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

Consolidated Annual Accounts

31 December 2016

Consolidated Directors' Report

2016

(With Independent Auditor’s Report Thereon)

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

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

Independent Auditor's Report on the Consolidated Annual Accounts

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

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

Report on the Consolidated Annual Accounts

We have audited the accompanying consolidated annual accounts of Naturgás Energía Distribución, S.A.U. (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated balance sheet at 31 December 2016 and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and consolidated notes.

Directors' Responsibility for the Consolidated Annual Accounts

The Directors of the Company 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 Naturgás Energía Distribución, S.A.U. and subsidiaries in accordance with the financial reporting framework applicable to the Group in Spain, specified in note 2 to the accompanying consolidated annual accounts, and for such internal control that they determine is necessary to enable the preparation of consolidated annual accounts that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated annual accounts based on our audit. We conducted our audit in accordance with prevailing legislation regulating the audit of accounts in Spain. This legislation requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated annual accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of the consolidated annual accounts by the Company's Directors in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated annual accounts taken as a whole.

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

Opinion

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 Naturgás Energía Distribución, S.A.U. and its subsidiaries at 31 December 2016, and their consolidated financial performance and consolidated cash flows for the year then ended in accordance with the applicable financial reporting framework and, in particular, with the accounting principles and criteria set forth therein.

Report on Other Legal and Regulatory Requirements

The accompanying consolidated Directors' report for 2016 contains such explanations as the Directors of Naturgás Energía Distribución, S.A.U. consider relevant to the situation of the Group, its business performance and other matters, and is not an integral part of the consolidated annual accounts. We have verified that the accounting information contained therein is consistent with that disclosed in the consolidated annual accounts for 2016. Our work as auditors is limited to the verification of the consolidated Directors' report within the scope described in this paragraph and does not include a review of information other than that obtained from the accounting records of Naturgás Energía Distribución, S.A.U. and subsidiaries.

KPMG Auditores, S.L.

(*Signed on original in Spanish*)

Estíbaliz Bilbao Belda

21 March 2017

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

Consolidated Annual Accounts
31 December 2016

Consolidated Directors' Report
2016

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

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

Consolidated Balance Sheet for the year ended

31 December 2016

(Expressed in thousands of Euros)

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

Assets	*Note*	*2016*
Intangible assets	**Note 5**	**52,109**
Patents, licences, trademarks and similar rights		9,367
Goodwill		39,898
Computer software		2,844
Property, plant and equipment	**Note 6**	**568,839**
Land and buildings		3,418
Technical installations, machinery, equipment, furniture and other items		551,973
Under construction and advances		13,448
Non-current investments in Group companies and associates		**14,747**
Equity-accounted investees	**Note 9**	595
Loans to companies	**Note 11**	14,152
Non-current investments	**Note 11**	**63,692**
Loans to third parties		63,169
Other financial assets		523
Deferred tax assets	**Note 18**	**206,888**
Total non-current assets		**906,275**
Inventories	**Note 4 (h)**	**4,416**
Goods for resale		4,416
Trade and other receivables	**Note 11**	**262,814**
Trade receivables – current		10,944
Trade receivables from Group companies and associates – current	**Note 20**	27,213
Equity-accounted investees – current	**Note 20**	1,536
Other receivables		11,767
Group companies and associates		8,059
Personnel		143
Public entities, other		203,152
Current investments	**Note 11**	**208**
Other financial assets		208
Prepayments for current assets		**232**
Cash and cash equivalents		**6**
Cash		6
Total current assets		**267,676**
Total assets		**1,173,951**

The accompanying notes form an integral part of the consolidated annual accounts for 2016.

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

Consolidated Balance Sheet for the year ended

31 December 2016

(Expressed in thousands of Euros)

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

Equity and Liabilities	*Note*	*2016*
Capital and reserves	**Note 12**	**(203,199)**
Capital		
Registered capital		100,000
Share premium		106,483
Reserves		
Legal and statutory reserves		118,272
Other reserves		(9,083)
Profit for the year		278,129
Interim dividend	**Note 3**	(797,000)
Grants, donations and bequests received	**Note 13**	**37,290**
Total equity		**(165,909)**
Non-current provisions		**358**
Other provisions		358
Non-current payables	**Note 16**	**1,684**
Other financial liabilities		1,684
Group companies and associates, non-current	**Note 16**	**952,000**
Deferred tax liabilities	**Note 18**	**69,320**
Total non-current liabilities		**1,023,362**
Current payables	**Note 16**	**4,432**
Other financial liabilities		4,432
Group companies and associates, current	**Note 16**	**62,209**
Trade and other payables	**Note 16**	**249,857**
Current payables to suppliers		9,306
Other payables		16,706
Payables to Group companies and associates		217,785
Personnel (salaries payable)		2,351
Public entities, other	**Note 18**	3,709
Total current liabilities		**316,498**
Total equity and liabilities		**1,173,951**

The accompanying notes form an integral part of the consolidated annual accounts for 2016.

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

Consolidated Income Statement
for the year ended
31 December 2016

(Expressed in thousands of Euros)

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

	Note	2016
Revenues	**Note 21**	**201,137**
Sales		173,214
Services rendered		27,923
Self-constructed assets	**Note 6**	**4,876**
Supplies	**Note 21**	**(6,009)**
Merchandise used		(2,352)
Raw materials and consumables used		(8)
Subcontracted work	**Note 21**	(3,649)
Other operating income		**527**
Non-trading and other operating income		343
Operating grants taken to income		184
Personnel expenses		**(13,949)**
Salaries and wages		(11,316)
Employee benefits expense	**Note 21**	(2,506)
Provisions	**Note 21**	(127)
Other operating expenses		**(33,600)**
External services		(29,939)
Taxes		(3,464)
Losses, impairment and changes in provisions for commercial transactions	**Notes 11 and 14**	50
Other operating expenses		(247)
Amortisation and depreciation	**Notes 5 and 6**	**(92,681)**
Non-financial and other capital grants	**Note 13**	**3,345**
Provision surpluses		**6**
Impairment and gains on disposal of fixed assets	**Note 21**	**3,029**
Gains on disposal and other		3,029
Results from operating activities		**66,681**
Finance income		**149**
Marketable securities and other financial instruments		
Other	**Note 10**	149
Finance costs	**Note 15**	**(620)**
Group companies and associates		(543)
Other		(77)
Net finance cost		**(471)**
Share of profit of equity-accounted investees	**Note 9**	**122**
Profit before income tax		**66,332**
Income tax	**Note 18**	211,797
Profit for the year		**278,129**

The accompanying notes form an integral part of the consolidated annual accounts for 2016.

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

Consolidated Statement of Changes in Equity
for the year ended
31 December 2016

A) Consolidated Statement of Recognised Income and Expense
for the year ended
31 December 2016

(Expressed in thousands of Euros)

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

	Note	2016
Profit for the year		**278,129**
Income and expense recognised directly in equity		
Grants, donations and bequests		2,256
Tax effect		(632)
Total income and expense recognised directly in equity	**Note 13**	**1,624**
Amounts transferred to the income statement		
Grants, donations and bequests		(3,345)
Tax effect		1,241
Total amounts transferred to the income statement	**Note 13**	**(2,104)**
Total recognised income and expense		**277,649**

The accompanying notes form an integral part of the consolidated annual accounts for 2016.

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

Consolidated Statement of Changes in Equity
for the year ended
31 December 2016

B) Consolidated Statement of Total Changes in Equity for the year ended
31 December 2016

(Expressed in thousands of Euros)

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

	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)**

The accompanying notes form an integral part of the consolidated annual accounts for 2016.

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

Consolidated Statement of Cash Flows
for the year ended
31 December 2016

(Expressed in thousands of Euros)

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

	Note	2016
Cash flows from operating activities		
Profit for the year before tax		**66,332**
Adjustments for:		
Amortisation and depreciation	**Notes 5 and 6**	92,681
Impairment		(13)
Change in provisions		89
Grants recognised in the income statement	**Note 13**	(3,345)
Proceeds from disposals of fixed assets		(3,029)
Finance income		(149)
Finance costs		620
Change in fair value of financial instruments		-
Share of profit of equity-accounted investees		(122)
Other income and expenses		(4,876)
Changes in operating assets and liabilities		
Inventories		(4,274)
Trade and other receivables		(214,372)
Other current assets		(115)
Trade and other payables		149,267
Provisions		-
Other non-current assets and liabilities		5,831
Other cash flows from operating activities		
Interest paid		(330)
Dividends received		93
Interest received		271
Income tax paid		(21,355)
Cash flows from operating activities		**63,204**
Cash flows from investing activities		
Payments for investments		
Group companies and associates		(14,152)
Intangible assets	**Note 5**	(3,479)
Property, plant and equipment	**Note 6**	(128,351)
Other financial assets		-
Other assets		(99)
Proceeds from sale of investments		
Group companies and associates		13
Property, plant and equipment		11,068
Other financial assets		998,172
Cash flows from investing activities		**863,172**
Cash flows from financing activities		
Proceeds from and payments for equity instruments		
Issue of equity instruments		-
Grants, donations and bequests received		1,851
Proceeds from and payments for financial liability instruments		
Issue		
Group companies and associates	**Note 16**	951,886
Other		-
Redemption and repayment of		
Other payables		(165)
Dividends and interest on other equity instruments paid		
Dividends		(1,879,942)
Cash flows used in financing activities		**(926,370)**
Net increase in cash and cash equivalents		6
Cash and cash equivalents at beginning of year		-
Cash and cash equivalents at year end		6

The accompanying notes form an integral part of the consolidated annual accounts for 2016.

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

Naturgas 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 Energías de Portugal S.A., with their registered office in Lisbon (Portugal).

During 2016 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 has 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 Naturgas 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 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 IET/2736/2015, stipulating the tolls and charges for third-party access to gas facilities and the remuneration for regulated activities for 2016, 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 IET/2736/2015 also sets the remuneration for regulated activities in 2016.

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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, according to the report attached to the Orders for 2017, the Ministry has budgeted a deficit of Euros 160 million for 2016, of which Euros 10 million is estimated to correspond 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.

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.

(Continued)

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.

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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.

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 2016 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 31 December 2016 and consolidated results of operations, consolidated changes in equity, and consolidated cash flows for the year then ended.

The Directors consider that the consolidated annual accounts for 2016, authorised for issue on 10 March 2016, will be approved with no changes by the sole shareholder.

(b) Comparative information

As explained in note 1, 2016 is the first year in which the Company forms a Group and meets the requirements to prepare consolidated annual accounts. Therefore, as the Company was the parent company of a group of companies during the year, the consolidated annual accounts reflect the entire financial year of the Parent.

The Directors have opted to omit comparative figures of the Parent for the prior year from the consolidated balance sheet, consolidated income statement, consolidated statement of changes in equity, consolidated statement of cash flows and the notes thereto.

(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 18). 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 31 December 2016, 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.

(3) Distribution of Profit

The distribution of the Company's profit for the year ended 31 December 2015, approved by the sole shareholder on 27 June 2016, was as follows:

	Euros
Basis of allocation	
Profit for the year	207,175,464.28
Distribution	
Goodwill reserve	18,333,659.95
Investment reserve	38,900,000.00
Dividends	149,941,804.33
	207,175,464.28

As indicated in note 5, in accordance with the sole transitional provision of Royal Decree 602/2016, of 2 December 2016, the Company has amortised retrospectively goodwill and intangible assets with an indefinite useful life. Therefore the Company's profit for 2015 has been restated from the Euros 207,175 thousand approved by the sole shareholder to the Euros 178,019 thousand presented in the consolidated statement of changes in equity.

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 2016 profit to be submitted to the sole shareholder for approval is as follows:

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

At 31 December 2016 the Company's non-distributable reserves are as follows:

	Thousands of Euros
Non-distributable reserves	
Legal reserve	20,000
Revaluation reserves	98,272
Parent share reserve	(9,320)
	108,952

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, and for the period from 4 November 2016 to 31 December 2016 for EDP España Distribución Gas, S.A.U., and from 29 November 2016 to 31 December 2016 for Naturgas Suministros GLP, S.A.U.

(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.

(Continued)

(c) Intangible assets

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

(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.

(Continued)

(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	12.5 - 25
Technical installations and machinery (regulation and metering stations: civil works)	Straight-line	5 -10
Technical installations and machinery (regulation and metering stations: machinery)	Straight-line	5 -10
Technical installations and machinery (synthetic natural gas plants and installations)	Straight-line	12.5
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.

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 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 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 Naturgas 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 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 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.

(Continued)

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.

In accordance with Ministry of Industry, Tourism and Trade Order ITC/3126/2005, and Ministry of 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 2016 in the amount of Euros 1,073 thousand. In 2015 the Group settled the measurement differences for 2008 to 2012 and those for 2014.

(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 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.

- 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.

(Continued)

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.

(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.

(Continued)

(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 are as follows:

2016	**Thousands of Euros** 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**

(a) General

In accordance with the sole transitional provision of Royal Decree 602/2016, of 2 December 2016, the Group has amortised 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 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 2016
Cost at 1 January	366,674
Cost at 31 December	366,674
Accumulated amortisation at 1 January	(290,108)
Amortisation	(36,668)
Accumulated amortisation at 31 December	(326,776)
Carrying amount at 31 December	**39,898**

(Continued)

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 has amortised retrospectively goodwill over 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 31 December is as follows:

	Thousands of Euros
	2016
Computer software	11,285
Supply points	7,045
	18,330

(d) Impairment

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

(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 for said amount.

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

(Continued)

(b) Fully depreciated assets

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

	Thousands of Euros
	2016
Buildings	1,964
Technical installations and machinery	149,606
Other installations, equipment and furniture	34,341
Other property, plant and equipment	4,283
	190,194

(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 483 thousand (see note 13). The cost of constructing these distribution networks amounted to Euros 1,592 thousand at 31 December 2016.

(d) Commitments

At 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 effect of Euros 103,443 thousand. The effect of the revaluation on depreciation for 2016 amounts to Euros 9,707 thousand. At 31 December 2016, accumulated depreciation totals Euros 43,522 thousand.

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 31 December 2016 is Euros 37,907 thousand, depreciated by Euros 36,980 thousand.

(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.

(Continued)

(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 is 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 15. Interest rate fluctuations affect future cash flows of liabilities pegged to variable interest rates.

(Continued)

The current account held with EDP Servicios Financieros España, S.A. (see note 11 (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 (increases/decreases in basis points) is as follows:

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

(10) Financial Assets by Category

(a) Classification of financial assets by category

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

(Continued)

	Thousands of Euros	
	Non-current	Current
	At amortised cost or cost	At amortised cost or cost
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 149 thousand at 31 December 2016 and reflect finance income measured at amortised cost.

(11) Investments and Trade Receivables

(a) Investments in Group companies and associates

Non-current loans to Group companies at variable rates amounting to Euro 14,152 thousand comprise the current cash pooling accounts held by the subsidiaries with EDP Servicios Financieros España, S.A. These accounts accrue interest at variable market rates.

(b) Investments

Details of investments are as follows:

	Thousands of Euros	
	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 31 December 2016 non-current receivables amount to Euros 63 million in relation to gas sector deficits pending collection (see note 1.1 (c)).

(Continued)

(c) Trade and other receivables

Details of trade and other receivables are as follows:

	Thousands of Euros
	2016
	Current
Group (note 20)	
Trade receivables	27,213
Other receivables	11,767
Associates (note 20)	
Trade receivables	1,536
Unrelated parties	
Trade receivables	10,951
Other receivables	8,059
Personnel	143
Public entities, other (note 18)	203,152
Impairment	(7)
Total	**262,814**

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 31 December 2016 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 cumulative deficit corresponding to the 15/2015 settlement attributable to the Group, totalling Euros 4,489 thousand and Euros 1,000 thousand, respectively.

(12) 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 31 December 2016 is negative in an amount of Euros 165,438 thousand 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 424,722 thousand, 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 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 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 20.

(Continued)

(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 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.

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 (see section (d) of this note) 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
	2016
Company	**Consolidated profit/(loss)**
Fully consolidated companies	
Naturgás Energía Distribución, S.A.U.	75,676
EDP España Distribución Gas, S.A.U.	202,353
Naturgás Suministro GLP, S.A.U.	(22)
	278,007
Equity-accounted investees	
Inkolan, A.I.E.	35
Tolosa Gasa, S.A.	87
	122
Total	**278,129**

(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.

(13) Grants, Donations and Bequests Received

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

	Thousands of Euros 2016
Balance at 1 January	37,770
Additions	1,726
Disposals	(102)
Amounts transferred to the consolidated income statement	(2,104)
Balance at 31 December	**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 2016
Capital grants	1,347
Connection and extension charges	1,813
Other deferred income	185
	3,345

Details of main capital grants

Grantor	Thousands of Euros 2016
European Economic Community	1,006
Principality of Asturias	9,100
Basque Government	2,967
CNMC	2,365
	15,438

(14) Commitments Undertaken with Third Parties

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

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.

(Continued)

(15) 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 31 December 2016 amount to Euros 620 thousand and comprise borrowing costs on debts and payables at amortised cost.

(16) Payables and Trade Payables

(a) Group companies and associates

At 31 December 2016 non-current payables to Group companies and associates comprise three loans extended by the group company EDP Servicios Financieros S.A. on 12 December 2016 to Naturgas Energía Distribución, S.A.U., EDP España Distribución Gas, S.A.U. and Naturgas 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 31 December 2016 current payables to Group companies and associates reflect the cash pooling balance payable by the Company to EDP Servicios Financieros S.A. at that date. This cash pooling account is subject to variable interest at market rates.

(b) Payables

Details of payables are as follows:

	Thousands of Euros	
	2016	
	Non-current	Current
Unrelated parties		
Suppliers of fixed assets	-	4,272
Payables	1,075	48
Dividends payable	-	-
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.

(Continued)

(c) Trade and other payables

Details of trade and other payables are as follows:

	Thousands of Euros 2016 Current
Group (note 20)	
Payables	217,785
Unrelated parties	
Suppliers	9,306
Payables	16,706
Personnel	2,351
Public entities, other (note 18)	3,709
Total	**249,857**

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

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)).

(17) Average Supplier Payment Period

Details of the average supplier payment period are as follows:

	2016 Days
Average supplier payment period	22
Transactions paid ratio	24
Transactions payable ratio	4
	Amount in Euros
Total payments made	46,545
Total payments outstanding	4,216

(18) Taxation

Details of balances with public entities are as follows:

	Thousands of Euros	
	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**

At 31 December 2016 withholdings and charges include Euros 2,890 thousand of charges for the use of subsoil.

The Group has recognised Euros 8 thousand receivable from and Euros 29,311 thousand payable to EDP Comercializadora, S.A.U. as a result of filing consolidated income tax in the territory of Vizcaya.

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 110 thousand as a result of filing consolidated income tax in the general taxation territory of Spain.

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 - 2016
Personal income tax	2013 - 2016

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 2016 will not be open to inspection until 25 July 2017.

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		
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**

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 916 million of the gains obtained on various transactions carried out during the year.

The Group has already met the reinvestment requirement for the amounts obtained on the sales as EDP Iberia, S.L., 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 Naturgas Energía Distribución, S.A. Following this reorganisation, the tax value of these assets has risen by Euros 810,736 thousand, generating deferred tax assets of Euros 202,684 thousand.

(Continued)

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

	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	(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
	2016
Current income tax	
Present year	30,641
Prior year adjustments	229
Previously unrecognised tax deductions applied	(26)
	30,844
Deferred tax	
Source and reversal of temporary differences	
Property, plant and equipment	(232,888)
Goodwill	(10,341)
Other intangible assets	268
Provisions	261
Other	392
Prior year adjustments	(333)
Total deferred tax	(242,641)
	(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	
	Assets	**Liabilities**
	2016	**2016**
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 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
	2016
Deferred tax assets relating to temporary differences	205,945
Rights to tax deductions and credits	-
Total assets	205,945
Deferred tax liabilities	35,828
Net	**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.

(19) 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 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.

(Continued)

The Group has received no environmental grants or income from activities related to the environment in 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.

(20) 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 10, 11, 15 and 16.

Details of balances by category are as follows:

	Thousands of Euros			
2016	**Sole shareholder**	**Group companies**	**Associates**	**Total**
Non-current investments in Group companies and associates				
Equity instruments	-	-	-	-
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:

	Thousands of Euros			
2016	**Sole shareholder**	**Group companies**	**Associates**	**Total**
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				
Finance income	-	-	-	-
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 the customer service provided by EDP Soluciones Comerciales, S.A.U. and other management services invoiced by the EDP Group.

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

In 2016 the Company's directors and senior management have accrued remuneration of Euros 223 thousand and Euros 29 thousand 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 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.

(21) Income and Expenses

(a) Revenues

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

	Thousands of Euros
	Domestic
	2016
Revenue from the sale of propane gas	4,057
Revenue from installations	3
Revenue from regulated activities	169,154
Revenue from the rendering of services	27,923
	201,137

Revenue from regulated activities comprises the amount accrued in 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
	2016
Merchandise used	
Purchases	6,697
Change in inventories	(4,345)
	2,352
Raw materials and other supplies used	
Other purchases	1
Change in inventories	7
	8
	2,360

At 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
	2016
Employee benefits expense	
Social Security payable by the Company	2,112
Pension plan contributions	285
Other employee benefits expenses	109
Annual contributions	127
	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
	2016
Gains	
Property, plant and equipment	3,082
Losses	
Property, plant and equipment	(53)
	3,029

(22) Employee Information

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

	Number
	2016
Directors	7
Managers	25
Other	119
	151

(Continued)

At the 2016 year end the distribution by gender of Company personnel is as follows:

	Number 2016	
	Female	**Male**
Directors	-	7
Managers	9	20
Other	26	96
	35	**123**

In 2016 the Group had no employees with a disability rating of 33% or higher (or equivalent local rating).

At 31 December 2016 all three members of the Board of Directors are male.

(23) Audit Fees

The auditor of the annual accounts of the Group has invoiced the following net fees during the year ended 31 December 2016:

	Thousands of Euros 2016
Audit services, consolidated annual accounts	36
Audit services, individual annual accounts of the Company	47
Audit services, annual accounts of subsidiaries	23
Other services	5
	111

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

(24) Events after the Reporting Period

On 31 January 2017, as part of the internal restructuring of EDP's operations in Spain mentioned in note 1, the Parent sold secondary natural gas distribution and transmission assets to its subsidiary EDP España Distribución Gas, S.A., 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 various municipalities in Cantabria.

(Continued)

(25) Segment Reporting

Segment reporting for 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
Item	**Natural gas**	**GLP**	
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 31 December 2016

(Expressed in thousands of Euros)

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

Subsidiaries

Name	Registered office	Activity	Auditor	Investment: Group company holding the investment	Investment: % ownership	Investment: Effective % ownership of the Company	Investment: Amount of the investment	Extent of control
EDP España Distribución Gas, S.A.	Oviedo (Asturias)	Supply and distribution of natural gas	KPMG Auditores, S.L.	Naturgas Energía Distribución, S.A.U.	100.00	100.00	185,000	100% of voting rights
Naturgas Suministro GLP, S.A.	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.	Naturgas 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	Investment: % ownership	Investment: Effective % ownership of the Company	Investment: 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	Naturgas Energía Distribución, S.A.U.	12.50	12.50	69
Tolosa Gasa, S.A.	Tolosa (Guipuzcóa)	Supply and distribution of natural gas	KPMG Auditores, S.L.	Naturgas 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 year ended 31 December 2016

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

	Thousands of Euros						
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 year ended 31 December 2016

(Expressed in thousands of Euros)

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

	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**

This appendix forms an integral part of note 12 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 year ended 31 December 2016

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

	Thousands of Euros				
	Non-current			Current	
	At amortised cost or cost			At amortised cost or cost	
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 15 to the consolidated annual accounts, in conjunction with which it should be read.

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

Consolidated Directors' Report

2016

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

1- Most significant events in 2016

In 2016 the Group continued its usual activity in the regulated market of the natural gas and LPG sectors. This consists of the management of regulated distribution assets, including the promotion, development and construction of new infrastructure, operating, maintenance and optimisation services, as well as the supply of LPG to end customers.
The Group continued its network expansion activity within its areas of influence. The following noteworthy initiatives were carried out in these areas in 2016:

- The Group continued to expand its networks in the Basque Country, Asturias and Cantabria.
- Entry into service of the CNG filling station in the Corredoria (Oviedo) work centre for HC Energía and Naturgas Energía fleet vehicles.
- Extension of the gas network to the new population centre in Corvera de Toranzo.
- Completion of the construction and entry into service of the Laguardia LNG plant.
- Completion of the work required for the supply of gas in Colunga (Asturias) from an LNG plant.
- Start of supply to ArcelorMittal at its Veriña (Asturias) facilities, firstly through the Gijon 16 bar MOP network, with a view to connecting in January 2017 to the new transmission/distribution point of the Musel-Llanera gas pipeline at the final stage of connection to the gas network by Enagás, which enables reconnection with the Gijon high pressure A ("APA") network.
- Acquisition of Repsol's LPG property, plant and equipment in Asturias, Cantabria and the Basque Country for Euros 116 million, comprising 82 thousand supply points.

Operating profit of Euros 66.7 million was generated in 2016 after amortisation/depreciation charges of Euros 92.7 million. EBITDA totalled Euros 153 million. Net profit for the year, taking into account the net finance cost, other expenses and income tax, totalled Euros 278.1 million.
Two new companies were created in December 2016: EDP España Distribución Gas, S.A.U., to which Naturgas Energía Distribución S.A.U. transferred its natural gas distribution assets located in Cantabria and Asturias, and Naturgas Suministro de GLP, S.A.U., created to manage the LPG assets.

2016 was defined by the development and implementation of the initiatives provided for in Royal Decree 984/2015, which regulates the organised gas market and third-party access to the natural gas system facilities, and establishes a new guarantee framework based on integrated management. The distribution activity has been affected by two resolutions of the Secretary of State for Energy, issued to regulate the framework agreement for access to the gas system's facilities and its guarantees.

- Ministry of Industry, Energy and Tourism Order IET/2736/2015 of 17 December 2015, establishing the tolls and charges for third-party access to gas facilities and the remuneration for regulated activities in 2016.

- Royal decree 244/2016 of 3 June 2016 implementing Metrology Law 32/2014 of 22 December 2014.

- The resolution of 2 August 2016 of the Secretary of State for Energy approving the framework agreement for access to the Spanish gas system's facilities.

- The resolution of 2 August 2016 of the Secretary of State for Energy approving the standards for management of the gas system's guarantees.

- The resolution of 6 October 2016 of the Spanish National Markets and Competition Commission (CNMC) publishing the list of dominant operators in the energy sectors.

- The resolution of 6 October 2016 of the Spanish National Markets and Competition Commission (CNMC) publishing the list of main operators in the energy sectors.

- CNMC Circular 2/2016 of 28 July 2016 on requests for information on claims addressed by electricity and natural gas consumers to suppliers and distributors.

2- Outlook

The Group's outlook is based on the following:

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

- Continue LNG supply activity in all scopes, maximising asset value and customer relationships.

- 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 the Group's results.

3- Research and Development Activities

In 2016 the EDP Naturgas 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:

- Programme Committee F (R&D&i) of INTERNATIONAL GAS UNION (IGU). Committee meeting in Washington (USA).

- European Gas Research Group (GERG): The Group holds the position of vice-chairman. Board and plenary meeting in Paris (France) and Gröningen (Holland).

- European Gas Research Group (GERG): The Group actively participated in the GERG Strategy Group meeting held in Brussels (Belgium).

- Energy Cooperative Research Centre "CIC energiGUNE": The Group is a trustee. Meetings in Parque Tecnológico de Miñano (Álava).

- 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.

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

- Public presentation of the four "Aula EDP NATURGAS ENERGIA" projects proposed for development in 2016-17.

Naturgas Energia Distribución, S.A.U., Parent of the Group, undertook the following noteworthy projects in 2016:

- Project Europeo HyGRID: 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 Hydrogen and Fuel Cells under contract number 700355.

- Project GAITEK BIOHYSIS: Research project with the TECNALIA foundation and the company NOVARGI; "FLEXIBLE ADAPTABLE HYBRID BIOGAS SYSTEM TO INJECT BIOGAS INTO THE NATURAL GAS NETWORK". Completed successfully and grant received from the Basque government.

- Project CIEN SMART GREEN GAS: Research project with the TECNALIA foundation and six other companies; "Energy recovery from residuals and effluent (SMART GREEN GAS)" Strategic programme of the National Business Research Consortium (CIEN) of the Spanish Centre for the Development of Industrial Technology (CDTI) and the Ministry of Economy and Competitiveness (2014-18). First milestone successfully completed and receipt of the corresponding funds from the Ministry of Economy and Competitiveness.

- Project RETOS RENOGAS: Research project with the Bilbao Higher Engineering Technical College (UPV-EHU); "Process for generating methane in remote areas from renewable electricity". The project activities planned for 2016 have been completed. This is an R&D project co-financed through the RETOS INVESTIGACIÓN programme of the General Directorate for Scientific and Technical Research of the Ministry of Economy and Competitiveness.

4- Own shares

At 31 December 2016 the Company 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 2016 reporting date that would require disclosure in these annual accounts, except for the matters indicated in note 24.

6- Risks

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

7- Financial instruments

At 31 December 2016 the Group has 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 2016

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

At their meeting held on 10 March 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 year ended 31 December 2016. The consolidated annual accounts comprise the accompanying documents that precede this certification.

Signed:

[Signed on original in Spanish]	*[Signed on original in Spanish]*	*[Signed on original in Spanish]*
Mr Juan Ramón Arraibi Dañobeitia	Mr Luis Álvarez Arias de Velasco	Mr Rui Pedro Ávila Campos Marques

[Signed on original in Spanish]

Mr. Carlos Arias Chausson
(Non-executive secretary)