix forms an integral part of note 16 to the consolidated annual accounts, in conjunction with which it should be read.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Details of Financial Liabilities by Category
for the four-month period ended 30 April 2017
and the year ended 31 December 2016

	Thousands of Euros				
	Non-current			Current	
	At amortised cost or cost			At amortised cost or cost	
31.12.2016	Carrying amount	Fair value	Total	Carrying amount	Total
Debts and payables					
Payables to Group companies					
Fixed rate	952,000	1,049,123	952,000	267	267
Variable rate	-	-	-	61,942	61,942
Security deposits	609	609	609	112	112
Other financial liabilities	1,075	1,075	1,075	4,320	4,320
Trade and other payables					
Suppliers	-	-	-	9,306	9,306
Payables	-	-	-	236,842	236,842
Total financial liabilities	**953,684**	**1,050,807**	**953,684**	**312,789**	**312,789**

This appendix forms an integral part of note 16 to the consolidated annual accounts, in conjunction with which it should be read.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Consolidated Directors' Report

2017

1. Most significant events in the period

In 2017 the usual activity in the regulated market of the natural gas and LPG sectors was ongoing. This consists of the management of regulated distribution assets, including the promotion, development and construction of new infrastructure, as well as operating, maintenance and optimisation services.

The Group continued its network expansion activity within its areas of influence. The following noteworthy initiatives were carried out in these areas during the period:

- Continued expansion of networks in the Basque Country, Asturias and Cantabria.
- Full connection capacity at bay D16.00 of the Musel-Llanera gas pipeline to supply Arcelor-Mittal at its facilities in Veriña (Asturias).
- Commencement of works on the Musel-Carreño reconnection and connection to HC Tudela Cogeneración, which will permanently eliminate any operating restrictions in the area and enable new supplies.
- Commencement of works on the new population centre in Carandía (Cantabria).
- Commencement of marketing of homes and premises in the population centres with a piped LPG network.
- Completion of the transfer of all Repsol LPG supply points.
- Procurement of authorisation from the autonomous regions of Asturias and Cantabria to transfer the piped LPG distribution assets from Naturgás Energía Distribución, S.A.U. to Naturgás Suministro GLP, S.A.U., scheduled for May.
- Study of LPG supplies to the Selaya (Cantabria) and Bustiello (Asturias) population centres and application for administrative and facility construction authorisations, as well as a municipal works licence, for the extension of the piped LPG distribution network in Villacarriedo (Cantabria).
- Investments amounting to Euros 5.6 million in the extension of the natural gas distribution network, adding a further nine kilometres to attain a total of 7,756 kilometres at 30 April 2017, which represents a 9% share of the sector in Spain.
- The investments in new natural gas networks and the saturation of supply points in existing networks has enabled the number of supply points to be increased by 2,807 to 929,153. The energy distributed by the networks was 11,292 GWh.
- LPG activity at 30 April 2017 amounts to 82,923 supply points and 365 km of LPG.

Operating profit of Euros 33.5 million was generated in the first four months of 2017 after amortisation and depreciation charges of Euros 26.9 million. Net profit for the period, taking into account the net finance cost, other income and expenses and income tax, totalled Euros 79.3 million.

In 2017, Naturgás Energía Distribución, S.A.U. has transferred its natural gas distribution and secondary transmission assets from the other municipalities of the autonomous region of Cantabria (except Castro Urdiales) to EDP España Distribución Gas, SAU.

In the first four months of 2017 the only noteworthy occurrence is the Order on tolls and remuneration for 2017 and the standards relating to the disqualification of the supplier Investigación, Criogenia y Gas, S.A.

- Ministry of Energy, Tourism and the Digital Agenda Order ETU/1977/2016 of 23 December 2016, establishing the tolls and charges for third-party access to gas facilities and the remuneration for regulated activities in 2017.
- Resolution of 15 February 2017 issued by the Directorate-General for Energy Policy and Mining, which disqualifies Investigación, Criogenia y Gas, S.A. from supplying natural gas.
- Ministry of Energy, Tourism and the Digital Agenda Order ETU/175/2017 of 24 February 2017, stipulating the transfer of the customers of Investigación Criogenia y Gas, S.A. to a last resort supplier and determining the supply conditions to these customers.

The Company's supplier payment policy establishes a payment period within the limits defined by law. In the year no payments exceeded the period defined by law.

2. Outlook

The Company's outlook is based on the following:

- Continued investment in the construction of new distribution networks in new population centres and expansion of existing distribution networks to saturate the catchment areas.

- Continuous improvement of quality and security of supply. Development of a very efficient operational system entailing a high level of responsibility and based on excellence in terms of operations, inspection and maintenance.

- Anticipation of risks and efficient regulatory management, which are fundamental given the nature of Naturgás' results.

3. Research and development activities

In the first four months of 2017 the EDP Naturgás Energia Group continued its efforts to develop cutting-edge projects and take part in the leading forums. It maintained an active presence in the following R&D&i forums:

- Research & Development + innovation Committee of the INTERNATIONAL GAS UNION (IGU). Committee meeting in Brisbane (Australia).

- GERG meeting in Brussels with Tudor Constantinescu of the Directorate-General for Energy of the European Commission regarding hydrogen gas in natural gas networks.

- European Gas Research Group (GERG): we hold the position of first vice-chairman. Board and plenary meeting in Paris (France).

- Energy Cooperative Research Centre "CIC energiGUNE": the Group is a trustee.

- In respect of the Spanish Gas Association (SEDIGAS), the Group has actively participated in the BIOGAS working group meetings on biomethane injection into gas networks, within the Technology and Training Committee, as well as in the PROGAS Committee meetings.

- Interim presentation of the five "Aula EDP NATURGAS ENERGIA" projects developed in 2015-16.

- Participation in the official Master in Sustainable Energy Engineering university course at the Bilbao School of Engineering in 2016-17.

- INTERNATIONAL GAS RESEARCH CONFERENCE 2017. Presentation of the paper entitled "DEVELOPMENT OF CARBON MOLECULAR SIEVE MEMBRANES FOR THE USE OF RENEWABLE GASES, BIOMETHANE AND HYDROGEN IN NATURAL GAS NETWORKS". Rio de Janeiro (Brazil).

Naturgás Energia Distribución, S.A.U. undertook the following noteworthy projects in the first four months of 2017:

- European HyGRID project: research project with the TECNALIA foundation and five other European companies; "FLEXIBLE HYBRID SEPARATION SYSTEM FOR HYDROGEN RECOVERY FROM NATURAL GAS GRIDS". Approved and launched in May, with a duration of three years and financed by the European Union's HORIZON 2020 programme for Fuel Cells and Hydrogen.

- Project CIEN SMART GREEN GAS: research project with the TECNALIA foundation and six other companies; "Energy recovery from waste and effluents (SMART GREEN GAS)". Strategic programme of the National Business Research Consortium (CIEN) of the Spanish Centre for the Development of Industrial Technology (CDTI), under the Ministry of Economy and Competitiveness (2014-18).

- Project RETOS RENOGAS: research project with the Bilbao Faculty of Engineering (UPV-EHU); "Methane generation in remote areas from renewable energy". The latest annual edition is underway. This R&D project is co-financed through the RETOS INVESTIGACIÓN programme of the Directorate-General for Scientific and Technical Research of the Ministry of Economy and Competitiveness.

4. Own shares

At 30 April 2017 the Group does not hold any own shares, nor did it acquire any during the period then ended.

5. Events after the reporting period

No significant events have occurred since the 2017 reporting date that would require disclosure in these annual accounts, except for the matters indicated in note 25.

6. Risks

The Group has analysed the risks and uncertainties of its activity and the board of directors deems that the internal procedures in place sufficiently cover the risks identified.

Note 8 describes the risk management policy.

7. Financial instruments

At 30 April 2017 the Company had not arranged any financial instruments.

NATURGAS ENERGÍA DISTRIBUCIÓN, S.A.U. AND SUBSIDIARIES

Authorisation for Issue of the Consolidated Annual Accounts and Consolidated Directors' Report for 2017

At their meeting held on 1 June 2017, pursuant to the requirements of article 253.2 of the Revised Spanish Companies Act and article 37 of the Spanish Code of Commerce, the Directors of Naturgas Energía Distribución S.A.U. authorised the issue of the consolidated annual accounts and consolidated directors' report for the 4 month period ended 30 April 2017. The consolidated annual accounts comprise the accompanying documents that precede this certification.

Signed:

Mr. Juan Ramón Arraibi Dañobeitia	Mr. Luis Álvarez Arias de Velasco	Mr. Rui Pedro Ávila Campos Marques

Mr. Carlos Arias Chausson
(Non-executive secretary)